UNIVERSITY OF CALIFORNIA SAN DIEGO

Is China an Exception to the Commercial Peace?

A dissertation submitted in partial satisfaction of the
Requirements for the degree Doctor of Philosophy

in

Political Science

by

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2018

The Dissertation of Jiakun Jack Zhang is approved, and it is acceptable in quality and form for publication on microfilm and electronically:

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2018

DEDICATION

To the many mentors
who have guided me through my development as a scholar

and
to my parents
who did their best to warn me from going down this difficult path

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LIST OF ABBREVIATIONS

ADIZ	Air Defense Identification Zone
AIIB	Asian Infrastructure Investment Bank
BRI	Belt and Road Initiative
CCG	China Coast Guard
CCP	Chinese Communist Party
CFR	Chinese Foreign Relations Dataset
CMS	China Maritime Surveillance
CNOOC	China National Offshore Oil Corporation
CPEC	China-Pakistan Economic Corridor
DPJ	Democratic Party of Japan
DPP	Democratic Progressive Party
DPRK	Democratic People's Republic of Korea
ECFA	Economic Cooperation Framework Agreement (with Taiwan)
EEZ	Exclusive Economic Zone
EU	European Union
FLEC	Fisheries Law Enforcement Command
GDP	Gross domestic product
ICB	International Crisis Behavior Dataset
JASDF	Japan Air Self Defense Force
JCG	Japan Coast Guard
JETRO	Japan External Trade Organization
JMSDF	Japan Maritime Self-Defense Force
KMT	Kuomintang Party

LDP	Liberal Democratic Party
MID	Militarized Interstate Disputes
MNC	Multinational Corporation
ODA	Official Development Assistance
OFAC	Office of Foreign Assets Controls (of the United States)
PLA	People's Liberation Army
PLAAF	People's Liberation Army Air Force
PLAN	People's Liberation Army Navy
PRC	People's Republic of China
PSEi	Philippines Stock Market Index
ROC	Republic of China
ROK	Republic of Korea
SCO	Shanghai Cooperation Organization
SDF	Japan Self-Defense Force
SSE	Shanghai Composite Index
TAIEX	Taiwan Capitalization Weighed Stock Index
TIES	Threat and Imposition of Economic Sanctions
THAAD	Terminal High Altitude Area Defense
UNCLOS	United Nations Convention on the Law of the Sea
USA	United States of America
USSR	Union of Soviet Socialist Republics
WTO	World Trade Organization

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ACKNOWLEDGEMENTS

I have been fortunate to stand on the shoulders of scholarly giants at UCSD. This dissertation benefited enormously from the helpful advice and insightful critiques of my committee members: Stephan Haggard, David Lake, Erik Gartzke, Victor Shih, and Megumi Naoi. I am especially grateful to Stephan Haggard for supporting this project from its inception and championing me throughout my graduate career. And also to David Lake for teaching me the craft of how to be a good political scientist and for always seeing the sliver of insight in a jumble of ideas. Their personal kindness was never overshadowed by their towering intellects; I could not have asked for a better pair of advisors than this dynamic duo.

I am also forever grateful to Erik Gartzke and the Center for Peace and Security Studies (cPASS) for generously supporting me with funding and co-authorship opportunities throughout my time at UCSD. This dissertation builds upon his pioneering research on the capitalist peace and grew alongside cPASS. My conversations with Erik and interactions with cPASS colleagues were some of my most formative experiences in graduate school.

I was also fortunate that my time at UCSD coincided with the beginning of a golden age for the 21st Century China Center. I not only benefited much from the patronage of Victor Shih and Susan Shirk, but was also delighted to be part of the dynamic community of China scholars that coalesced around the Center. As I leave La Jolla, I have no doubt that the UCSD faction will be one of the most influential cliques in the study of Chinese politics for decades to come. I am grateful to have had a chance to get to know Lei Guang, Weiyi Shi, Tai Ming Cheung, Barry Naughton, Richard Madsen, Jude Blanchette, Molly Robers, Yiqing Xu, Jessica Weiss, Suisheng Zhao, Scott Kastner, my colleagues on the China Focus Blog, and countless other scholars, journalists, and policymakers through the China Center.

My education as a political scientist would not have been complete without the mentorship of so many amazing faculty members at UCSD. I am particularly indebted to Megumi Naoi and Lawerence Broz for inspiring my interest in international political economy and for providing feedback on the many iterations of this dissertation. I also learned much about scholarship and service from Branislav Slantchev, Christina Schneider, Peter Gourevitch, Miles Kahler, Karen Ferree, and Sam Popkin.

But my fellow graduate students, particularly the members of 'the best cohort ever', will always be the most memorable aspect of my time at UCSD. I count myself lucky to have shared this grand adventure with Shannon Carcelli, John Kuk, Deborah Seligsohn, Jason Wu, Brian Tsay, Matthew Nanes, Andrew Janusz, Nazita Najevardi, Dotan Haim, and Kelly Matush. I benefited from the wisdom and encouragement of predecessors in the program such as Weiyi Shi, Ben Graham, Jonathan Markowitz, Blake McMahon, Jeff Kaplow, Rupal Mehta, Chris Fariss, Zachary Steinert-Threlkeld, Michael Plouffe, Jason Kuo, Dimiar Gueoguiev, Steven Oliver, and Jonghyuk Lee. And I have been delighted to befriend, work with, and help mentor the next generation of UCSD scholars in Andres Gannon, Patrick Hulme, Abigail Vaughn, Brandon Merrell, Luke Sanford, Christina Cottiero, Rachel Schoner, Gregoire Phillips, Nhat-Dang Do, Yin Yuan, Taylor Carlson, Huchen Liu, and Duy Duc Trinh.

My research involved field work in China and benefited from a talented team of undergraduate research assistants (Yingjie Fan, Yiyi Sun, Qitao Wu, Jianbing Li, Cailen Rodriguez, and Amanda Madany). I am grateful for the generous support of the Fulbright U.S. Student Program, the University of California Institute on Global Conflict and Cooperation (IGCC) Herbert York Dissertation Fellowship, the Smith Richardson Foundation World Politics and Statecraft Fellowship, and the Charles Koch Foundation Dissertation Grant. I thank

Professor Wang Yong and the Center for International Political Economy at Peking University for hosting me during my Fulbright year. I also thank my friends, mentors, and fellow China hands for getting me interested and keeping me interested in how markets and politics intersect in China: Nick Consonery, Damien Ma, Sasha Riser-Kositsky, Raymond Lu, Cecilia Sze, Yifei Zhang, Emily Feng, Spencer Li, Samantha Voertherms, Graham Webster, Tao Xie, Scott Kennedy, and Tom Rafferty. My final thank yous go to my mentors at Duke who set me on a path of academic scholarship: Peter Feaver, Joseph Grieco, Michael Ward, Emerson Niou, and particularly Tianjian Shi, who gave me my first research assistantship and taught me what it means to be a scholar.

There's a Chinese proverb 饮水思源 which means "when you drink water, honor the source". I want to honor all of the people and processes that made this small drop in the pool of knowledge possible and dedicated this manuscript to all of the mentors who helped me along my academic journey.

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Gartzke, Erik and Jiakun J. Zhang, "Trade and War" in *Oxford Handbook on the Politics of Trade,* ed. Lisa Martin (Oxford University Press, 2015).

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ABSTRACT OF THE DISSERTATION

Is China an Exception to the Commercial Peace?

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University of California San Diego, 2018

Professor Stephan Haggard, Chair
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Contrary to commercial peace theories, which predicted that economic engagement would make possible China's peaceful rise, China seems to be engaging in more militarized disputes with its neighbors and trade partners. I offer an explanation for this apparent anomaly by examining the relationship between borders, trade, and conflict in a new dataset on Chinese Foreign Relations (CFR). I integrate the three main causal mechanisms in the commercial peace literature, constrain, inform, and transform, into a unified theoretical framework and use China's foreign policy behavior to develop and test this theory. I show that economic engagement, while capable of creating new areas of cooperation, is not effective at resolving

underlying causes of military conflict such as territorial disputes or constraining the use of military force during crisis bargaining. Though disputed borders have been found to depress international trade flows in other regions, they have not impeded China's growing trade with its disputant neighbors. At the same time, China's use of military force against trade partners does not disrupt economic ties or produce opportunity costs as previously assumed. I find that conflict over unresolved territorial disputes account for 87% of Chinese uses of military force and China is not constrained by growing trade dependence with other claimants. These results suggest that trade may lead to stability at higher intensities of conflict --making wars more unthinkable-- but can also create instability at lower intensities of conflict -- incentivizing calibrated uses of military force, against which revoking trade would not be a credible response. Therefore, as long as China's territorial disputes remain unresolved, economic interdependence will not decrease the frequency with which China uses military force in these disputes but will put a ceiling on the intensity of these conflicts.

