The Merchants of Shanghai, the Mandarins of Beijing: Economic Interdependence in Chinese Foreign Policy

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China is a rising power whose very rise presents threats to international stability. Economic interdependence has been singled out as a way to get out of the “Thucydides Trap.” However, the optimism disregards the other aspect of economic interdependence, which is asymmetric interdependence and vulnerability. For over a decade, China has been wielding its stick of economic interdependence in order to pursue its interests rather than been restrained by concerns for opportunity costs from ruptured trade. Beijing puts pressures upon Seoul and Tokyo. China would also likely use its financial leverage to do so against the United States. Under the current circumstances, a “balance of financial terror” seems to prevail, but the recent crisis in the U.S. financial system and the consequential recessions in the American product markets decreased the level of economic interdependence between the two. Therefore, China will be less restrained by the “balance of financial terror” and more likely to wield its power of asymmetric interdependence even against the United States. In order to prevent such economic duels between two great powers, the world trade system should be maintained liberal and open, while economic interdependence is to be kept mutual and symmetric rather than asymmetric.

Key Words: economic interdependence, signaling, China in East Asia, rare earth material, trade dispute

The beginning of the twenty-first century has observed a power transition between the United States and China, which might be one of the most fundamental changes in international structure. The American unipolarity—often dubbed as the “American Empire”—seems to have been replaced by a “G-2” of

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China and America, which is a bipolar system and is expected to be stable (Lee 2013). In contrast, the process of power transition might present serious dangers. Rising powers tend to challenge declining powers, which could lead to major wars between great powers for hegemony. Graham T. Allison (2012) illustrated the risk in a recent article: As Thucydides wrote that it was the “rise of Athens and the fear that this inspired in Sparta that made war inevitable,” the rapid emergence of China would “disturb the status-quo.” According to Allison, a “diva of such proportions cannot enter the stage without effect.” In eleven out of fifteen cases since 1500, power transition led to conflict between a rising power and declining power, and in some cases even war.

However, the future of the world is not doomed. As Allison acknowledges, political leaders are not prisoners of the “iron laws of history”; they could figure out ways to get out of the trap. The bridge which will help the world overcome the trap is “economic interdependence” between Beijing and Washington. The economic relationship is so tight that the Americans and the Chinese would not dare to fight with each other. Over the last decade, the world economy has been built upon a “Chimerica” or a “Bretton Woods II” constellation that combined Chinese export-led development with U.S. over-consumption; China boosted its economy fourfold since 2000 through producing for the United States, while America consumed more and saved less by 45 percent (Ferguson and Schularick 2009).

This symbiosis is a powerful foundation for optimistic predictions. In his landmark article, Aaron L. Friedberg put faith in economic interdependence for “Liberal Optimists”: The “greater the volume of trade and investment flowing between two countries, the more groups on both sides will have a strong interest in avoiding conflict and preserving peace” (Friedberg 2005). Economic interdependence would enable Beijing and Washington to overcome strategic differences—something not possible between the United States and the Soviet Union during the Cold War, as the two did not share an economic relationship.

However, the argument is flawed. First, it assumes that economic links would exert powerful influence upon political decisionmaking, without investigating the actual decision-making process and regime types.¹ It implies that the merchants of Shanghai will exercise dominating influence over Chinese foreign policy. Though plausible, it requires further investigation whether the mandarins of Beijing would listen to “advice” from the merchants of Shanghai. Second, it

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¹ There are some exceptions. In his various works, Moravcsik (1998) investigated into the decision-making process for the European integration and found that economic interdependence was the driving factors and that business interests overwhelmed political decisions for the union.

does not explore the possibility that states would take advantage of economic interdependence as a tool or an instrument of foreign policy. In other words, economic interdependence is not an independent variable over states' behavior, but a dependent variable or an outcome of states' decision. The argument fails to review that the economic link does not exert influence upon political decisionmaking.

I highlight this possibility with a specific focus upon China. I suggest that states would not be loyal servants of business interests, but powerful players to shape business environments even in the international arena. The merchants of Shanghai might not be the kingdom's regent. The mandarins of Beijing are still king. As Beth Simmons (2003) suggests, Pax Mercatoria—peaceful relationship from commercial interaction—is possible when states reflect vested interests in society; when a state enjoys autonomy from social interests, it is more likely that choices of war and peace would be made with less reference to business interests. Economic interdependence is one of many tools that states would take advantage of in pursuing their political objectives. Allowing trade access is one of the traditional instruments in foreign policy, while trade embargoes are effective in economic pressures. Moreover, states respond to prospective political conflicts by adjusting their trade relations. Faced with the prospect of political hostilities with the business partners, states would manipulate their economic interdependence and switch their business counterparts into somewhat more friendly countries.

