

Chinese Economic Statecraft and the Political Economy of Asian Security

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China's rise is expected to re-shape Asian security in at least two ways. First, economic growth will fund the development of national military power. China's rising prosperity makes it possible for the government to devote more resources to all of its domestic programs, including spending on military modernization, which rose throughout the 1990s. Moreover, trade, investment, and technology provided by the United States, Japan, and Europe could make China militarily more powerful than it would otherwise be. Foreign investment—total utilized investment totaled US\$61 billion in 2004¹—and a positive trade balance allows China to accumulate significant foreign reserves (over \$700 billion as of 2004), some of which has been used to purchase advanced weapon systems from Russia, Israel, and other foreign suppliers. Senator Paul Sarbanes may have summed the argument up best: “It is difficult to escape the conclusion that the large bilateral trade surplus that China runs with the United States is used, at least in part, to bolster and support the Chinese military establishment.”²

Second, China is expected to use its new diplomatic and economic power to influence the regional security order. As the Chinese economy continues to develop, the countries of the region are becoming increasingly dependent on China for trade and investment. Growing trade ties have expanded Beijing's political and diplomatic influence.³ Although Washington still plays a large role in the region, changing trade patterns might in the future marginalize the United States as an economic and political partner. Without a strong Japan to act as a counterweight, the countries of Southeast Asia might become more dependent on trade ties to China and thus more sensitive to PRC preferences. Similarly, in Northeast Asia, Korea might

distance itself from the United States. Even Japan may decide that it is unwilling or unable to balance against China's rising power. A political shift toward Beijing could deprive the United States of the regional allies and access to bases required to pursue American security objectives.

Much of the literature on the political economy of Asian security has focused on China's economic growth, regionalism and economic interdependence, and how these trends either increase or dampen the possibility of military conflict.⁴ While these developments define the environment in which the regional actors interact, the focus of this chapter is China's attempts to coordinate the building of national military power with the use of influence through economic statecraft—the employment of economics as an instrument of power.⁵

The central argument of this chapter is that for Beijing there currently is an overlap between security and economic concerns. In most assumptions of realist political economy, states sacrifice short and medium term economic gains for security benefits.⁶ Power wins out over plenty. By contrast, liberal institutional approaches suggest that the pursuit of economic objectives (and participation in multilateral institutions) may eventually moderate or modify a state's security objectives. The increased interaction that accompanies trade and foreign direct investment encourages communication, fosters cooperation, and promotes a more collective sense of security.

In addition, since conflict risks jeopardizing very real gains from trade, public officials and private businesses dependent on trade have a strong interest in maintaining stable relations. In the case of China, Papayoanou and Kastner argue that engagement “empowers more cooperative economic internationalists in China.”⁷

Beijing at present does not have to choose between strategic and economic objectives, and so can pursue both power and plenty. China's security concerns are addressed by closer

economic relations with its neighbors. Conversely, the pursuit of economic goals does not mean that Beijing has abandoned or modified its security objectives, or that it is necessarily any less likely to employ military or other coercive measures to achieve core strategic goals, especially in the case of a potential Taiwan conflict. Focused on domestic issues—economic growth, regime stability, and leadership succession—the Chinese government’s primary foreign policy goal is creating the stable international environment necessary to address these challenges at home. For China, the central objective is fostering a peaceful international environment that lacks a balancing coalition. Beijing’s promotion of regional multilateral institutions, its offer to enter into free trade agreements with ASEAN, and its promotion of direct investment in regional economies all have both a strategic and an economic logic. They foster economic development while lowering suspicion in neighboring countries about China’s growing power, making it more difficult for the United States and its allies to contain Beijing.

This overlap between economic and security objectives—what some observers call “enlightened self interest”—raises two interrelated questions. First, will Beijing have the necessary institutional, political, and economic capacity to maintain the unity between “high” and “low” politics, between security and foreign economic policy? In the near to mid term, it will not be easy to maintain a coherent economic and security strategy. A unified vision must be maintained within the leadership core, and the central leadership must have the ability to insulate the policy from economic and political disruptions, as well as compensate losers within the domestic economy.

Second, even if Beijing has the ability, will it have the desire to continue to coordinate economic and political objectives? Once Beijing attains what it sees as an adequate level of power and stability, could it simply decide that there are goals that could best be achieved

through swift military action? Simple self interest would replace “enlightened” self interest. Or are there political crises that could abruptly end Beijing’s reliance on diplomacy, influence, and other instruments of soft power? Beijing has made it clear that it will sacrifice immediate economic gains if core security interests are threatened, at either a domestic or regional level and especially in the case of Taiwan. There may also be pushback from China’s neighbors—they may be less willing to accept assurances from China that economic ties do in fact offer reassurances about Beijing’s peaceful intentions. Although China is now Japan’s largest trade partner, and Japanese investment in China is at record levels, China and Japan have recently clashed over control of the Senkaku/Diaoyu Islands, the portrayal of history in textbooks, the incursion of a PLA Navy submarine into Japanese waters, continued visits to Yakusuni shrine, new National Defense Program Guidelines highlighting China’s military modernization, and a joint U.S.-Japan declaration on Taiwan. Despite close economic ties, Korea and China recently clashed over the historical lineage of the Goguryeo Dynasty.