Chapter 1 Understanding the China Challenge

China's pursuit of wealth has led it to become deeply integrated with the global economy, but its quest to become more powerful risks disrupting the status quo in the U.S.-led international system. The rise of China thus poses a unique challenge for Western scholars and policy makers: how to deal with serious security differences and avoid military conflict with a power that is so integrated with the world economy.

China also seems to be engaging in more militarized disputes with its neighbors and trade partners. Since coming to power in 2012, Xi Jinping has espoused an expansive foreign policy vision for China and accelerated the modernization of the People's Liberation Army (PLA). Standoffs involving Chinese navy or coast guard vessels and aircraft in the South China Sea and East China Sea have prompted a vigorous debate among scholars and policymakers about China's 'new' or 'rising' assertiveness (Chen, Pu, & Johnston, 2013).

War between China and the United States would be ruinous for both countries and destabilizing for the global order, yet this apocalyptic outcome is no longer considered unthinkable in serious policy circles. A 2016 RAND study predicts that economic factors will play the decisive role in a military standoff between China and the United States. The authors estimate that a yearlong conflict between the two powers would destroy as much as 25-35 percent of Chinese GDP and 5-10 percent of U.S. GDP, equivalent to roughly the entire economies of India and Brazil respectively.[1] Given the interdependent nature of the two economies, the scale of destruction would be unprecedented. Indeed, China's deep integration with the United States and her allies, is the main reason why the strategic challenge posed by

[1] Gompert, David C., Astrid Stuth Cevallos, and Cristina L. Garafola. *War with China: Thinking Through the Unthinkable*. Rand Corporation, 2016.

its resurgence differ fundamentally from the Cold War waged against the Soviet Union. Rather than fighting to impose two opposing systems of economics and governance on each other and on the world, China and the United States share a common interest in preserving a liberal (at least in economic terms) international order in which they have both been major beneficiaries.[2]

At the same time, a growing chorus of voices the U.S. are beginning to call into question the efficacy of economic engagement with China. Their confidence shaken by the 2008 Global Financial Crisis, American elites have become increasingly troubled that China seems to be catching up fast, even surpassing the United States in certain areas, by playing a game whose rules were largely set in Washington. The narrative that China is winning by cheating has gained more and more appeal, most significantly in the presidency of Donald Trump whose "America First" vision of foreign policy that contained a large dose of anti-China protectionism. Under the Trump administration, China's use of industrial policy to gain a competitive edge over the United States, including the international activity of its state-owned and state-backed companies, and how it might use economic coercion to achieve political interests rather than military force have all been pushed to the forefront of public discourse. Chinese scholars generally agree that the brewing trade war between the United States and China poses one of the most severe challenges to the Sino-American relationship since the 1970s, when the sides began to normalise their diplomatic ties. At the beginning of this period of reform and opening up, Deng Xiaoping correctly judged that the two major trends in international politics were towards peace and development. China's economic development required a peaceful international environment, and was made possible, in large part, by diplomatic normalisation with the US. Today, these decades-old trends seem to be in flux: following the rise of Trump,

[2] Westad, Odd Arne. "Has a New Cold War Really Begun?" *Foreign Affairs*. 10 June 2018. Web. 10 June 2018.

China's success in development has transformed trade from a cornerstone of peace in the U.S.-China relationship to a source of uncertainty and instability. Due to the deep economic interdependence of the US and China, a trade war between them would lead to a catastrophic collapse in bilateral trade and a substantial decline in output and wages[3]. The high-level of trade interdependence between countries increases the economic costs of political tensions between them currently. But a pro-longed period of trade tensions between the U.S. and China could gradually reduce their trade interdependence until their economies finally decouple. The history of the 20th century has shown that economic globalisation is not inevitable, and that economically interdependent countries can resort to conflict with one another if their leaders choose national security interests over economic interests.

As outlined by Ratner and Campbell's controversial 2018 *Foreign Affairs* essay, "How American Foreign Policy Got China Wrong"[4], these debates over new assertiveness and economic engagement challenge many long-standing assumptions about the trajectory of China's development and its implications for the United States. Since the 1980s, commercial liberalism has been the guiding principal for why the U.S. should engage with China. As Thomas Wright of the Brookings Institution notes, "if there is one idea that has consistently influenced western foreign policy since the Cold War, it is the notion that extending interdependence and tightening economic integration among nations is a positive development that advances peace, stability, and prosperity." (Wright, 2013) Liberal scholars and policymakers championed the idea that with economic interdependence comes peace, stability,

[3] Meixin Guo, Lin Lu, Liugang Sheng, and Miaojie Yu, "Evaluating the Burden of a U.S.-China Trade War", VoxChina, 25 April 2018, available at http://voxchina.org/show-4-229.html.

[4] Campbell, Kurt M and Ely Ratner. " How American Foreign Policy Got China Wrong," *Foreign Affairs*. March 2018. Web. 10 June 2018.

and prosperity, and policymakers bought into the prediction that free trade will make possible China's peaceful rise.[5] The logic is that as it becomes integrated into the global economy, China's peaceful rise will culminate in its emergence as a 'responsible stakeholder' in an American-led liberal international order or, at the very least, facilitate win-win cooperation as part of a 'new model of great power relations'.

Western liberals were thus sorely disappointed when President Xi Jinping embraced a domestic policy agenda to strengthen the role of the Chinese Communist Party (CCP) and crackdown on dissenting voices rather than adopt western-style political reforms and further open up China's society. The narrative on China among American observers has shifted decisively, the idea that China is heading towards what Francis Fukuyama has called "the end of history," which has had wide intellectual currency since the normalization of relations, has been replaced by anxiety over a dizzying variety of indicators – from building military bases to tightening internet censorship -- that China is headed in the "wrong" direction.[6] While there's growing consensus about where China is NOT headed (ie. peaceful, liberal, free-market, democracy), there remains great uncertainty about where China IS headed.

[5] Kang (2003) offers a cultural explanation for the East Asian peace, claiming that East Asians see a strong China as stabilizing the region. Rationalist IR scholars like Goldstein (2007) and Solingen (2007) trace the link between economic interdependence and peace, arguing that a growing number of Asian (read Chinese) national leaders have come to prioritize economic growth and good relations with the USA over more diverse or provocative aims. Also see Katz, Richard. "Mutual assured production: why trade will limit conflict between China and Japan." Foreign Affairs. 92 (2013): 18; Holslag, Jonathan. China and India: prospects for peace. Columbia University Press, 2010.; Zhu, Zhiqun. US-China relations in the 21st century: Power transition and peace. Routledge, 2006. Tønnesson, Stein. "What is it that best explains the East Asian peace since 1979? A call for a research agenda." Asian Perspective (2009): 111-136. On the importance of economic interdependence to the policy discourse: Wright, Thomas. "Sifting through interdependence." The Washington Quarterly36.4 (2013): 7-23.; Kissinger, Henry, and Nicholas Hormann. On China. New York: Penguin Press, 2011.

[6] See: Fallows, James. "China's great leap backward." *The Atlantic* (2016) and "How the West Got China wrong", *The Economist* (2018). These indicators are used to predict a variety of outcomes for what lies ahead for China that are all undesirable but do not hang together by consistent logic or common theory -- war, gray zone conflict, military crises, military coercion, economic coercion, economic influence or statecraft, foreign influence operations, growing influence in international organizations, censorship of the internet, restricting academic freedom, posing an ideological challenge to the West, trying to establish a new global order.

Thus, U.S.-China relations now stands at a critical juncture with enormous implications for the future of global order. China has become too integrated to contain and too assertive to ignore.

1.1 The Search for a Theoretical Framework

To understand what the rise of China means for the future of world peace, scholars have looked from ancient Greece to the German Empire for historical analogies to understand the present moment. The limitation of observational data of rare events like wars is that we are captive to history and must be careful about the inferences we draw from the data that is available. However, without a systematic model, these exercises only tend to confirm our existing biases and validate our pet theories. To understand what the rise of China means for peace and stability, we must first unpack the effects of economic interdependence on conflict behavior.

The modest aim of this dissertation is to advance a theory of Chinese foreign policy that can explain the impact of growing economic interdependence on pattern of Chinese uses of force from 1949-2017. In this chapter, I first outline why China represents a puzzle and an opportunity for existing international relations theory on economic interdependence. I review the international relations literature on China to show that this research draws insights from both the literature on security studies and political economy and that, by understanding the process of Chinese foreign policy in this area, I can help shed light on structural debates about the implications of China's rise. The larger ambition for this project is to contribute to our general understanding of economic interdependence by using China to reconcile and test

mechanisms of commercial peace literature. I show how commercial peace theories[7] share a common prediction but have contradictory causal mechanisms about how rising trade should impact China's use of military force. My research establishes the scope conditions for when each of these major causal mechanisms and synthesize their insights to explain Chinese foreign policy outcomes.