From this perspective, in this article I explore economic interdependence in the Chinese foreign policy by reviewing the relevant literature and by investigating two relevant issues: exploitations of economic interdependence and purchase of dollar denominated assets. Implications for further research as well as policy are provided in the conclusion.

ECONOMIC INTERDEPENDENCE: NEGLECTED SOURCES OF POWER AND SPOTLIGHTED SOURCES OF PEACE

When first proposed in the early 1970s, economic interdependence was to replace power politics in realism. Robert O. Keohane and Joseph S. Nye, Jr. (2012, 7-9) defined interdependence as “mutual dependence” and “situations characterized by reciprocal effects among countries or among actors in different countries.” However, they aimed to provide a supplementary framework for power in international relations.

ASYMMETRIC ECONOMIC INTERDEPENDENCE AS A SOURCE OF POWER

From the title of the book, Keohane and Nye did not disregard the importance of power in international relations. Instead, they built another framework to understand power and provided two dimensions of interdependence: sensitivity and vulnerability. Sensitivity is “degrees of responsiveness within a policy framework”—the effect of a country upon another country. Vulnerability is defined as an “actor’s liability to suffer costs imposed by external events even after policies have been altered” and to be measured by the “costliness of making effective adjustments to a changed environment over a period of time” (Keohane and Nye, 10-11).

The genius lies at vulnerability. Keohane and Nye focused upon asymmetric interdependence as a source of power. A less dependent country has critical political resources over its partner, since its capability to adapt to new environments is greater than that of its partner. Asymmetry in vulnerability is a powerful source of power in an era of globalization. The new century has observed steady growth in international trade, despite some fluctuations, which boosts the level of economic interdependence among trade partners. The increase in trade contributes to greater sensitivities among partners, though it may not lead to evenly distributed vulnerability. Some countries would be more dependent upon others in terms of exports and imports. Monopolistic exporters have no problem in taking advantage of their sole products for the rest of the world. Meanwhile, economies with large domestic markets are more powerful, and less vulnerable, than their exporters for their monopsonic and hegemonic position in absorbing products.

ECONOMIC INTERDEPENDENCE AND ITS PEACEFUL EFFECTS?

Economic interdependence contributes to peace, or is at least regarded as so. Countries with strong economic relationship are less likely to fight with each other because of potential damages to their trade and investment in three ways. First, wars are already expensive in terms of opportunity costs, and the cost would be higher if they are deeply engaged in mutual trade and investment. Second, with commercial interactions, countries will attain their objectives through alternative means other than fighting. They will be able to achieve gains more efficiently through trade than through warfare (Gartzke and Lupu 2012). Third, economic interdependence creates peace-friendly domestic constituencies. With trade, countries will transform their own domestic structure from economic autarky to liberal economic order and openness, which contributes to peaceful relationship with foreign countries (Solingen 1998).

However, some scholars are skeptical of these optimistic estimates (Barbieri 2002). Some argue that economic interdependence and conflict are not related at all and that wars are the outcome of strategic calculation rather than economic interests. Others believe that there would be strategic interaction between countries with high economic interdependence; if a country reduces hostility toward another country for trade benefits, its trade partner would take advantage of the lower hostility for its strategic gains and behave aggressively. Therefore, the total amount of aggressiveness in international relations would not change much. Also, companies anticipate political conflicts and adjust themselves to political environments rather than shape the strategic landscape; they would switch to friendly countries and strengthen their business ties with new partners (Morrow 1999).

Most of all, the optimists are faced with a powerful counter-example in reality: the outbreak of World War I. Before 1914, the world economy was well integrated and globalized, which was expected to contribute to peaceful relationship among major trade partners. However, the world failed to survive a series of crises and suffered the carnage of the Great War; a total of 9.5 million soldiers were killed on the battlefield, excluding additional civilian deaths of one million from collateral combat fire.² The First World War might be a single, isolated case and a potential outlier, but its impact is too huge to disregard. Countries believed that they would survive the war and that they would be able to take more pains than their adversaries. Economic interdependence existed, but countries aimed to exploit the asymmetry in interdependence.