This chapter is divided into three parts. The first looks at the dominant descriptions of economic statecraft and how they might be applied to China. The second section introduces some of the economic, political, and strategic factors that might result in a greater degree of distance between economic and security policies. Currently Beijing’s pursuit of “enlightened self interest” is rooted in two perceptions: 1) trends across the Strait are moving in a positive direction (the forces of independence are losing ground; Chinese is increasing its military power; the United States is playing a constructive role in reining in the Chen administration); and 2) that the United States will continue to be the preponderant power for the next several decades. Shifts in either or both of these views among Chinese policymakers could result in the replacement of influence by coercion. The final section suggests what Beijing’s economic statecraft means for

regional security and for the United States. Currently, China's active engagement in the region serves a number of American interests. But over the longer term, this more positive outcome is only possible if the United States is broadly engaged in the region.

China and Economic Statecraft

Coercion and Influence

Much policy analysis of China's potential economic statecraft draws heavily on Albert Hirschman's discussion of foreign trade as an instrument of national power.⁸ In *National Power and the Structure of Foreign Trade*, Hirschman uses Nazi Germany's trade relations to illustrate how asymmetric trade relations create political gains for the larger state. Since trade makes up a smaller percentage of the larger nation's total trade and may make up to 50 percent of the smaller state's total, threats of interruption affect smaller states disproportionately. Implicit or explicit threats to break commercial relations thus give the larger state coercive power. In Hirschman's view, the ability to threaten to interrupt trade with another state is "an effective weapon in the struggle for power."⁹

In addition to coercive power, as Abdelal and Kirshner note, Hirschman also describes an influence effect.¹⁰ Commerce affects the domestic politics in the smaller state, shaping politics and definitions of national interest. Firms and sectors form political coalitions, create vested interests in target states, and reshape governmental policies in different ways than if they had been affected by domestic pressures alone.¹¹ This happens in all economic relations, but it is especially true in asymmetric relations where the effects are visible and almost wholly found in the smaller country in the trade relationship.

The mainland's economic policy toward Taiwan best exemplifies the political relationships—and the uses of coercion and influence—that Hirschman describes. China displaced the United States as Taiwan's largest export market in 2001; in 2004, 37% of Taiwan's total exports went to Mainland China, Macao and Hong Kong. Taiwan sent 25% of its total exports to China in 2001, and accepted 7.3% of its total imports from China. In 2004, exports to China had increased to 36%, while imports from China increased to 11%. China plays a similarly large role in shares of Taiwan's outward foreign direct investment. In 2003, Taiwan invested \$5.68 billion abroad, \$3.38 billion of that in China—making China the recipient of 59.5% of Taiwan's total FDI. In 2003 cumulative Taiwanese investment in China totaled more than \$24.72 billion.¹²

From the beginning of economic contact between the two sides, Chinese policy makers have had a clear view of the political objectives of cross-strait trade. As an internal 1990 Chinese document explained, expanding trade with Taiwan would break through the “three no's” policy, contain separatist trends, and help “interest groups involved closely with the mainland emerge in Taiwan's politics in the future and facilitate peaceful unification.”¹³ Chinese President Yang Shangkun noted at a December 1990 National Conference on Taiwan Work that the “emphasis should be placed on economic and other exchanges in order to use business to press politics (*yi shang wei zheng*) and use the public to pressure the official (*yi min bi guan*).”¹⁴

Taiwanese politicians have been equally clear about how they perceive the politics of economic integration. Under former President Lee Teng-hui, the Taiwanese government refused to negotiate the opening of the “three links” (trade, transport, communication between China and Taiwan) and limited exchange through a conservative policy of investment, *jieji yongren* (no haste, be patient). The Chen Shui-bian administration replaced “no haste” with *jiji kaifang*,

youxiao guanli (active opening, effective management) and opened the three “mini links”¹⁵ but has placed a ceiling on Taiwanese investments on the mainland, proposed a “national technology protection law” to regulate the flow of high tech products, and attempted to lure Taiwanese- and foreign-invested firms back to Taiwan by offering preferential tax exemptions and other incentives.¹⁶ Taiwan has tried to reduce its dependence on China by promoting investment in Southeast Asia (the “go south” policy) and by calling for the creation of free trade agreements with the United States and Japan.¹⁷ Speaking to a group of Taiwanese businessmen in July 2002, President Chen Shui-bian warned that Taiwan should not become too reliant on the Chinese market: “It’s good to create fortunes overseas, however, Taiwan’s national security should be considered a priority and the public interest must be put first. We should not have any illusions about seeking peace by stooping to compromise with China. If our country is not secure, making more money does not mean anything.”¹⁸