I offer an explanation for this apparent anomaly by examining the relationship between borders, trade, and conflict in a new dataset on Chinese Foreign Relations (CFR). Conflict over unresolved territorial disputes account for 87% of Chinese uses of military force and these rates are unaffected by China's growing trade dependence with other claimants. While disputed borders have been found to depress international trade flows in other regions, they have not impeded China's growing trade with its disputant neighbors. I show that trade can lead to stability at high levels of conflict --making wars more unthinkable-- but creates instability at lower levels of conflict -- incentivizing calibrated uses of military force, against which revoking trade would not be a credible response. Therefore, as long as China's territorial disputes remain unresolved, economic interdependence can increase the frequency with which China uses military force in these disputes while putting a ceiling on the intensity of these conflicts.

Forests have been felled to supply the pages of books on the rise of China and its implications for international relations. But this plethora of perspectives can be distilled into the paradigmatic debate between realists and liberals. Realists believe China is a revisionist power – either by deliberate strategy or structural position as a rising power – and that conflict

[7] I will use 'commercial peace' as a shorthand for the collection of economic interdependence theories that predict a pacifying effect between commerce and conflict. This literature is also known as the capitalist peace, economic peace, Pax Mercatoria, and is often discussed as part of a larger discussion of the liberal peace, Kantian peace, or democratic peace.

is inevitable. Liberals believe that economic interdependence makes war unprofitable and will pacify or domesticate China and turn it into a responsible stakeholder. Neither perspective seem sufficient to account for the full range of Chinese foreign policies. As I noted earlier, the uniqueness of the China challenge lies precisely in the fact that it has *both* security differences that can produce military conflict *and* deep economic integration with the world economy. It is impossible to grasp China's grand strategy without understanding its model of economic development. There are large communities of scholars who study the security and political economy of China, yet relatively very few work at the intersection of these two approaches. Recent worries about Chinese industrial policy[8], foreign influence, and economic statecraft (Norris, 2016) also reveal that the relationship between economic interdependence and national security can run in the other direction as well.

It is important to recognize that these dynamics are not unique to China nor are they particularly new to the current moment in the history of globalization. Military and economic power have always been intimately linked in the conduct of statecraft. The question of economic interdependence was at the heart of the 'paradigm wars' in IR and links back to this much older set of debates in international relations (Krasner S. , 1976; Keohane & Nye, 1977; Wallerstein, 1979; Hirschman, 1980; Kindleberger, Dominance and leadership in the international economy: Exploitation, public goods, and free rides, 1981; Gilpin, 1983; Buzan, 1984; Conybeare, 1987; Lake, The state and American trade strategy in the pre-hegemonic era, 1988), and was the preoccupation of Marxist theorists like Hobson, Bukarin and Lenin long before this. It has also been extensively studied by economic historians (Tooze, 2014; Findlay

[8] "How the West got China wrong" *The Economist*. https://www.economist.com/leaders/2018/03/01/how-the-west-got-china-wrong

& O'rourke, 2009; Kindleberger, World economic primacy: 1500-1990, 1996; Brewer, 1989), and military historians alike (Gaddis, 1986; Barnhart, 2013; Lambert, 2012; Mahan, 1890). As Edward Mansfield (1995) points out "empirical studies of war often gives short shrift to economic factors; and studies of international political economy often ignore the effects of security and war on trade" and shows that variation in systemic war is best explained by combining political variables (concentration of power) and economic variables (trade levels) in multivariate models.

This dissertation attempts to bridge the divide between security studies and political economy by adopting a similar approach to the study of the effects of economic interdependence on Chinese foreign policy. To date, only Scott Kastner (2009) has seriously engaged with the effects of economic interdependence in China at both the structure and process level using qualitative case studies of cross-strait relations. My dissertation attempts a more systematic review of China's economic interdependence and use of military force by applying insights from the bargaining theory of war to a more complete dataset of Chinese foreign policy. I want to move away from the rigid notion that there is only one relationship between interdependence and security and toward a framework where several effects can occur at different time intervals and intensity levels. I show that economic interdependence has no effect on China's willingness to use military coercion, but that coercion is largely used in the context of territorial disputes. This use of coercion is not necessarily an indicator of revisionism; by implication, if the territorial disputes were settled reflecting the power balance between China and its neighbors, China would no longer be a revisionist state.

1.2 Is China an Exception to the Commercial Peace?

China's integration into the regional economy offers excellent scope conditions to study whether trade can serve as an alternative means of costly signaling for another reason. The endogeneity between trade and conflict has long plagued the empirical study of the commercial peace (Mansfield & Pollins, 2003; Schultz, 2015; Keshk, Pollins, & Reuveny, 2004). It is difficult to disentangle whether trade reduces conflict or whether the termination of conflict stimulates trade. The two regions often used in case studies of the pacifying influence of trade, Western Europe and Latin America, also housed regional integration projects where the settlement of political conflicts was a precondition for economic community (EU and Mercusor). European economic and security integration proceeded in tandem as part of a larger political project to bind powerful countries like Germany to a structure that would oblige them to take the interests of weaker neighbors into consideration.

By comparison, Asia has also experienced high levels of economic integration. However, unlike Europe, fundamental disagreements about sovereignty continue to persist in Asia. The political settlement of WWII clearly defined borders in Europe, but failed to do so in Asia. WWII shattered colonial empires in Asia, but did not include the subjects at the negotiating table. The collapse of the Japanese empire and surrender of Japanese troops created border problems on the Korean Peninsula, Manchuria (borders with Russia and Mongolia), and the South China Sea (claims by China, Taiwan, Vietnam, Philippines, and Malaysia). The dissolution of British rule left problems between Burma, Thailand, China, Nepal, Tibet, and India. The partition of India, Pakistan, and Bangladesh is at the root of most of the conflict in South Asia. The dissolution of French rule in Indo-China created disputed borders between Vietnam, Laos, Cambodia, and China. Almost all the militarized conflicts in Asia over the past

half-century can be attributed to one of these border disputes. China, with 33 land and maritime disputes along its vast borders, accounts for roughly 40% of total disputes in Asia (Fravel, 2008).

But, since embarking on economic reform and opening in the late 1970s, China's share of world trade had increased more than ten-fold by 2013. But China seems to be engaging in more militarized disputes with its neighbors and trade partners. Figure 1 shows the distribution of China's militarized disputes (MIDs)[9] over time and Figure 2 show the pattern across adversaries both before reform and opening (red) and after (blue). What is remarkable about China's pattern of militarized disputes is that a large share of them are with major trading partners such as Japan, Taiwan, and the United States and that the majority occurred after China began the process of economic integration with the region and the world.

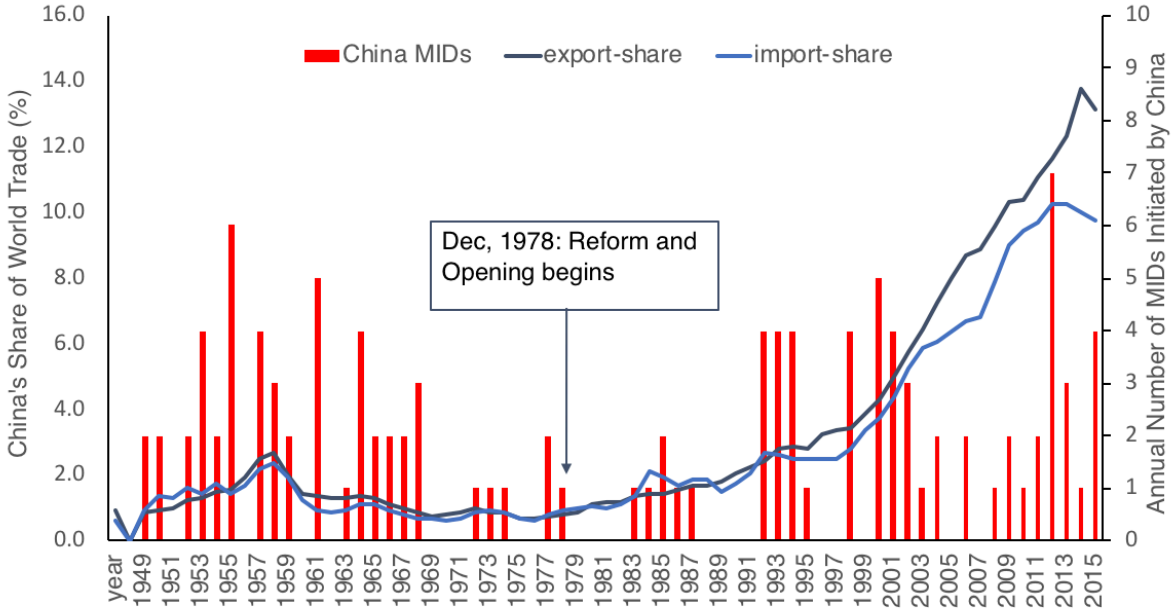

Figure 1 China's Trade Integration and Involvement in Militarized Disputes

[9] This paper will focus on militarized disputes as the measure for conflict, specifically the widely used militarized interstate disputes (MIDs) measure from the Correlates of War dataset. These data provide a pragmatic middle ground between noisy machine coded events data and rare events data (like war or battle deaths). Additionally, security studies scholars have developed a rich body of theory to help us understand when and why crises escalate into war based on analysis of MIDs data.