ASYMMETRY IN ECONOMIC INTERDEPENDENCE AND ITS IMPACT

A recent study aims to restore the commercial peace out of the Great War's trauma and suggests that the war started not between countries with high economic interdependence, but between the Habsburg Empire and Serbia whose economic interdependence was limited (Gartzke and Lupu 2012; Copeland 1996; McDonald and Sweeney 2007). The world before 1914 was highly integrated, but the level of economic interdependence varied across regions. The argument states that Eastern Europe was weakly interdependent, while Western Europe was well integrated.

However, this theory disregards another aspect of economic interdependence—a source of power. Austria-Hungary was a predominant economic power in Eastern Europe and in the Balkans, while other countries including Serbia were

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² The number covers direct combat deaths and excludes excess casualties from famine, disease, and accidents. The military deaths is from Ferguson (1999, 295 and 337).

asymmetrically dependent upon the markets of the Habsburg Empire. Most of Serbia's foreign commerce was with Austria-Hungary, while Vienna was not dependent upon Belgrade's exports. Under the circumstances of asymmetric interdependence and political tension, the Serbs were determined to end their asymmetric dependence and the Austro-Hungarians tried to stop the Serbian efforts. They fought on commercial grounds before they actually exchanged fire on the battlefields. Vienna exerted commercial pressure upon Belgrade and blocked Serbian access to the Austria-Hungarian market in the "Pig War." Serbia was more determined to solve the problem even with military power, which led to the assassination of Archduke Franz Ferdinand of Austria and the First World War (Lafore 1991, 147-150 and 173).³

Asymmetric interdependence is a source of power. It favored the less dependent countries, which happened to be more powerful countries. This has been the case in the past, is the case in the present, and will be the case even in the future. Interdependence can be a deterrent as long as it generates a similar amount of costs to each adversary; otherwise, it would generate asymmetric interdependence and favor one country over another. In the longrun, countries will recover from their temporary weakness, but in the short-term, asymmetric interdependence is a source of power.⁴ Particularly under the expected long war, countries with a higher threshold for pain would prevail over their adversaries. Asymmetric advantage is likely to increase the threshold, contributing to ultimate victory.⁵

This aspect has been largely neglected in the literature of economic interdependence. The previous research discussed whether economic interdependence would contribute to peace and stability, while they left the issue of asymmetric interdependence unaddressed, both theoretically and empirically. In this article, I

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³ Beginning in 1904, Serbia imported munitions from France rather than Austria-Hungary and built a customs union with Bulgaria. In response, the Habsburg Empire closed the borders to Serbian pork and Belgrade pursued other markets with the French and the Russian financial assistance, which escalated political tensions in the Balkans and contributed to the Great Power of 1914.

⁴ With some exceptions, countries will find in the long run alternatives to their unilateral dependence. However, it takes time; in the short run, they are exposed to asymmetric interdependence and to pressures under which they are expected to make political decisions. Therefore, I will focus upon short-run interactions rather than long-run responses for implications in international relations.

⁵ On the eve of World War I, the Europeans expected a short war. Many believed that soldiers would return from battlefield before the Christmas of 1914. However, there are many evidences that countries actually anticipated a prolonged, not short, war in 1914. The Germans planned another "Seven or Thirty-Years War" with the French and the Russian, which forced Berlin to devise some strategy to terminate a war in shortest time. The Schlieffen Plan was a desperate commitment by the German Officer Corps to avert a "prolonged, bloody, exhausting, and possibly unwinnable undertaking" rather than a "logical outcome of short war illusion." For detailed discussion, see Lieber (2007).

explore China's wielding of asymmetric interdependence as a tool for its policy objectives. Given that the world is entering a second bipolarity, figuring out China's pattern in asymmetric interdependence is a rather important issue. How has China wielded the power of asymmetric interdependence—in bilateral trades with South Korea and Japan, in building a multilateral trade network in East Asia, and in bilateral financial relationship with the United States? These are the main questions that I will address.

CHINA WIELDS ECONOMIC INTERDEPENDENCE: ASYMMETRIC VULNERABILITY AND FOREIGN POLICY

China is the second largest economy in the world. The size of its domestic market enables Beijing to wield economic power over its neighboring countries. As the volume of trade has increased between China and its partners, Beijing's advantages have grown and its leverages strengthened. Two episodes of trade dispute—with South Korea and Japan, respectively—provide an interesting glimpse into China's new source of power: asymmetric interdependence. In both cases, the mandarins of Beijing mobilized the merchants of Shanghai, not vice versa. They were not restrained by economic interdependence. Instead, the mandarins of Beijing found their asymmetric advantage in economic interdependence and mobilized the merchants of Shanghai for their political purposes.