From the beginning of renewed trade, China has attempted to use the Taiwanese business community to influence policy, especially to push for the three links. Members of the KMT, People’s First Party, and Chamber of Taiwan Businessmen in China have been invited to meet with central leaders in Beijing to facilitate political and business exchanges across the strait. Faced with the Chen administration’s refusal to negotiate over the three links, Chen Yunlin, director of the Taiwan Affairs Office, proposed in 2002 that Taiwan send business leaders, preferably tycoon Wang Yung-ching and food baron Kao Chin-yen, to negotiate the issue of direct transport, postal and trade links. The head of Taiwan’s Mainland Affairs Council Tsai Ing-wen responded that China cannot “appoint people on our behalf” but it is clear that flexibility by China plays into the hands of Taiwanese business.¹⁹ In April 2005 China hosted a

visit by KMT Party Chairman Lien Chan, followed in May by People First Party Chairman James Soong.

China has also tried to drive a wedge between the business community and Chen. Several papers in Hong Kong sympathetic to the mainland ran editorials in 2002 that emphasized how Chen Shui-bian's agenda is to "cheat Taiwan businessmen." One noted that Chen Shui-bian's refusal to establish direct links is "making the business circles...in Taiwan feel greatly indignant."²⁰

Always lurking behind the attempts at influence was the threat of economic coercion, although it played a largely supporting role in Beijing's overall strategy from the 1980s to the mid 1990s. During the 1995-1996 Taiwan Strait crisis China sent its message through military exercises and public pronouncements harshly criticizing Lee Teng-hui and other "separatist" influences, not through economic policy. Political coercion, however, had severe economic costs. For example, during the second half of 1995, the Taipei stock market dropped 20%, and the New Taiwan Dollar depreciated 10%. Taiwan's Central Economic Research Institute estimated that the 1995 tensions cost Taipei NT\$23.7 billion to stabilize foreign exchange markets and restore public confidence.²¹ The political efficacy of the measures was mixed. On one hand, the threats imposed huge costs on Beijing's friends in the business community. On the other, it successfully demonstrated the fragility of the economy and the need for good relations across the Strait to Taiwan's populace.

In the run-up to and in the immediate aftermath of the 1999 Taiwanese elections, economic coercion played a larger role in Beijing's strategy, but in a targeted, directed manner. A message was sent to specific business with strong political ties to Chen Shui-bian, the DPP, or others seen to "favor independence." On March 16, two days before the presidential elections,

Vice Chairman of Association for Relations Across the Taiwan Straits Tang Shubei stated that if the “forces of Taiwanese independence won,” economic relations between the two sides would be seriously impaired. As a result, the stock market fell 4.5%, and the Taiwanese government injected NT\$1.5 billion; by mid-March, the Taiwanese government was estimated to have spent NT\$3.4 billion to shore up the Taipei index.²²

Economic pressure continued after the election. Li Bingcai, deputy director of China’s Taiwan Affairs Office of the State Council and Taiwan Work Office of the Central Committee of the CCP, stated that Taiwan’s industrial and commercial leaders would not be allowed to advocate the “Lee Teng-hui line” while engaging in business and economic operations in China.²³ Beijing warned that individual Taiwanese companies could be barred from business if they promoted independence.

After Chen Shui-bian assumed Taiwan’s presidency, his ties with ACER president Stan Shih may have exposed ACER to harassment on the mainland. Acer products apparently disappeared from the shelves of many stores and the company was more or less forced to introduce a new brand name to sell its products. During the dispute, Shih made a trip to Beijing to restate his support for reunification.²⁴

Taiwanese businesses with strong links to either the DPP or Chen Shui-bian faced similar concerns in 2001. For example, SOEs were ordered not to do business with the petroleum conglomerate Chi Mei Group, whose PRC operations faced constant scrutiny from zealous tax inspectors.²⁵ In response to a question about Hsu Wen-lung, chairman of Chi Mei and the first leading businessmen to support Chen Shui-bian’s presidential campaign, the head of MOFERT Shi Guangsheng declared “We will not allow Taiwanese businessmen to make political capital at home by supporting independence and make economic profits in the mainland.”²⁶

The pattern of coercion suggests a limited sanction policy directed at those with close ties to Chen and the DPP and those who have actively engaged in political support for independence. In fact, Chinese leaders tried to reassure the majority of Taiwanese businesses that they would not be affected. In December 2002, for example, Vice Premier Qian Qichen traveled around Guangdong inspecting Taiwan-invested enterprises and holding meetings with Taiwan businesspeople to discuss cross-strait trade. In his conversations, Qian stated that “In the last decade, exchange across the strait, especially economic exchange, has seen very great progress. Under any circumstances, the mainland’s policy of welcoming Taiwan compatriots to carry out economic activities on the mainland will not change, and so Taiwan compatriots can completely feel assured.”²⁷

Trade and Power

Trade and investment are essential elements of power politics, strengthening ties among countries that have similar defense and military orientations. Because trade creates security externalities—trade releases economic resources for potential military use—adherence to a policy of free trade may not make the most sense in an anarchic system. Rather, trade should be used to bind potential allies closer together, and free trade is more likely to emerge across political-military alliances.²⁸