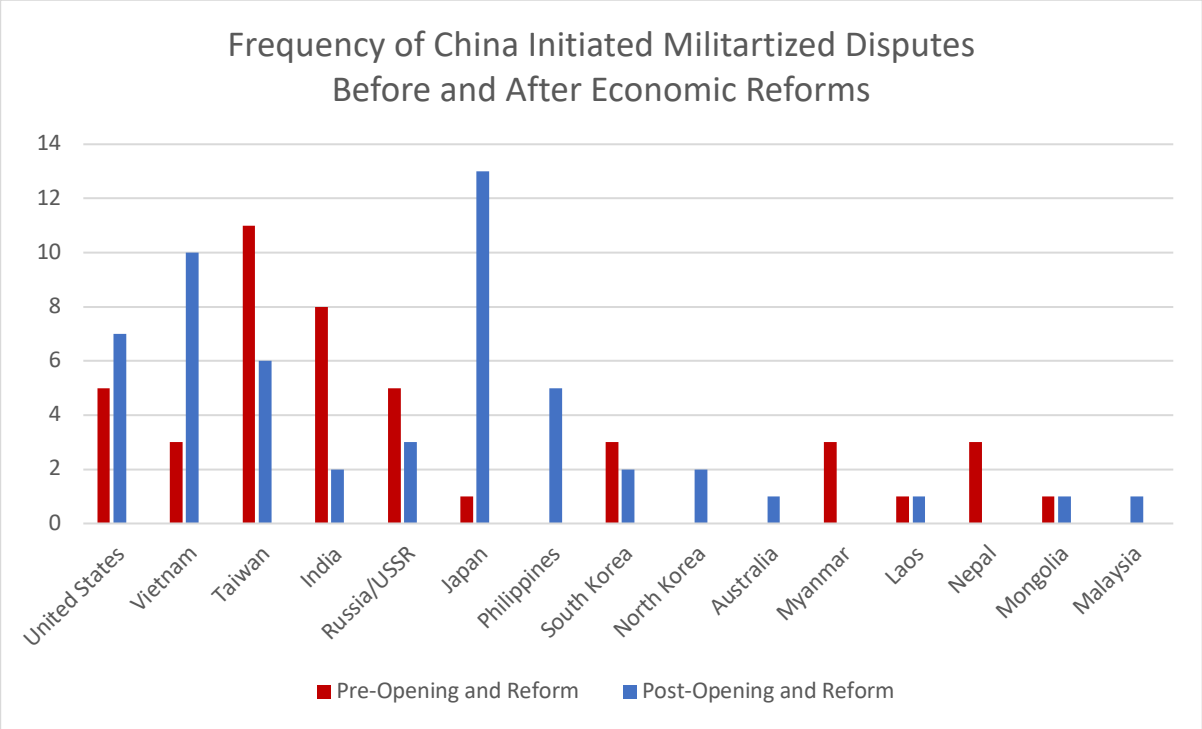

Figure 2 China's MIDs by Country (1949-2016)

In the case of China, endogeneity concerns are minimized by the fact that the reestablishment of diplomatic relations with the United States and Japan was motivated by security concerns vis-à-vis the Soviet Union. Unlike the European Union and Mercosur, the subsequent economic liberalization was not preconditioned on the settlement of territorial or political issues. The rapid expansion of trade was likewise driven by market forces rather than political considerations. U.S. investment in China was low between 1979-1989 despite low levels of military conflict (China was a U.S. ally against the USSR) but the opportunity for profit was not certain until the late 1980s. But after 1992 when China further liberalized its stance on FDI and higher profits seemed certain, American firms clambered to enter the China market despite heightened political risk after Tiananmen and other events (Taiwan Straits Crisis 1995-1996, Belgrade Bombing 1998, EP3 Incident 2001). Non-American firms behaved in a

similar way. The potential for profit is a lot more salient than the risk of military conflict for the investment behavior of foreign firms. Taiwanese firms were among the first to invest in the mainland despite the ongoing conflict between Beijing and Taipei. Similarly, the Senkaku/Diaoyu island dispute with Japan was a source of tension in the negotiations to normalize diplomatic relations in 1972, but trade between the two countries flourished even though the dispute remains unresolved. Thus, Chinese foreign policy provides the perfect setting to demonstrate the deficiencies in existing theories of the commercial peace and to build new theories of economic interdependence. The emergence of this counter-intuitive result for the commercial peace in China exposes potential blind spots in the existing mechanisms that are believed to drive the pacifying effects of trade.

Figure 3 Map of China's Active Territorial Disputes

Viewed in the light of its unsettled borders (shown in Figure 3), the pattern of military force usage in Chinese foreign policy is not exceptional. China contests or has contested at least one territorial boundary with almost all of the countries displayed in Figure 3. These territorial disputes follow standard political science theories about strategic bargaining in zero sum disputes. Instead, as Chas Freeman pointed out, "Under the People's Republic, China has established a seven-decade-long record of strategic caution and a preference for diplomatic and paramilitary rather than military solutions to national security problems. China clearly prefers to use measures short of war to protect itself but has shown that it is fully prepared to go to war to defend its borders and strategic interests. Chinese uses of force have been notably purposive, determined, disciplined, and focused on limited objectives, with no moving of the goalposts." Or as Fravel (2008) noted in *Strong Borders Secure Nation*, Chinese decisions to use force in its territorial disputes reflect declining claim strengths and inferior claim postures where it occupied little or none of the lands contested. This is consistent with predictions that the bargaining theory of war would make, that is as bargaining power declines, Beijing needs to demonstrate its resolve in order to maintain the status quo. According to Fravel, China has generally tried to delay resolution of border disagreements indefinitely as its default position in the absence of rising threats or declining claim strengths. Its leaders have also settled many disputed territories for external support in securing its frontier regions when faced with domestic threats and recalcitrant border minorities. My research shows that China's rapid economic integration with its neighbors since the 1980s has not had an impact on these dynamics between territorial disputes and military force.

1.3 Outline of the Dissertation

In summary, China's puzzling deviation from the predictions of commercial peace theory stem from the fact that it has significant security disputes with its neighbors and the United States while remaining deeply economically integrated with them. This unique set of parameters create ideal conditions to disentangle the tangle of causal mechanisms that link trade and conflict. I will elaborate in Chapter 2 how theories of economic interdependence theory lack common micro-foundations, with some mechanisms making structural claims about how trade transforms the preferences of actors while other mechanisms make bargaining claims about how trade effect the process of costly signaling or the opportunity cost of conflict. These mechanisms are difficult enough to observe even in a small number of cases and the difficulty is compounded as we increase the number of cases and consider variation over time.

In Chapter 3, I introduce the Chinese Foreign Policy dataset, which contains information on Chinese territorial disputes, military conflicts, and economic coercion, along with a number of important covariates towards 31 neighboring countries, including all countries in Asia plus Russia and the United States, from 1949-2016. This dissertation builds on The Militarized Interstate Disputes (MIDs) v.4 data by [10] from the Correlates of War project and Threat and Imposition of Economic Sanctions (TIES) v.4 data by [11] which are the workhorse datasets for their respective subjects. However, both datasets are poorly documented in places and incomplete with regards to Chinese foreign policy. As Johnson (2012) found, nearly half of MID data involving China suffer from some sort of factual error, some of them major

[10] Glenn Palmer et al., "The MID4 Dataset, 2002-2010: Procedures, Coding Rules and Description," *Conflict Management and Peace Science* 32, no. 2 (2015): 1–21, doi:10.1177/0738894214559680.
[11] T Clifton Morgan, Navin Bapat, and Yoshiharu Kobayashi, "Threat and Imposition of Sanctions (TIES) Data 4.0 Users? Manual Case Level Data," *Chapel Hill: University of North Carolina*, 2013.

(miscoding the other side of the dispute dyad or questionable coding of the revisionist actor). MIDs prior to 1990 do not provide reliable sourcing for the events in question, and no narratives or specific sources exist for the entries in the TIES dataset. Additionally, the existing MIDs data end in 2010, while the TIES data end in 2005. Given that China's 'new assertiveness' in foreign policy begins in 2010, this is a real problem for analyzing the theory outlined above. To address these problems, I constructed the *Chinese Foreign Relations (CFR)* dataset to enable more systematic case study and statistical analysis of Chinese uses of economic and military coercion. I perform quantitative analysis on this data to determine the average treatment effect of economic interdependence on China's use of military force, conditioned on territorial status.