CELLPHONES AND GARLIC: CHINA DEMONSTRATES POWER FOR ECONOMIC INTERESTS

South Korea is an industrial power, but the political power of the agricultural sectors—the voting power in the elections for the National Assembly—has been overrepresented in South Korean politics: South Korea's administrations, the conservative and the liberal, altogether have protected the rural interests with a variety of measures.⁶

In November 1999, South Korea implemented a temporary raise on the tariff for domestic garlic producers and began negotiations with China, since most of the garlic imports (80 percent) to the South Korean market were from China.⁷

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⁶ This is a chronic problem in advanced countries. The United States has maximum 66 to 1 "inequality" in voting power. One voter in Montana counts for 66 voters in California in the U.S. Federal Senate elections. As of 2012, in contrast, South Korea allowed electoral disproportion of 2 to 1 in the number of voters.

⁷ Garlic and garlic products from China amounted to 15 million dollars in 1999 to 2000. South Korea targeted the 75 percent of the import (10 million) from China.

During the six-month bargaining period, Seoul offered to purchase other items from China and asked Beijing to restrain the garlic exports “voluntarily,” but the Chinese negotiators rejected the offer. The first trade negotiation between South Korea and China, since the 1992 “normalization of the diplomatic relationship,” did not lead to a cooperative outcome. In June 2000, South Korea chose to formalize the protection and extend the protection period to three years. The government initiated a safeguard measure and raised the tariffs from 30 to 315 percent.

China responded with fierce countermeasures. Though applying to be a member of the World Trade Organization (WTO), China imposed a retaliatory ban against South Korea’s cellphones and chemical products such as polyethylene. The Chinese decision was unprecedented because the amount of cellphones and polyethylene overshadowed that of garlic by enormous margins. The Chinese exports of garlic was 10 million dollars in 1999 and 2000, while the South Korean exports of cellphones and polyethylene were 470 million and 41 million dollars respectively in 1999 (Len 2000).

Seoul hurried to settle the disputes through bilateral channels rather than resorting to WTO procedures, but South Korea negotiated under the shadow of China’s asymmetric advantage in economic interdependence. Seoul’s total damage reached 260 million dollars, including a direct import ban by China and the subsequent decreases in production in relevant industries (Korea Times 2000). Seoul’s negotiators offered to import up to 32,000 tons of garlic a year at a low tariff rate: 20,000 tons of Chinese garlic at a 30 percent tariff and minimum market access quota of 12,000 tons upon a 50 percent tariff. In exchange, Beijing was expected to lift its embargo on South Korean products, which would return the trade relationship to what it was before the dispute of November 1999 (Korea Herald 2000).

However, the Chinese negotiators demanded more than returning to the status-quo ante bellum. They chose to take maximum advantage of their asymmetric interdependence for further concessions from South Korea. They mobilized garlic exporters, while silencing numerous domestic groups such as the importers of cellphones from Korea, domestic consumers of cellphones, and domestic manufacturers who were dependent upon imported petrochemicals from South Korea. China wanted South Korea to guarantee that the quota would increase by 5.25 percent a year over three years and that South Korea would not extend the safeguard over garlic beyond 2002. Beijing prevailed and secured everything it pursued (Zhang 2007, 188-189).

In this dispute, China was not restrained by its economic interdependence. Instead, Beijing mobilized the merchants for its political objectives. The Chinese and South Korean economies had become more and more interdependent since the

diplomatic normalization of August 1992, but the merchants of Shanghai did not play a role in the settlement of the dispute. The power of Beijing's mandarins might have been reinforced by China's status at the WTO. Since China was not a member of the WTO yet, Beijing enjoyed almost complete liberty in wielding its advantage from asymmetric interdependence. However, even after China's entry to the trade organization, Beijing was not fully deterred in taking advantage of economic interdependence for its political objective.

RARE EARTH MATERIALS: CHINA WIELDS POWER FOR POLITICAL INTERESTS

Rare earth materials are essential in manufacturing various products in the twenty-first century. China supplies over 95 percent of the world's production of rare earths, coming mostly from Inner Mongolia, which has 37 percent of the world's proven reserves (Bradsher 2010b). China's position is by far stronger than the Organization of Petroleum Exporting Countries (OPEC), which produced less than 40 percent of the world's supplies during the oil crises in the 1970s. OPEC exploited its power of monopoly. China on the other hand was ready to wield its power even under the WTO regulations. In the 2000s, the demand for rare earth materials exceeded the supply, which pushed the price higher.