China is not creating an alliance system in Asia, but Beijing does use commercial relations to bolster the position of its friends. During the Vietnamese invasion of Cambodia, China provided guns, tanks, armored personnel carriers, and antiaircraft guns to Thailand at “friendship” prices. In the 1980s, China and Thailand signed a “Strategic Partnership” arrangement, which has included a regular exchange of military personnel and exercises. Today,

Cambodia and Myanmar both receive economic and military assistance from Beijing. In 1999, Cambodia obtained \$18.3 million in foreign assistance guarantees and \$200 million in no-interest loans for infrastructure projects. China has supplied substantial official development assistance to Myanmar with much of it going to improve the road system in the upper reaches of the country and to support the building of a navigable waterway down the Irawaddy River, projects which could have commercial and possibly military applications. In addition, Beijing is the major supplier of arms to the Burmese regime—some estimates of the value of the supplies exceed \$2 billion.

For the majority of the countries in East Asia, China's increasing economic and political standing in the region creates a new type of influence—the need to consult with Beijing before making major decisions. US naval officials report that requests to increase port calls to Vietnam from one to two a year are met with the response: “we must first gauge reaction in China.” Across issue areas, according to Abdul Razak Baginda, “there is now this feeling that we have to consult the Chinese. We have to accept some degree of Chinese leadership, particularly in light of the lack of leadership elsewhere.”²⁹

In addition, China may use trade policy to indicate intentions, signal commitments, or project overall foreign policy orientations.³⁰ Besides the economic benefits that may accrue from any future cooperation, China's recent push for a free trade agreement with ASEAN sends a number of important messages: China is now a status quo power in Asia, more engaged in multilateral diplomacy, supportive of free trade, and committed to the development of the region. Goldstein argues that the decision not to devalue the yuan during the Asian financial crisis in 1997 reflected in part Beijing's desire to substitute the image of a responsible power for its reputation as an “irredentist, revisionist, rising power” that it was acquiring in 1995-1996.³¹

Furthermore, as Frost argues in this volume, “Intra-Asian FTAs [free trade agreement] in particular have assumed a role akin to that of security alliances, serving as an expression of political and security ties as well as a harbinger of trade and investment. FTAs do not affect the military balance of power, but they alter and redefine the balance of influence, perceptions of security, and new political alignments.” Frost notes that trade negotiations and FTAs in particular open new avenues for influence throughout the region.

How Successful Can Economic Statecraft Be?

Despite Beijing’s widespread efforts to cultivate political sway through economic relations, converting trade and investment into influence is not a simple linear process. Beijing’s attempts to build regional influence appear to depend on the size and level of development in its own market, the nature of the interests (regional, sub-regional, global) at stake, and the degree of threat the smaller economies perceive in China’s rise.³²

In the case of trade, a large, developing economy may be less able to exert influence in the region than a large developed nation (such as Japan or the United States). Pursuing political objectives at the cost of shorter-term economic goals requires a fairly stable and mature economy as well as the ability to balance the demands of competing domestic interests. Serious economic dislocation would put pressure on Beijing to adjust trade or investment patterns, undermining the political coherence of economic and security policies. Faced with rising unemployment and social instability, Beijing may be less willing to run trade deficits with and open domestic markets to its neighbors. Even in the absence of a serious downturn, the center would have to be able to compensate the industrial sectors or geographical regions that lost as a result of trade concessions made in pursuit of political goals.

Beijing will also have to convince its trading partners that it can follow through and implement its trade commitments. Without political transparency and accountability, China's proposals on trade risk becoming good public relations with little substance.³³ The highly touted China-ASEAN free trade pact signed in November 2004 is an example. Close observers note that the more than 100 exceptions in the agreement, which would eliminate tariffs between China and the members of ASEAN by 2015, render it far less substantial than has been advertised.

There may also be a mismatch between what the Chinese economy can offer and what other developing economies need. The Chinese and Southeast Asian economies may be competitive rather than complementary. The rather widespread belief that the FDI available to the region has been largely diverted to China is not, according to the Ravenhill chapter in this volume, supported by the data. Ravenhill argues that "diversion" of FDI to China is almost certainly overstated, and fails "to take into account the substantial 'round-tripping' of mainland funds in China's FDI inflows, and peculiarities in China's reporting of inward FDI." On the trade side, however, while Beijing portrays itself as a new export market, Chinese goods could flood global export markets at the expense of the region's smaller or less developed members (and to some degree, already are). Ravenhill's chapter, for example, shows ASEAN producers losing market shares and value in office machinery, footwear, apparel and clothing and electrical machinery.

Strong economic ties may also coexist with strained political relations, diminishing Beijing's ability to influence domestic politics in the target state. Here my analytical framework differs from that applied by Robert Ross in his chapter in this volume. For Ross, the response of states along China's periphery is essentially explained by the balance of power and geography. Over the last decade, China has greatly improved its ability to project power across land borders

against smaller countries. As a result, Thailand, Vietnam, and Korea have essentially accepted the conclusion that they will not be able to balance against China and have so realigned their politics toward Beijing. States that can rely on the ocean to provide defense in depth have more leeway since PLA power projection capabilities remain limited, especially over the sea.