In Chapter 4 and 5, I evaluate the role played by each of the competing commercial peace mechanisms in a set of critical cases using a causal process observation design. Chapter 4 examines trade's transformative capacity to resolve the underlying causes of conflict and move the conception of national interests from zero-sum competition to positive sum cooperation. Chapter 5 explores how economic interdependence constrains states from using military versus economic instruments in a setting of zero-sum competition and uses the bargaining theory of war as a baseline model. In Chapter 6, I try to move away from the rigid notion that there is only one relationship between interdependence and security and toward a framework where several effects can occur at different time intervals and intensity levels. I consider all three major mechanisms in a synthetic approach and hope to uncover scope conditions for when each of these might drive national strategy and help explain foreign policy outcomes over time for the same pair of countries and over the same dispute.

Chapter 2 Competing Mechanisms: Constrain, Inform, and Transform

The relationship between trade and war has been both a cornerstone of statecraft and a subject of debate for centuries. In recent decades, a sprawling literature on trade and conflict emerged, representing nearly 10% of articles published in international relations. Regrettably, research has not been able to establish an overarching relationship between globalization and conflict. While most experts agree that trade reduces conflict, available evidence is contingent, contradictory and theoretically fragmented (Gartzke & Zhang, 2015). The most fruitful path to improving understanding of the security implications of interdependence lies in moving away from the obsession with identifying a single monolithic causal relationship and instead focusing on reconciling, consolidating and extending the three main theoretical mechanisms delineated in the literature: *constrain, inform, transform*.

I distinguish between the effects of economic interdependence on strategy (ends) and its effect on tactics (means). The *transform* mechanism is driven by the idea that the expansion of commerce rearranges the strategic goals of trading states, leading them deprioritize conflictual ends such as conquest. By contrast, the *constrain* and *inform* mechanisms do not assume that trade solves the underlying sources of conflict. Instead, economic interdependence is believed to alter the tactical means trading states engage in competition. Trade makes military instruments less attractive either because the opportunity cost of conflict becomes too high (constrain) or because it allows states to signal using non-violent economic instruments instead (inform).

I will use this dissertation to show that economic linkages have multiple, often contrasting, effects on conflict in different settings, at different intensities and across different time intervals. This approach departs from the tendency in previous literature to assume that

cooperation begets more cooperation and that conflict begets more conflict to show that economic interdependence can simultaneously contribute to cooperation and conflict in different domains of foreign policy. In the standard regression framework where the dependent variable is whether or not a militarized dispute is observed in a given year, it is difficult to distinguish the effects of these mechanisms. I adopt a process-oriented approach examine whether and when economic interdependence produces an effect on the People's Republic of China's foreign policy behavior that is consistent with each of the three main causal mechanisms.

2.1 Critique of the Commercial Peace Literature

The contemporary commercial peace literature grew out of the broader liberal peace research agenda of the 1980s-1990s. Liberal theories have dominated discourse on economic interdependence. Advocacy of a commercial peace appears prominently in the writings of Montesquieu, Rousseau, Kant, Adam Smith, and other Enlightenment figures. Classical liberal political economy espoused policies that would restrict the war making power of the aristocratic elite and increase the autonomy of the commercial classes. The key mechanisms driving liberal trade theories to peace involve opportunity costs, domestic interest groups, and constitutional republicanism. Commerce is seen as creating bonds of mutual benefit between countries that are costly to sever. War threatens to disrupt these beneficial ties and so with increased trade, the liberal logic predicts that the incentives to fight will recede. In modern economic terms, trade raises the opportunity cost of war. A notable articulation of this logic can be found in Norman Angell's 1910 book *The Great Illusion*, in which Angell criticized the jingoistic nationalism of turn-of-the-century Europe and argued that war, even when victorious, was

socially and economically futile because wealth in the modern era is tied to credit and commercial contracts, not to war.

But liberalism is not without its theoretical rivals. Realists and Marxists make starkly contrasting predictions about the effect of trade on war and peace. Whereas liberals believe that trade creates virtuous interdependencies that tend to dampen down conflict tendencies, realists view trade more harshly, believing that it creates vulnerabilities and imbalances of power, each of which make war more likely. Realists view the effects of interdependence as at odds with the competitive logic of politics under anarchy (Carr 1964; Krasner 1976; Waltz 1979; Grieco 1988; Mastanduno 1998). Kenneth Waltz (1970) maintains that "close interdependence means closeness of contact and raises the prospect of at least occasional conflict" (1970, page 250). Elsewhere, Waltz argues that the rise of globalization has widened inequalities between rich and poor states, producing dependencies rather than interdependencies. "A world in which a few states can take care of themselves quite well and most states cannot hope to do so is scarcely an interdependent one" (1979, page 159). To realists like Waltz, trade has the effect of exacerbating imbalances by changing relative capabilities, usually in favor of those states that already wield disproportionate influence in world affairs. Marxists are in agreement with realists on the more general point that trade tends to increase conflict at the systemic level, mostly between the core and the periphery. They see the modern industrial state as captured by expansionist capitalist interests. As capitalists continue to reinvest their wealth into greater production, they soon exhaust demand for goods in their domestic markets and must look for foreign markets to absorb the surplus goods and capital that they can't use at home. Lenin (1916) built on Hobson (1905)'s idea of excess production to argue that capitalism is the primary source of international wars as more powerful nations exploit weaker ones for economic gains.

Marxists point to World War I as an example of a capitalist war, where business interests prospered from the war while millions of ordinary people lost their lives in the trenches.

With the publication of Keohane and Nye (1977)'s *Power and Interdependence*, the commercial peace literature became one of the major fronts in the so-called paradigm debate in international relations between neoliberals and neorealists. At the same time, new econometric techniques gained popularity in political science and scholars collected data on trade and militarized disputes and debated about how best to interpret the correlations observed in large-N cross-national regressions. The details of this debate has been rehashed in a number of edited volumes and literature reviews and do not need to be recreated here (Gartzke and Zhang 2015; Mansfield and Pollins 2009; Mansfield and Pollins 2003; Schneider, Barbieri, and Gleditsch 2003). A table summarizing the empirical findings of this literature is included in Appendix F. These early empirical studies suffer from important shortcomings related to endogeneity, temporal dependence, and the measurement of key concepts (Beck, Katz, and Tucket 1998, Gleditsch and Ward 2000; Gartzke and Li 2003; Dafoe 2011; Dafoe, Oneal, and Russett 2013). Even though a plurality of scholars have gravitated towards the view that trade reduces conflict, the economic interdependence literature remains empirically contradictory and theoretically fragmented (Gartzke and Zhang 2015). Only in the last decade have researchers begun to establish a common set of micro-foundations flowing from the bargaining theory of war. Our analytical understanding of trade and war has also progressed from the system level, to dyad, and more recently to network based theories. But disagreements among scholars about theoretical first principles will be continue to stymie progress in this research agenda.

I identify three barriers that have impeded the accumulation of knowledge in the commercial peace literature:

Outcomes

The first barrier is the tendency to conflate different measures for conflict in conceptualization and operationalization. The economic interdependence literature has operationalized the outcome variable, conflict, with a wide array of measures ranging from major power war (Copeland 2014, 1996; Mansfield 1995), to conquest (Rosecrance 1986; Liberman 1996, 1998; Brooks 1999, 2007, 2013), to fatal disputes (Bussmann 2010), to dyadic militarized disputes (Oneal, Russett, et al 1997, 1999, 2003, 2010; Barbieri 1996, 2002; Gartzke, Li, and Boehmer 2001; Gartzke and Li 2003, Gartzke 2007), to foreign intervention (Aydin 2008; Peterson 2011; Bove and Gleditsch 2016), to conflictual events (Crescenzi 2003, 2005; Gartzke and Westerwinter 2016). Closely related literatures have also explored the effects of economic linkages on civil wars (Barbieri and Reuveny 2005; Gleditsch 2007; Bussmann and Schneider 2007; Martin, Mayer, and Thoenig 2008), the economic statecraft or coercion (Drezner 2003; Kahler and Kastner 2006; Lektzian and Souva 2003; Hafner-Burton and Montgomery 2008). It is important to recognize that these different outcomes vary greatly in their intensity, degree of state agency, and imply different theories about the conflict process. This matters for theory because economic interdependence could have heterogenous effects on different outcomes depending on if it serves as a substitute for, constraint on, or source of conflict. For example, it may be the case that trade linkages reduce the attractiveness of conquest (a level 5 MID), particularly if it risks war with a great power, but it could have no effect on the likelihood that a state threatens military force (a level 2 MID) as seems to be true of China's recent behavior in the South China Sea. This becomes especially problematic in parts of the literature that imply one measure of conflict in the theoretical discussion (ex. war) but operationalizes the concept using a different measure (ex. MIDs) and conflate the two when

interpreting results. Converging towards a standard model for conflict behavior – such as the bargaining model of war – would go a long way in solving this research design problem and potentially generate different predictions about the effects of interdependence on conflicts at various thresholds of intensity.