Furthermore, China controlled a supply quota of 35,000 tons with the worldwide surplus in demand reaching 40,000 tons per year; the official aim was to "conserve scarce resources and protect the environment" (Ma 2012). Ever since 2010, Beijing has decreased the export quotas. China manipulated its supremacy for its advantage. "Slashing their exports of rare-earth metals has little to do with dwindling supplies or environmental concerns. It is all about moving Chinese manufacturers up the supply chain, so they can sell valuable finished goods to the world rather than lowly raw materials" (Economist 2010). In March 2012, the advanced economies of the United States, the European Union, and Japan sued through the WTO over restrictions and China responded by claiming environmental protection and resource depletion in its defense (Reuters 2012).⁸

In the maritime territorial dispute with Japan, China was more than ready to exploit the asymmetric interdependence. In September 2010, a Chinese fishing boat collided with a Japanese patrol boat in the waters around the Senkaku Islands, whose territorial title has never been accepted by China. The Japanese Coast Guard detained a Chinese captain for his violation of "Japanese territory."

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⁸ In March 2014, the WTO Panel ruled that China violated the WTO obligations. Beijing reportedly has appealed (World Trade Organization 2014).

The arrest enraged the Chinese. Beijing requested an immediate release of the skipper of the fishing trawler, but Tokyo declined and extended the detention. In retaliation, China cancelled official meetings of ministerial level and above. In Beijing, the Japanese Embassy was surrounded by Chinese protestors and anti-Japanese slogans appeared on the streets in Chinese cities (Fackler and Johnson 2010). After a 17-day detention, the captain was released along with his crew mates and allowed to return to China.

During this time, China mobilized the merchants of Shanghai and took full advantage of the asymmetric interdependence. Despite official denials, China imposed an embargo of rare earth materials on Japan, which led Tokyo to “surrender to the Chinese pressure.” Beginning on September 21—two weeks after the arrest—the Chinese exporters stopped shipping rare earth materials to Japanese counterparts and scrapped previous contracts for no reason. The Chinese authorities—specifically, the customs service—held the exports to Japan and persuaded the merchants of Shanghai to divert their products to countries other than Japan. One trading company asked for a shipment via South Korea, but its Chinese counterpart refused the offer for fear of punishment (Yamaguchi 2010). Three days later, Tokyo released the Chinese skipper.

China strangled the shipment until mid-November 2010. Since the imposition was not officially announced, the lift of the embargo was not fully executed. Some companies in Japan began to receive what they were promised before, while others still waited for Chinese shipments. By mid-November, sixteen of twenty-seven Japanese companies that imported rare earth minerals from China had reported that their ability to buy them had improved, the Japanese government announced (Bradsher 2010a).

In this dispute, the merchants of Shanghai did not pressure the mandarins of Beijing into taking conciliatory positions toward Japan, one of their biggest buyers. Instead, the mandarins “advised” the merchants to delay the shipments, without making official decisions. “China does not have a trade embargo on rare earth exports to Japan,” a Chinese spokesman for the Ministry of Commerce announced. However, it was undeniable that the shipments to Japan had been delayed instantly into a halt (Bloomberg News 2010). Furthermore, Beijing aimed to consolidate China’s supremacy in the market by cutting the supply: “China has behaved in a way that resembles OPEC, the oil-producers’ cartel, cutting exports by 5-10% a year. In July the export quota was cut by 40%. Prices have soared” (Wiggin 2010).

In other words, economic interdependence did not work to restrain countries from conflicting with one another. They had conflicts and disputes, which are natural under an anarchical international system, and China took advantage of its supe-

rior position in economic interdependence.

CHINA AS A CREDITOR NATION: WIELDING ASYMMETRIC INTERDEPENDENCE OVER THE UNITED STATES?

The U.S. twin debt—the government and trade deficits—is one of the most fundamental problems in the world economy. A large chunk of the U.S. debt has been absorbed by Chinese investors—both official and private—and the mandarins of Beijing began to raise their voices over the financial patterns of China's financing of U.S. debt. In March 2009, Prime Minister Wen Jiabao expressed his worry about China's investment in the United States: "We have lent a huge amount of money to the U.S. Of course, I am definitely a little worried" (Wines, Bradsher, and Landler 2009). Can China wield asymmetric interdependence over the United States?