Although the Strait separates China from Taiwan, 700 short-range missiles and a growing fleet of destroyers and attack submarines makes Taiwan's future more like that of Korea and other countries with land borders than maritime Southeast Asia.

In this chapter, domestic politics and national identity play a larger explanatory role. Geography is a constant and defining condition, but it is important to remember that exerting influence is a political process that requires domestic mediators. Beijing's influence is in the end expressed through military threat and domestic politics in the target states. These politics help define the threat and are contingent; they can be remade by shifting alliances within the target state. In the case of China's bilateral relations, political battles over national identity and history can have a large impact on the perception of threat.

In 2004, China replaced the United States as Japan's top trade partner, with total trade of US\$167.9 billion. Japanese investment in China totaled almost \$5.5 billion. But even as the two economies grow increasingly interdependent, analysts characterize the current bifurcation of Sino-Japanese relations as "cold politics; hot economics."³⁴ In the recent past, Tokyo and Beijing have clashed over the exploration of natural gas in the East China Sea, the presence of a Chinese submarine off Okinawa, Japanese politicians' visits to Yasukuni Shrine, the granting of a visa to Lee Teng-Hui, the new National Defense Program Guideline which specifically refers to a threat from China, and a joint US-Japan declaration identifying stability in the Taiwan Strait as a common strategic objective.

The trick for Beijing (and in some part Tokyo) is to balance nationalist public sentiment—feelings that are often nurtured by government propaganda—with the need to maintain stable economic relations. In the past, Saunders and Downs argue, China’s “government proved willing to incur significant damage to its nationalist credentials by following restrained policies and cooperating with the Japanese government to prevent the territorial disputes from harming bilateral relations.”³⁵ Chinese leaders were relatively successful in preventing anti-Japanese nationalism from influencing foreign policy decisions in the 1980s and 1990s. The April 2005 protests against Japanese textbooks as well as subsequent attack on the Japanese embassy and commercial entities in Beijing, Shanghai, Chengdu, Shenzhen, and Chongqing certainly suggest that technological and generational change may be weakening the ability, or willingness, of Chinese leaders to insulate these decisions from public opinion. As a result of the protests, the percentage of Japan’s population holding positive views of China has decreased dramatically, as has the influence of the “China school” in the foreign ministry. Japan’s pursuit of “normal nation” status, a goal that seems to be held across party lines, is likely to promote continued friction.³⁶

Although nowhere close to reaching the level of vitriol in the Sino-Japanese relations, Sino-Korean relations have also lost some of their sheen. Since normalization of relations between Seoul and Beijing in 1992, commercial relations exploded, and China passed the United States as South Korea’s number one trade partner and investment destination in 2003. For much of the 1990s, Korea was swept by “China fever”; Chinatowns emerged in cities throughout South Korea, language schools reported surging demand for Chinese lessons, and South Korean students came to dominate classrooms in Chinese language programs at the top Chinese universities. Many analysts were surprised when former president Kim Dae Jung referred to the

“special relationship” between South Korea and China, an expression usually reserved for Seoul’s ties with Washington.³⁷ While differences between the United States and South Korea over the handling of the North Korean nuclear program are helping push Seoul closer to Beijing, Korea’s desire to benefit from the opening of the Chinese markets is also playing a role.

Even though there is optimism about export opportunities to China, Korean producers are increasingly worried about competition from low cost Chinese manufacturers and the hollowing out of Korean industry. If the rate of growth in bilateral trade slows, it will become more difficult to ignore potential trade conflict. Scott Snyder argues that with the loss of momentum in the economic relationship, “there will also be less excuse to gloss over political disputes between South Korea and China over refugees, historical issues, or other disagreements in the relationship.”³⁸ China’s claim to the ancient Goguryeo Kingdom in 2004 appears to have cooled some of the fervor that gripped South Korea, injecting a greater degree of suspicion into South Korean thinking about China’s motives and methods.

The degree of threat perceived by the smaller actor plays a large, and perhaps the defining, role in determining Beijing’s success in actually converting asymmetric trade relations into political influence. The Chinese have been unable to convert economic dependence into political influence in Taiwan. Increased trade clearly created interest groups in Taiwan who pushed for even greater economic integration. From the first business people who funneled money illegally through Hong Kong to invest on the mainland to the industrial leaders claiming to be too restricted by the “Go Slow, Be Patient” policy, Taiwanese businesses have continually pushed the pace of economic integration. For example, in a 1998 survey 70% of Taiwanese businesses had investments in China, and 50% hoped for greater relaxation of restrictions on investments.³⁹ Industries with direct interest in the trade such as shipping lines and computer

manufacturers have taken the lead in the campaign for cross strait shipping ties. Taiwan Semiconductor chairman Morris Chang, for example, protested against the Taiwanese government's "blatant interference" in investments on the mainland.