Interactions

The lack of careful theorizing about different types of economic flows and whether they are likely to have an effect on conflict through changing state interests or strategy poses a related challenge. Without a commonly accepted set of first principles, different parts of the literature have tended to speak past each other about whether economic interdependence changes what states are likely to bargain over (ie. their *interests* change from preferring conquest to preferring trade) or how they behave in the bargaining process (ie. they adjust their *strategy* according to how trade changes the costs and benefits of conflict). This distinction is subtle, because neither interests or strategy is directly observable, yet also crucial, because it can lead to very different expectations for observable implications to be tested empirically. Scholars working in the paradigmatic part of this literature tend to focus on how globalization transforms the interests of states (Rosecrance 1986, Brooks 2007, Copeland 2014) while rational choice scholars (Gartzke et al) tend to focus instead on how, given a competitive bargaining situation, how do economic linkages change the strategies of states. While both sets of scholars see economic interdependence and increasing the cost of conflict, paradigmatic scholars put more weight on major outliers (ex. Fashoda, Tangiers, & World War I,[12] the Opium Wars, the Second Sino-

[12] Though even this is contested by McDonald, Patrick J., and Kevin Sweeney. "The Achilles' Heel of Liberal IR Theory?: Globalization and Conflict in the Pre-World War I Era." *World Politics* 59.3 (2007): 370-403. And Gartzke, Erik, and Yonatan Lupu. "Trading on preconceptions: Why World War I was not a failure of economic interdependence." *International Security* 36.4 (2012): 115-150.

Japanese War) and dismiss minor skirmishes while for rational choice scholars, wars are off the equilibrium path and thus less informative about the bargaining process that militarized disputes.

Within this context, differentiating different types of economic flows is also important. Much of the of the economic interdependence literature focuses on trade flows and have debated about how best to measure trade dependence (Gartzke and Li 2003; Barbieri and Peters 2003; Oneal 2003). Scholars have also explored alternative measures such as foreign direct investment flows (Polachek et al 2001; Gartzke, Li, and Boehmer 2001; Bussmann 2010), level of economic development (Gartzke 2007; Brooks 2007; Markowitz, Fariss, and McMahon 2018) and shared economic norms (Mousseau 2009; McDonald 2009). It should be noted that all of these measures are highly correlated dyadically and endogenous to the probability of conflict but produce different domestic winners and losers and operate through different causal mechanisms. They may also have different effects depending on the state's structural position in the international system. For example, whether the economic tie is asymmetric might matter for bargaining dynamics (Keohane and Nye 1977; Hirschman 1980; Barbieri 1995; Crescenzi 2005) and whether the target state have allies, preferential trade agreements, or outside partners have also shown to be important (Mansfield, Pevehouse, and Bearce 1999; Mansfield and Pevehouse 2000; Martin, Mayer & Thoenig, 2008; Dorussen & Ward, 2010; Hegre, Oneal, and Russett 2010; Maoz 2011; Kinne 2012, 2014b; Lupu and Traag 2013; Haim 2016; Gartzke and Westerwinter 2016). Economic interdependence scholars can adapt insights from the recent advances in research that explore the relationships between global financial markets, multinational corporations, and integrated-supply chains to evaluate how increased interdependence might alter the cost and benefit of conflict (Jensen 2008; Milner and Tingley 2015; Pandya 2016; Kim 2017). But it is essential for any theory of economic interdependence

to clearly articulate how the measure chosen changes what states are likely to bargain over (interests) and how they bargain (strategy).

Mechanisms

The final barrier for is disagreements about causal mechanisms and the failure to empirically define scope conditions or verify observable implications to establish common micro-foundations. Much of the theory in the economic interdependence literature is motivated by, and framed in terms of, stylized debates between and among traditional paradigms in international relations. Moving beyond paradigmatic approaches, I advocate that future work adopt the bargaining model of war as a first principle and focus on empirical tests of auxiliary hypotheses generated by three broad mechanisms that could potentially link trade with war and/or peace — *constraints, information, and transformation* (Gartzke and Zhang 2015; Kastner 2009). The bargaining theory of war literature establishes asymmetric information and credible commitment problems as the two major causes of costly conflict (Ramsey 2017, Trager 2016; Powell 2002). Interpreted from the lens of bargaining theory, the constraint mechanism would predict that increased economic interdependence will increase the opportunity cost of conflict by mobilizing domestic interests who stand to lose from conflict. This should enlarge the bargaining range and thereby decrease the probability of conflict in equilibrium. By contrast, the information mechanism holds that increased economic interdependence will generate other means or costly signaling, reducing the need to use military force and increasing the use of economic coercion in equilibrium (ie substituting military signals for market signals). Finally, the transformation mechanism does not lend itself to bargaining theory because it starts with the assumption that globalization transforms the interests of states, moving them out of the realm of zero-sum bargaining. But one way to test for the observable implications of this would

be to observe whether states in fact redefine their interests and become more cooperative over issues such as territorial disputes when economic interdependence increases. Much work need to be done to test the constrain and information causal mechanisms as well. A major limitation of the large-n cross national designs that are ubiquitous in this literature is that they do not actually test for the stipulated causal mechanisms and large datasets are also vulnerable to substantial measurement error. A new wave of research is beginning to inquire whether or not conflicts at various intensities negatively impact trade, investment, or consumer sentiment as the constraint mechanism assumes (Li and Sacko 2002; Long 2008; Davis and Meunier 2011; Davis, Fuchs, and Johnson 2014; Fisman et al 2014, Heilmann 2016; Tanaka, Tago, and Gleditsch 2017) and also to test whether the market signaling mechanism functions as theorized (Dafoe and Kelsey 2014).

2.2 Competing Causal Mechanisms

Commercial peace theories provide us with three distinct sets of causal *mechanisms* of how trade can have an effect on the outbreak of conflict: constrain, inform, transform. It is imperative to establish a model of conflict capture the effects of economic interdependence on the *interactions* between states. Simply being explicit about why nations are believed to fight will go a long way to whittling down the number of possible ways that trade is likely to have an impact on decisions of war and peace.

Over the past twenty years, the bargaining theory of war has emerged as the work horse model for conflict in international relations. James Fearon (1995) places Blainey's basic insight that the causes of war reside not in disparities of power but in incompatible beliefs about power in a rationalist and internally consistent framework. The theory models foreign policy between

two states as a competitive negotiation or zero-sum bargain. Reasoning leaders generally are trying to avoid war because it is a costly outcome. Warfare is only one way in which states can pursue their interests. Leaders that negotiate and obtain the settlements that result from fighting before fighting begins are made better off than those that must pay the high costs of war (Wagner 2007). Bargaining theory promises to link war onset, initiation, prosecution, termination, and consequences into a single overarching and parsimonious theoretical framework.

The paradigmatic approaches to commercial peace debate the direction of the relationship between trade and conflict (outcomes) at the expense of providing evidence about the causal mechanisms (process). Moving beyond these, I adopt the bargaining theory of war as the baseline model for understanding the effects of economic interdependence (for those unfamiliar with its mechanics, I include a detailed discussion about the bargaining theory of war in Appendix G). But, as noted earlier, I believe it is critical to distinguish between whether economic interdependence enters into the model at the level of strategy (ends) or at the level of tactics (means) when designing empirical tests and measures.

Strategy and tactics are conflated in the applications of standard bargaining theory because the object of dispute (the issue space) between the two actors is assumed to have a fixed value, depicted on a (0,1) interval. If the object of dispute is territory (or anything else where the value is finite), then bargaining theory offers a compelling model for how the two players can maneuver tactically to achieve this fixed end. In these cases, it is relatively easy to determine how a parameter like economic interdependence might fit into the model. However, bargaining theory is often invoked to model more abstract ends such as the balance of power between two states that are at the level of strategy. In these cases, it is much more difficult to

operationalize economic interdependence because it is endogenous to the issue space; trade increases the total amount of surplus to be bargained over as well as the relative distribution of power between the two actors. But the growing surplus is not reflected in the standard bargaining framework because the issue space is fixed at 0, 1.

I outline the logic behind each causal mechanism below and interpret the constrain and inform mechanisms in the context of the bargaining theory of war. The transform mechanism differ from the other two mechanisms because it predicts that trade changes the strategic goals that states are likely to pursue (thus expanding the issue space). While the constrain and inform mechanisms can be modeled theoretically by introducing a parameter for economic interdependence into bargaining theory, it would not be fair to evaluate the transform mechanism in the context of competitive bargaining. I construct auxiliary hypotheses generated from these three broad mechanisms linking trade and conflict -- constraints, information, and transformation – that can be tested using data from Chinese foreign policy in the following section. The traditional interpretations of these three mechanisms are consistent in predicting that as trade increases, China should be less likely to engage in militarized conflict in these economically interdependence dyads. However, the mechanisms produce very different auxiliary hypotheses that I will test in subsequent chapters.