Some believe that it is difficult to translate financial power into political leverage and that China would be damaged too severely by its financial manipulation to exploit its creditor position. In this regard, Daniel W. Drezner (2009) paraphrases John Maynard Keynes: "when the United States owes China tens of billions, that is America's problem. When it owes trillions, that is China's problem." If Beijing chooses to blow up Washington's financial bomb, it would be the Chinese investors who would be damaged too. As Larry Summers said, the "balance of financial terror" kept them in check and economic interdependence will sustain the peace. China found itself in the middle of a "dollar trap"—that is, too much dollar assets in its pocket. Beijing had to keep its currency undervalued in order to boost its export to the United States, buy U.S. dollars in order to keep its currency undervalued, and purchase the dollar denominated assets in order to buy the dollars (Krugman 2009).

In contrast, "political might is often linked to financial might." If a "debtor's capacity to project military might hinge on the support of its creditors," China would take advantage of its financial power for its political objectives (Setser 2008). This is because the creditor's position can enjoy an asymmetric advantage and because economic interdependence in the China-U.S. financial relations does not guarantee an equal vulnerability. Over decades, China has used its cheap labor and currency, produced low-cost items for the American market, and purchased U.S. Treasury Bonds rather than realign its cheap currency, which has contributed to China's growth. The Bretton Woods II had worked well until 2007/08 when the financial system in the United States began its own melt-down. China is now ready for a new strategy. Sensitivity between the two coun-

tries is strong, and disparity in vulnerability is significant. Beijing is less vulnerable, and it is ready to wield its power as it used to do against its neighbors—South Korea in 2000 and Japan in 2010. The United States might be China's next target.

As Niall Ferguson and Moritz Schularick mentioned, the mandarins of Beijing believe that the Americans are too indebted to pay back the Chinese, who purchase U.S. bonds, by spending on Chinese goods (Ferguson and Schularick 2009). China is also concerned about the exposure of Shanghai's merchants to the U.S. dollar in two trillions of the Treasury Bonds. It is possible, but unlikely, that China would realign its currency at a new—appreciated—level to the U.S. dollar, as West German and Japan did during the Cold War. This would be a cure for today's problem for the U.S. trade deficit, but the merchants of Shanghai would not welcome the decision.

Given that the United States has been saving more and spending less on Chinese products, Beijing found itself in a “dollar trap” that China could not easily escape. Despite difficulties, Beijing has made a choice and pursued its “internationalization of the currency” objective, which will make it easy for the mandarins of Beijing to wield asymmetric interdependence. The weakening of economic symbiosis facilitated this decision. China still does not allow the capital account to be fully convertible, but as many as 24 countries—and their central banks—swap the Chinese renminbi (RMB; Chinese currency) in exchange for their own currencies (Jones 2013).

Moreover, the mandarins of Beijing would persuade the merchants of Shanghai into building their own trade bloc and using China's renminbi as an international key currency, though not a sole reserve currency. After a decade of rapid reserve accumulation, the mandarins of Beijing realized that their growth has been too dependent upon policy choices of Washington whose main concerns were dictated by domestic rather than international agendas (Dyer 2009). As one of the two great powers in the new bipolarity, China will go for its own trade subsystem under the WTO. Since the financial crisis of 2007/08, Beijing has been pushing for a greater role for the renminbi in trade and investment and almost 10 percent of China's foreign trade is settled in renminbi. Under the blessing of Beijing's mandarins, the merchants of Shanghai pledge to boost the status of the city into a trading and clearing center for RMB (Wei 2012).

China is pursuing an alternative trade network, too, under which China would be freer to take advantage of its less vulnerable position. The Trans-Pacific Partnership (TPP) that the United States eagerly supports has high standards for intellectual property and the environment, which practically prevents China from joining the initiatives. The mandarins of Beijing did not raise the bar for the TPP membership, but searched for new trade partners for the merchants of Shanghai.

They negotiated several free trade agreements with Australia, Japan, New Zealand, South Korea, and Switzerland. In addition, China is going for a regional system with RCEP (Regional Comprehensive Economic Partnership) initiative which includes Australia, China, India, Japan, South Korea, and New Zealand. If completed, the RCEP will cover 3 billion people, a combined GDP of about 17 trillion dollars, and 40 percent of world trade (Sinha and Nataraj 2013).