Yet, for the most part, these organized interests have pushed for greater economic, not political, integration. There have been some limited cases of calls for political concessions, but these remain at the margins.⁴⁰ In the end, it appears that economic integration has polarized Taiwanese domestic politics, creating one pole around Lee Teng-hui and Chen Shui-bian, and another around the business community. Chen Ming-Chi argues that economic losers in cross-strait integration tend to be concentrated in central and southern Taiwan and that these groups tend to identify with the DPP.⁴¹ In addition, the more dependent the economy has become on the mainland and the greater perceived vulnerability of Taiwan to China, the greater the political pressure on Chen to expand and tighten ties with the United States and to continue to promote the development of a separate Taiwanese national identity.

The larger problem is that the goal Beijing is trying to achieve through influence—essentially to convince the Taiwanese to give up de facto sovereignty—appears incompatible with the use of threat. Since the mid-1990s, one of the central goals of military modernization has been to pose a credible threat to Taiwan in order to influence Taiwan's choices about its political future; or, failing that, to prevent Taiwan from achieving political independence.⁴² The most visible sign of this coercive ability has been the deployment of over 700 short-range missiles opposite Taiwan. In addition, China's arsenal includes major weapon systems purchases from Russia like the Kilo-class submarine, Sovremenny-class destroyer, and SU-27 and Su-30 aircraft as well as the comprehensive transformation of PLA tactics, doctrine and training. Beijing has also adopted an increasingly inflexible position toward Taiwan, defining

sovereignty narrowly and rejecting any diplomatic space for Taiwan in international institutions like the World Health Organization. In this political context, the objects of influence—the business associations and the “pan Blue” coalition (the coalition among the KMT, People’s First Party and the New Party more willing to accept the status quo across the Strait) —have little political room to maneuver. Beijing’s threats de-legitimize accommodation with Beijing—concrete suggestions about working with the mainland take the cast of selling Taiwan out.

How Long will Beijing’s Interest in Economic Statecraft Last?

Beijing’s commitment to economic statecraft and to the uses of influence in particular will continue only as long as the policy is seen to be effective. China could quickly shift its emphasis to coercion if Taiwan crosses one of Beijing’s “red lines” in a move toward formal independence. Under such circumstances, the high economic costs of military conflict—in the disruption of trade and investment as well as possible sanctions from the United States, Japan, and the European Union—might not persuade China’s leaders to maintain the current emphasis on international cooperation. Chinese scholars note that Beijing came to Pyongyang’s assistance during the Korean War, facing a much more technologically advanced enemy while it was still engaging in economic reconstruction after the end of World War II and the civil war. “If China could make such huge national sacrifice at the cost of national construction to aid another country, then it will definitely go to war to achieve territorial integrity and national reunification.”⁴³

The balance between influence and coercion is already a source of debate in Beijing. Some analysts have argued that the focus on economic integration may have in part convinced Taiwanese politicians to pursue separatist policies more aggressively. Taiwan has moved closer

to independence “not because the response was too strong but rather because the response was insufficiently strong.”⁴⁴ The focus on peaceful reunification and economic integration reduced the credibility of Chinese deterrence. To prevent further erosion of China’s current position, Beijing must make Taiwan, and the United States, recognize that it is “willing to pay any price” to contain Taiwanese independence.

The pursuit of influence and attempts to reassure neighbors is also based in a particular view of Sino-US relations. In the late 1990s, Chinese foreign policy analysts and policymakers began to believe that US preponderance was likely to continue at least for the next several decades. Belligerence toward the United States, and toward the region as a whole, was counterproductive.⁴⁵ At the 16th Party Congress in November 2002 Jiang Zemin described the first twenty years of the 21st century as a “period of important strategic opportunity,” a period during which Beijing could cooperate with other powers. Hu and Wen have continued this policy line, working to establish long term stable relations with the United States that will be conducive to China’s modernization drive.

A breakdown in this consensus view of the world—caused by an increased sense of threat or internal struggle among different policy factions—could shift the balance between economics and security. A greater sense of encirclement by the United States might prompt greater defense spending and/or an effort to formalize alliance relationships. Chinese efforts to balance the United States might provoke counterbalancing from ASEAN, to the detriment of economic cooperation with China.