Constrain

Much of the literature relies on constraint as the key mechanism behind commercial peace. Scholars in this tradition view trade as generating efficiency gains. Constraint mechanisms begin with the assumption that military conflict disrupts valuable commercial ties between economic partners that happen to be sovereign, independent states. Because the

disruptions caused by military conflict are costly for domestic actors (export-oriented firms and consumers), these groups appeal to their government to refrain from escalating crises to open conflict or war.

Constraints, also referred to as "opportunity costs," are the mechanism most frequently used by liberal scholars to account for commercial peace (Levy 2003). As with the Kantian conception of liberal political restraint on warlike monarchs, leaders may still want to go to war, for territory or nationalistic reasons. However, the disruption of commerce associated with war leads domestic constituents to oppose these other objectives (McDonald 2009). As a result, the leader avoids or deescalates fighting, despite his or her initial preferences.

At the heart of the constraint mechanism is the postulate that increased economic interdependence will increase the opportunity cost of conflict and that leaders will factor in these costs as they engage in bargaining. The idea of opportunity costs seem intuitive at their face and seem to directly relate to one of the key parameters of the bargaining model of war: the cost of conflict for both sides. But when we apply opportunity costs to the bargaining theory of war, a counterintuitive set of expectations emerges that might surprise the original authors of this mechanism. While opportunity costs could inhibit conflict, they need to be large enough to alter the calculus of war. Marginal increases in the overall cost of fighting can at most have a marginal effect on whether conflict occurs. At the same time, factors that increase war costs create leverage that opponents, even trade partners, can use to extract additional concessions or increase the odds that an adversary concedes rather than fighting. Having more reasons not to fight makes it easier for other states, even other trade partners, to make more extractive demands, since the nominal risk that the opponent will refuse is lower. Additionally the level of economic interdependence is common knowledge for both actors prior to bargaining, as Morrow (1999)

pointed out, this means that " If higher trade flows reduce both sides' resolve for war, then the effect of trade on the likelihood of conflict is indeterminate. Trade flows are observable ex ante, and a state contemplating conflict considers its effect on both sides' actions before beginning a dispute. The initiator is less willing to fight, reducing the chance that it initiates a dispute. At the same time, the target is also less willing to fight, increasing the chance that it makes concessions to the initiator to avoid war, and thus increasing the chance that the initiator begins a dispute. The net effect of these two changes is indeterminate." Slantchev (2005)'s military threats model makes a similar prediction about the changes to the costs of fighting. The cost of war, however high, is outside of the Slantchev's model because the utility of military threats is high regardless of the cost of war because they would not be paid in equilibrium. That is the model is driven by other factors such as how much each state value the issue being bargained over and what capabilities they can bring to bear to signal their resolve (ie. arming as a way of sinking costs).

Additionally, the assumption that military conflict generates opportunity costs seems plausible at face value but has also not been systematically investigated to determine the threshold at which it becomes true. The basic bargaining model offers a parsimonious set of explanations and parameters to explain the outbreak of war but is open-ended about the logic of the use of military force short of war. War in bargaining theory is the division of the finite issue space at some point p with each side paying some cost of fighting (a and b). The model predicts that bargaining failure results in wars and these should be relatively rare but is ambiguous in its predictions about the use of military force during the bargaining process. Much more common is the strategic use of mobilization of military force, the commonly used militarized disputes behavior records some 2000 MIDs between 1816-2010 and less than 100

wars. Branislav Slantchev (2005; 2011) develops a model that combines elements of previous formal theory research on signaling and bargaining to explain this larger class of phenomenon when states use strategically military force.

A military threat is defined as any physical move that is 1) inherently costly and 2) changes the distribution of power during the crisis. These military threats function as a hybrid of two signaling strategies identified by Fearon (1997), resembling both sunk costs strategies (because it is inherently costly to mobilize troops) and hand tying strategies (because they are a form of "incentive rearrangement" by ex-ante raising the cost of conflict). Military threats can be useful to the actor because "it sometimes allows him to compel the opponent's capitulation in circumstances when he would not have been able to do so at the status quo distribution of power without mobilizing additional resources." (p. 69).

My research shows that commercial interests are not immediately impacted by this sort of low intensity military signaling (such as military exercises and other shows of force, the kinds of military operations we increasingly observe in the East China Sea and South China Sea). Even though Chinese policymakers almost certainly intend these moves to be interpreted as part of diplomatic bargaining and American policymakers certainly view the use of military threats in these incidents with grave concern because they read these signals as intended. Nevertheless, most forms of military mobilization and uses of military force do not trigger economic costs because market actors correctly anticipate that they will not lead to a wider escalation. Thus is the costs of war are not paid by either state or market actors, the logic behind the use of military force that generates most of the MIDs that we observe should be not be constrained by growing economic interdependence.

Increased economic interdependence will increase the opportunity cost of conflict marginally and enlarge the bargaining range. But greater trade between China and an adversary is likely to have an indeterminate effect on the likelihood of militarized disputes and is better explained using variables that measure relative capability and resolve. Whether or not these crises escalate to war is driven by how effectively states can signal their resolve in the face of the asymmetric information problem. It does not matter much for the constraint mechanism if we treat the bargaining space as fixed because as long as economic interdependence does not impact the valuation of the issue or the capabilities that China can bring to bear, it is irrelevant for the predicted probability of escalation. Economic interdependence might effect these variables but only over the long run, not in the time frame of a particular crisis to have an effect on the conflict outcome. The one potential exception to this is that economic interdependence can contribute to a credible commitment problem (as discussed in the theory section), here the logic is that sudden shifts in trade expectations can lead to preventative war. These cases are exceedingly rare because the swing in trade would have to be very large (ex. an economic embargo) and is excluded from the analysis here.

Inform

A second set of mechanisms focuses on the role of information and attempts to explain the relationship between commerce and conflict within a bargaining theory framework (Fearon 1995; Gartzke 1999; Morrow 1999; Powell 2002). As discussed in Appendix G, war can occur as competitors mistake relative resolve or capabilities, and because competition generates incentives for actors to conceal true information about these variables. In these models, military disputes result when leaders misjudge the relative commitment of their opponents. Both sides

benefit from overstating the level of their commitment, hoping that the opponent will back down. Wars result when at least one side underestimates an adversary's commitment, assuming that they are bluffing when in fact they are resolved. To overcome the problem of incomplete information, leaders must demonstrate their commitment through costly acts such as tying hands or sinking costs (Fearon 1997). Sunk costs occur when a state takes an action that is costly up front such as mobilizing forces during a crisis. They are informative because they to the degree that they differentiate resolved or capable actors from those that are less willing to pay the cost of fighting. Tying hands occur when an actor imposes on themselves a cost that they only incur in the event that they fail to act in a manner consistent with their ex ante claims. Costly signals avoid the cheap talk problem, backing up words with action.

Threatening to cut off trade or investment is one way that leaders can communicate resolve during crises. Without economic interdependence, threats have relatively little cost until one side escalates to military violence. Economic interdependence creates a middle step in the escalation ladder between war and peace. Making threats or taking actions that harm commerce is costly to both parties in an interdependent relationship. Therefore, as the degree of economic interdependence increases, the costs involved in threatening war rise as well (as merchants and investors abandon markets when and where war becomes more likely), ensuring that leaders more credibly communicate resolve. Economies that are well integrated into the global markets face the risk of capital flight when conflict is on the horizon. Markets are thus a credible mechanism for revealing information, because they offer leaders a way to signal resolve that is costly but also short of military violence.

Theories about the informational effects of trade on conflict were developed with the bargaining theory of war in mind (Gartzke, Li et al. 2001; Gartzke 2007). However, the

foundations of this mechanism remain under-theorized and in need of additional empirical support. The core logic of the inform mechanism is essentially the substitution of economic sanctions for military force in costly signaling. Given the long and inconclusive debate about the efficacy of economic sanctions, we should not be surprised that we cannot reach a blanket judgement on the effects of economic sanctions in bargaining. Instead domestic political factors such as domestic political economy of the target state, problems of coordination among senders, and credible commitment problems that emerge in quid pro quo negotiations have been shown to affect the success of engagement strategies (Haggard and Noland 2017).

This volume seeks to make a contribution by testing the main observable implication of this mechanism: the substitution of economic signaling for military signaling. Whether or not this substitution occurs depends on the balance of domestic political costs leaders incur when they use these two sets of instruments. Commercial peace theories hold that increased trade gives private actors such as firms a political stake in foreign policy; that these firms are not just passive ciphers for political events but active political agents capable of influencing policy. Compared to the political costs of economic coercion, military force can often be the less costly options for states to resolve their foreign policy disputes. The threat or show of military force is useful for interstate bargaining (Slantchev 2011), but these actions do not impinge on business or capital markets. The majority of MIDs involve these types of low-intensity displays or uses of military force, such as sending a naval vessel into disputed waters or test firing a ballistic missile, that do not produce causalities. These types of military mobilization have a dual role in crisis bargaining: they simultaneously sink costs (because they must be paid for regardless of the outcome), and tie hands (because they increase the probability of winning

should war occur). Thus, they are not cheap talk but useful foreign policy tools for states that carry the additional benefit of not disrupting trade and finance linkages.