Though ostracized out of the TPP and threatened to be denied from the U.S. market, the merchants of Shanghai failed to push the mandarins of Beijing. Instead, the mandarins embraced the RCEP for their merchants and for access to new markets. “We uphold regional economic integration, and this is a way to fight against the global financial crisis,” a Chinese vice minister for foreign affairs said of the proposal in November 2012, adding, “We will actively support the negotiating process” (Perlez 2012). A year later, in the Asia-Pacific Economic Cooperation forum where the U.S. President failed to attend for the shut-down, China reinvigorated its efforts for its own trade grouping—RCEP—while the Chinese newspaper criticized the TPP as “confidential talks” and the pact as “a new step for the United States to dominate the economies in the Asia-Pacific region” (Perlez and Cochrane 2013).

It might be premature to assert that China will wield its power from asymmetric interdependence against the United States in a year or so. However, the current situation in East Asia along with new issues such as maritime territory, Air Defense Identification Zones (ADIZs), and the U.S. ‘pivot to Asia’ reinforces the risk. The previous bonds between Beijing and Washington have been weakened since the financial crisis of 2007/08 and the trade system is being divided into a group of subsystems whose memberships overlap. The balance of financial terror is less effective.

RETURNING TO THEORY WITH MORE AGENDAS

China exploits asymmetric interdependence for its own advantage. There is nothing unusual about Beijing’s behavior. The mandarins of Beijing were not restrained by merchants of Shanghai whose business interests might have been jeopardized. Symmetric interdependence might be effective in preventing wars, but asymmetry in economic interdependence would encourage the favored country to wield its power. What does this mean in the literature of international relations?

REGIME TYPES AND ASYMMETRIC INTERDEPENDENCE

Some believe that only between democracies can economic interdependence work for peace. With less state autonomy, democracies are likely to reflect social and business interests for peace. Democracies have broader political bases than non-democracies, which contribute to peaceful responses to international adventures. Finally, opportunity costs from economic interdependence would make states back down from armed conflict, as governments are exposed to pressures from business sectors (Gelpi and Grieco 2003).

However, this restraining effect does not prevent democracies from wielding their economic power. Democracies also flex their trade muscles for policy purposes. Various types of economic sanctions—trade embargos to freezing financial assets—have been tools of U.S. foreign policy. Washington has maintained economic sanctions against Havana since the 1960s and against Teheran since the 1980s. Democracies might be more restrained by economic interdependence, but they are not likely to refrain from wielding their economic power for political purposes.

In other words, the literature of economic interdependence should widen its coverage rather than focus upon effects of interdependence. Asymmetry has been, is, and will be a critical source of power. Recently, Russia flexed its “natural gas” muscle in defiance of international pressures and took advantage of the asymmetry in the energy market against Europe. Moscow convinced Kiev to purchase cheap gas from Siberia, only to raise the price by more than 40 percent since the new administration came to power in February 2014 (Economist 2014). Russia also threatened to cut off its gas supply to Europe in case of international sanctions against its “involvement in the Crimean affairs.” More research needs to be done in order to understand the uses of asymmetric interdependence, with a specific focus on economic sanctions.

ECONOMIC INTERDEPENDENCE AS A POLICY INSTRUMENT

The slogan for liberal optimism has been “Pacific effects” of economic interdependence. The future of the Sino-American relationship might be stable, optimists argue, because loss of trade benefit would deter Beijing and Washington out of political tensions and armed conflicts. Some suggest that trade would not have a deterrent effect, while others believe that trade might promote more frequent-fighting (Barbieri 2002). Most researches focus upon economic interdependence as an independent variable, despite disagreements over the effects upon states’ behavior.

This article highlights economic interdependence as a dependent variable. States take advantage of asymmetric interdependence as a policy instrument for

their purposes; but economic interdependence is not a determinant of states' behavior, but rather is a tool. Emphasis upon interdependence might not be enough to analyze various aspects of economic interdependence. In this respect, Simmons (2002) suggests ways to measure the asymmetry—qualitative asymmetry—with trade elasticity and strategic importance of products; however, numerical and quantitative symmetry would be more common and critical. Sheer market size is a way to gauge this factor.

One critical issue is that economic interdependence is mostly asymmetric and favors certain states over others. Under the circumstances, states would take advantage of its asymmetry rather than wait to be influenced by symmetric interdependence. In the future, the recent events between Russia and Ukraine that we are witnessing today would be not be seen as an isolated episode. More research is needed to examine exploitation by states of asymmetric interdependence.

SIGNALING THROUGH ECONOMIC INTERDEPENDENCE?