Conclusion

While the increasing confidence of Chinese diplomacy in the region has often been cast as a zero-sum competition with the United States, the end results may be less disruptive and adversarial than predicted for at least two reasons.⁴⁶ First, the other states of the region are not passive players, but are also involved in shaping and reacting to China's rise. Much depends on how we perceive the behavior of the states on China's periphery, and if we see them as balancing, bandwagoning, or "hedging" against the rise of China. For example Acharya describes the states of ASEAN as unwilling to rely on either Beijing or Washington for their security and therefore engaged in "double binding" –efforts to enmesh China and the United State in regional institutions.⁴⁷ These institutions have so far proven surprisingly flexible and durable in supporting regional stability. There has been a tendency to see rising economic cooperation as a sign of bandwagoning. But the smaller states of Southeast Asia may be engaged in a strategy that mirrors Beijing's own efforts to reassure the region, using economic ties to reduce threat perception while improving defense coordination with the United States. As Lyall Breckon argues, "U.S. trade and security involvement in Southeast Asia, and improved U.S.-China relations overall, may be necessary conditions for the climate of confidence in which China has achieved its striking gains in Southeast Asia."⁴⁸

Second, in many respects, China's current use of economic statecraft overlaps with many US security concerns in the region. As Frost notes in her chapter: "Beijing's new commercial-diplomatic 'embedded-ness' bodes well for regional peace and prosperity and is broadly consistent with U.S. interests – provided, and it is a crucial proviso, that the United States stays engaged in the region." For example, Chinese plans for market oriented regional integration complement rather than oppose U.S. interests.⁴⁹ As Iain Johnston has noted, the evidence supporting Beijing's drive for regional hegemony is not clear cut.⁵⁰ China's increasing military

weight in the region could constrain American security capabilities. Even before the war in Iraq and the nuclear standoff with North Korea, U.S. military planners were thinking about how to use a greater maritime emphasis and long-distance strike capabilities to compensate for fewer U.S. bases and lack of infrastructure in the region.⁵¹ But there is little evidence that China is actively using economic ties to try and separate the United States from its regional allies. In fact there is mixed evidence that China continues to see the U.S.-South Korea and U.S.-Japan alliance as the basis of regional stability.

As the introduction and conclusion note, the overlap of Chinese and American interests is not a given, and in large part depends on the attitudes, behaviors, and responses to the rise of China by North and Southeast Asia, the United States, and the Chinese themselves. The United States must in particular hedge against two future possibilities. First, the primary focus on international stability and internal development may not prevent the use of coercion, despite the best intentions of China's current leaders. As Christensen notes, even if the pursuit of economic growth is Beijing's main policy goal, unease "about domestic stability and national integrity, and the need for military might and nationalistic posturing, often make the straightforward pursuit of national wealth an impossibility for the CCP."⁵² A legitimacy crisis, provoked by either domestic disturbance or external threats to territorial integrity and national sovereignty, could derail the mainly status-quo orientation of Beijing's current foreign policy.

Moreover, cooperative behavior from Beijing now may not ensure responsible action in the future. Economic development may create a degree of lock-in for Beijing, generating domestic expectations about continued growth and empowering social forces in China that inhibit the flexibility of Beijing (much as U.S. business interests influence Washington). But it is also possible that Beijing has chosen to rely on influence because it does not yet have the

ability to follow through on coercive threats. Without the ability to project power and sustain a military presence in maritime East Asia, military threats would be more than counterproductive. They would expose Beijing's weakness.

Given the uncertainty about Chinese intentions (and the inability to block Beijing's rising influence), this chapter reinforces the point made by the introduction, Frost and others: to maintain at the least the possibility of China's peaceful rise, the United States must actively re-engage with Asia. China has benefited from the perception that it is now the status quo power in Asia—in contrast to what Breckon describes as a regional perception of the United States as “unilateralist, given to preemptive military action, and insistent in pushing an agenda that ignored Southeast Asian interests in favor of counterterrorism and non-proliferation.”⁵³ The United States must renew its interest in developing multilateral trade agreements and institutions in the region, while at the same time strengthening bilateral cooperation with Japan and India. The key for Washington is to realize that both the bilateral and multilateral paths must be pursued in order to counter Beijing's rapidly deepening multilateral engagement with Asia.⁵⁴ In effect, a policy that responds to the rise of China should pay as much attention to the larger Asian framework as it does to China.

¹US-China Business Council, “Foreign Investment in China: 2005,” available at:

http://www.uschina.org/statistics/2005foreigninvestment_2.html

² Prepared statement of Paul Sarbanes to US-China Security Review Commission, June 14, 2001.

³ Edward Cody, “China's Quiet Rise Casts Wide Shadow,” *Washington Post*, February 26, 2006.

⁴ See for example, Mike M. Mochizuki, “Security and Economic Interdependence in Northeast Asia,” Asia Pacific Research Center, 1998; available at:

<http://aparc.stanford.edu/publications/10089/>

⁵ David Baldwin, *Economic Statecraft* (Princeton: Princeton University Press, 1985).

⁶ Jonathan Kirshner, “The Political Economy of Realism” in *Unipolar Politics: Realism and State Strategies after the Cold War*, ed. Ethan B. Kapstein and Michael Mastanduno (New York: Columbia University Press, 1999).

⁷ Paul Papayoanou, and Scott Kastner., “Sleeping with the (Potential) Enemy: Assessing the US Policy of Engagement with China. In *Power and the Purse: Economic Statecraft, Interdependence, and National Security*, edited by Jean-Marc F. Blanchard, Edward D. Mansfield, and Norrin M. Ripsman. (London: Frank Cass, 2000): 157-187.

⁸ Albert Hirschman, *National Power and the Structure of Foreign Trade* (Berkeley: University of California Press, 1945, 1980).

⁹ Hirschman, *National Power*.

¹⁰ Rawi Abdelal and Jonathan Kirshner, “Strategy, Economic Relations, and the Definition of National Interests,” *Security Studies*, 121.1

¹¹ Michael Mastunduno, “Economic Engagement Strategies: Theory and Practice,” in *Interdependence and Conflict: New Perspectives on an Enduring Debate*, ed. Edward Mansfield and Brian Pollins (Ann Arbor: University of Michigan Press, 2003).

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¹³ The three no's were a KMT policy and were: no contact, negotiation, and compromise between Taiwan and China. Chang Kao, *Dalu Jingji yu Liangan Jingmao Guanxi* [Mainland Economic Reform and Cross-Strait Relations] (Taipei: Wu Nan, 1994). Quoted in Tung Chen-yuan, *China's Economic Leverage and Taiwan's Security Concerns with respect to Cross-Strait Economic Relations* (PhD Dissertation, Johns Hopkins University, May 2002).

¹⁴ Mainland Affairs Council, *Dalu Gongzuo Cankao Ziliao* [Reference Documents of Mainland Work]. Quoted in Tung, *China's Economic Leverage and Taiwan's Security Concerns*.

¹⁵ Direct contacts between Taiwan's Jinmen (Kinmen) and Mazu (Matzu) islands and the mainland.

¹⁶ Chiu Yu Tzu, "Technology Law to Guard Valued Assets," *Taipei Times*, 17 April 2002; Lawrence Chung, "Taiwan Woos Its Companies Back," *Strait Times*, 12 December 2002.

¹⁷ "President Chen Calls for Taiwan-US-Japan Free Trade Agreement," *Chinese Economic News Service*, 12 April 2002.

¹⁸ Lin Chieh-yu, "Nation Must 'Go its Own Way': Chen," *Taipei Times*, July 30, 2002.

¹⁹ "China Invites Taiwan Businessmen for Talks," *BBC Online* 22 May 2002.

²⁰ "Chen Shui-bian Again Provokes the Mainland." *Hong Kong Ta Kung Pao*, in Foreign Broadcast Information Services-China [Hereafter FBIS-CHI], 30 July 2002.

²¹ Quoted in Tung Chen-yuan, *China's Economic Leverage and Taiwan's Security Concerns*

²² Quoted in Tung Chen-yuan, *China's Economic Leverage and Taiwan's Security Concerns*

²³ "China Will not Yield on a Matter of Principle." *Xinhua*, 8 April 2000.

²⁴ Mire Dickie and James Kynge, "Business in Taiwan Heeds Warning on Independence," *Financial Times* March 11, 2000.

²⁵ Craig Addison, *Silicon Shield: Taiwan's Protection against Chinese Attack* (Irvington, Texas: Fusion Press, 2001), 203. See also, "Presidential Office Cautions Mainland Over Chi Mei Plant," *China Post*, March 12, 2001.

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²⁷ "Qian Qichen Inspects Guangdong, Holds Discussion with Taiwan Businessmen." *Xinhua*, FBIS-CHI, 8 December 2002.

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²⁹ Quoted in Edward Cody, "China's Quiet Rise Casts Wide Shadow," *Washington Post*, February 26, 2005

³⁰ Baldwin, *Economic Statecraft*.

³¹ Avery Goldstein, "An Emerging China's Emerging Grand Strategy: A Neo-Bismarckian Turn?" in *International Relations Theory and the Asia-Pacific*, ed. G. J. Ikenberry and M. Mastanduno (New York: Columbia University Press, 2003)

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³³ Elizabeth Economy and Adam Segal, "China's Luster Fades," *Los Angeles Times*, December 30, 2004.

³⁴ James Pryzstup, "A Volatile Mix: Natural Gas, a Submarine, a Shrine, and a Visa. Japan-China Relations." *Comparative Connections*, October-December 2004.

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³⁸ Scott Snyder, "Waiting Game: China-Korea Relations," *Comparative Connections*, October-December 2004. http://www.csis.org/pacfor/cc/0404Qchina_skorea.html

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⁴³ Mu Lu, "Sino-U.S. Relations: A Century of Strategic Cooperation and Competition," *China Strategy*, vol 3 July 2004 (Center for Strategic and International Studies). Available at: <http://www.csis.org/isp/csn/040720.pdf>

⁴⁴ Yan Xuetong, "Origins of the Policy to "Pay Any Price to Contain Taiwan's Independence," ," *China Strategy*, vol 3 July 2004. (Center for Strategic and International Studies). Available at: <http://www.csis.org/isp/csn/040720.pdf>

⁴⁵ Evan Medeiros and M. Taylor Fravel, "China's New Diplomacy," *Foreign Affairs* (November/December 2003).

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⁵³ Breckon, A New Strategic Relationship

⁵⁴George Gilboy and Eric Heginbotham, "U.S. Asia (and China) Policy Reconceived," *National Interest*, no. 69, (Fall 2002), 99-109.