When states fail to settle their disagreements, they fight with each other. They cannot communicate with each other because they have incentive to misrepresent their resolve and capabilities (Fearon 1995). Credible signaling would enable states to overcome the problem and to settle their disputes. Economic interdependence might be one of the ways for states to communicate their true—and accurate—intentions and resolve. Faced with opportunity costs, states with high economic interdependence—the United States and China in the twenty-first century—might communicate and overcome their differences, while states with low interdependence—i.e., the United States and the Soviet Union during the Cold War—cannot (Morrow 2003).

This is a persuasive argument, but asymmetric interdependence would suggest that costly signals from economic interdependence are not credible enough for states to communicate. Asymmetry favors certain states over others, which makes it difficult for them to send credible signals. States with favorable interdependence would be faced with smaller opportunity costs and could not send credible signals; states with unfavorable interdependence will not engage in signaling because the opportunity cost is too severe. A costly—therefore, credible—signal requires a certain range of effective cost, which is bounded by upper and the lower limits (Kydd 2005).

Asymmetric interdependence causes asymmetry in opportunity costs, which renders interstate communication more difficult. Thus the questions are complicated: Under what conditions of economic interdependence are states likely to communicate and to bargain for an agreement? How would states estimate their respective costs for mutual communication? What would be the minimum and

the maximum amounts of cost required for effective signaling? These issues have been left unaddressed.

ECONOMIC INTERDEPENDENCE IN EAST ASIA OF THE NEW CENTURY

China is a rising power; there is no way to deny it. The world has been, is, and will be integrated into a single market. This is undeniable. In addition to this economic future, our political future appears to include a new bipolarity with the United States and China as the two great powers. Unlike the old bipolarity between the United States and the Soviet Union, the new bipolarity will be characterized by trade openness and economic interdependence. Some believe that the future will be stable for economic interdependence and that globalization will enable the United States and China to overcome their differences and to avert intense geopolitical competition. The world economy is in desperate need of G-2 cooperation for a recovery. As commentators said back in 2009, “Without a strong G-2, the G-20 will disappoint” (Zoellick and Lin 2009). A strong G-2 seems to be guaranteed because of Sino-American economic interdependence.

However, some have their reservations. First, economic interdependence does not necessarily lead to stability. Interdependence is “mutual dependence,” but it does not guarantee symmetric dependence. Economic interdependence will characterize the future, but it does not guarantee that asymmetric interdependence will be exploited. China’s recent behavior illustrates that Beijing is more than ready to wield its economic stick to achieve political objectives. China took advantage of its position with Japan over maritime territory and with South Korea over agricultural products. China is building its economic sphere of influence with a regional trade bloc. China has accumulated massive amount of financial assets and is ready to use the financial leverage for a political contingency with the United States. China would be more interested in its political aims than in due process.

Second, economic interdependence would provide a new source of power that the Soviet Union did not have during the Cold War. Moscow was the economic champion of the communist bloc, but lacked economic links with the market economies of the world. Therefore, the Soviets were deprived of exploiting economic interdependence for their political advantage and asymmetric interdependence did not enable Moscow to wield such power. In contrast, China is an essential part of the world economy and the world’s second-largest economy, which provides more leverage to Beijing over other capitals. Now Beijing aims to

build its own trade networks

With a more assertive China, countries—that is local neighbors in East Asia as well as the United States—will respond to Beijing’s exploitation of economic interdependence. As the mandarins of Beijing mobilize the merchants of Shanghai, the mandarins of other capitals would “persuade” their merchants to search for other options. The Americans, for example, would decrease their economic dependence upon Chinese exports and the East Asians would cooperate more with each other rather than stay dependent upon China. Such interactions would aggravate strategic risk in East Asia, which is already charged for many reasons.

As Dale Copeland argues, trade expectation is a more powerful determinant than simple economic interdependence. When countries expect the volume of trade to decrease, they would not care much about the economic interdependence in the present and might engage in armed conflicts. Nazi Germany in the 1930s pursued an autarkic economy to build self-sufficiency, however this virtually isolated the German economy from the world. Even on the eve of World War II, Germany was a major member of the world economy, but its expectation was that trade would decrease in the future. Therefore, the Germans were not restrained by economic interdependence, freeing Hitler to unleash his war machines in 1939 (Copeland 1996).

Therefore, it is important to keep the international economic transactions—that is, trade as well as finance—revived. It is also significant that economic interdependence be guaranteed to be balanced and symmetric rather than asymmetric. As Allison contends, China is a “diva” and should be treated as a diva. The diva itself should be balanced in every sense—in ballet, business, foreign affairs, and politics. Otherwise, the performance will be in trouble. For the world, such “trouble” will spring itself as a Thucydidean Trap.

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