Recent work by Dafoe and Kelsey (2014) tested the information causal mechanism by qualitatively examining six crucial cases in which the mechanism is most likely to be operative and observable. These cases were military disputes between the UK and Argentina in 1982, USA and Panama in 1989, Singapore and Malaysia in 1992, Bahrain and Qatar in 1986 and political tension between Honduras and Nicaragua (1966-1976) and between Kuwait and the UAE (1972-1977). They analyzed media reports, government documents, and other sources, to evaluate the extent to which relevant individuals drew the appropriate inferences about market-mediated costs and resolve. But they ultimately find that the causal mechanism does not hold in the majority of these cases and that there is little evidence that states choose to bear economic costs as a form of costly signaling but instead that economic costs arose as a byproduct of escalation towards war (that is the arrow of causation is reversed). They conclude that "market-mediated signaling may operate in major conflicts, [but] it is unlikely to account for much of the association between capital openness and peace." Thus, while the information mechanism is the most compatible with bargaining theory and straightforward in terms of its observable implications, it may not be the primary driver for the variation we observe in China's use of military force.

Transform

The transform mechanism is the most removed from bargaining theory of war and closest to the classical liberal views about the effects of trade on conflict. Transformation does not lend itself to empirical testing within a bargaining theory framework because it starts with

the assumption that globalization transforms the interests of states, moving them out of the realm of zero-sum competition to positive sum cooperation. There are two distinct ways to model how economic engagement can mitigate security dilemmas with adversaries: "as a chip in a bargaining game" or "broader transformative effects" (Haggard and Noland 2017). The bargaining model consists of what Keohane (1984) calls specific reciprocity and works by changing the *strategic* costs-benefit analysis of the target state. Specific reciprocity follows the same logic as economic sanctions discussed in the previous section and can be studied as part of the inform mechanism.

The second model of "broader transformative effects" is more similar to what I call the transformation of *interests* and operates by strengthening political coalitions with more moderate foreign policy preferences or socializing the target's political leadership to new opportunities and norms (Solingen 2007; Qin 2010). Whereas the first two mechanisms treat the interests of leaders as exogenous and fixed, the transformation predicts that heightened economic exchange will not just change the payoffs, but also the preferences of decision makers. In other words, economic integration harmonizes the goals and interests of interdependent states. The most salient example of this is the integration of Europe after the Second World War. In advancing the Marshall Plan, American policy makers argued for rebuilding Germany's economy alongside the rest of Western Europe, in order to tie German interests to peace and prosperity in the West. Together, the Marshall Plan and the rise of European economic and political institutions transformed European geopolitics. Economic integration ensured development and growth, enabled economic cooperation, reduced strategic mistrust, and created bonds of common interest between historical rivals. International commerce catalyzed fundamental changes to the culture, civil society, and political institutions of these states. As

the exchange of capital, goods, people, and ideas across borders increases, the preferences of leaders are said to change such that conquest is no longer considered a legitimate tool of foreign policy. Indeed, despite recent turmoil in the Eurozone, European leaders, and their populations, would find another continental war like those of the 20th century inconceivable.

Haggard and Noland (2017) write that economic interdependence create "stakeholders in the target state who now risk losses from bellicose behavior and thus act as a political constraint on the government. Interdependence can then gradually shift the overall political balance – the ruling political coalition – in favor of reform. Unless this scenario be thought far-fetched, consider China, where a nominally Communist party not only opened its economy but subsequently moderated its foreign policy and even welcomed capitalists into its ranks…international ties can also have socializing and learning effects…high-ranking politicians reassess their grand strategies in light of new information delivered via increasing political and economic integration." The authors go on to note that this model of economic engagement was central to Kim Dae-jung's Sunshine Policy towards North Korea and also a staple of current Chinese approach to Pyongyang. I would add that a similar rhetoric can be found in American and Japanese engagement of the PRC and in subsequent PRC policy towards Taiwan. This model of transformation is at the core of Richard Rosecrance's notion of the trading state. Rosecrance (1986) argues that changes in the world economy have led modern states to become less reliant on territory than on commerce. Trade has become more efficient than military conquest as a way to acquire goods and services for the state, just as buying things at the store is often more efficient than stealing them, even for thieves and bank robbers.

This section focuses on the transformation mechanism, which I will try to distinguish from the constraint mechanism (opportunity cost of conflict) and inform mechanism

(substitution of economic sanctions) as discussed in the previous sections. The simple correlation between economic interdependence and MIDs would not be a fair test of the transform mechanism because it is measuring the wrong outcome variable. It is possible that the transformative effect of economic engagement operates in other realms of foreign policy (ex. coordination on macroeconomic policy) or at a different level of intensity (ex. prevents wars but not) that is not captured by MIDs as the outcome variable. One way to test for the observable implications of this mechanism would be to observe whether states in fact redefine their interests and become more cooperative over various issues when economic interdependence increases.

The challenge lies in operationalizing the spectrum of *interests* where the transformation mechanism can be expected to operate. As is common in the economic interdependence literature, the Haggard and Noland passage quoted earlier conflates political and economic outcomes (domestic economic liberalization and moderate foreign policy) that appear correlated in the case of China but may be driven by very different domestic political processes. Historically, it has certainly been true that economic liberals at home can prefer expansionist foreign policies abroad as was the case with British imperialism under William Gladstone. Additionally, some interests should be easier to transform than others and it is important to think about how to array these along a spectrum before we can measure the transformative effects of economic interdependence. I propose the following ordinal scale for national interests ranging from subordination to dialogue along which economic interdependence can be expected to operate (see Figure 4).

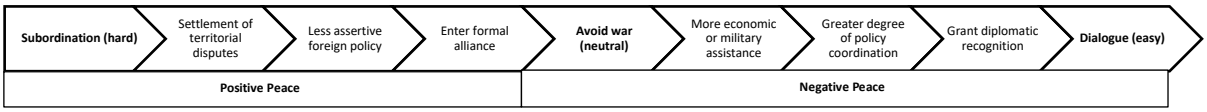

Figure 4 Ways that Economic Interdependence can Transform National Interests

The scale is arrayed based on the degree of sovereignty that would have to be given up in order to achieve the outcome where subordination to another country would require the greatest amount of sacrifice while dialogue would require the least. Based on the bargaining theory of war, nations generally prefer a negotiated settlement short of war to actually paying the cost of fighting. Thus, the avoidance of war is the status quo ante between nations and should not be viewed as the success of the success of the transformation mechanism. This is a major theoretical departure from previous work on the commercial peace so I will elaborate further on this point. What I am arguing that two nations can avoid war without economic interdependence transforming their interests in any way just by virtue of the costliness of war itself. The absence of war is therefore overdetermined. This is why my scale is centered on avoiding war as the neutral outcome, with everything to the left requires the sacrifice of some degree of sovereignty and everything on the right requiring little or no sacrifice of sovereignty[13]. Another distinction is that everything to the left of the spectrum can be considered positive peace (elimination of the causes of conflict) while everything to the right of the right of the spectrum can be characterized as negative peace (the absence of war).

[13] The scale is a gross simplification of reality and the relative positions between the various ordinal categories can be debated (ex. whether policy coordination "easier" than economic or military assistance and which requires a greater sacrifice of sovereignty probably depend on the specifics of policy involve). The general point here is that national interests can be arrayed along some scale and that the transformation mechanism is stronger at one end of this scale than the other.

This distinction between positive and negative peace is the subject of much debate in the commercial peace literature. Stein Tønnesson and the East Asia Peace Project group at PRIO claim that since 1979 there has been an East Asian peace, marked by a decline of battle deaths in domestic and interstate conflicts in the region compared to earlier decades in the Cold War. The peace they describe is a negative peace and they explain this peace using existing paradigmatic frameworks, particularly constructivist explanations that emphasize changing perceptions and identity (Tonnesson 2008, 2009, 2016). David Kang (2009) offers a cultural explanation for the East Asian peace, claiming that East Asians see a strong China as stabilizing the region. Rationalist IR scholars like Avery Goldstein (2007) and Etel Solingen (2007) trace the link between economic interdependence and peace, arguing that a growing number of Asian (read Chinese) national leaders have come to prioritize economic growth and good relations with the USA over more diverse or provocative aims. This is more in line with the liberal conception that trade leads to a positive peace in Asia.

The transformation interpretation of trade and conflict gives most cause for optimism and appears to offer the potential for the most dramatic change. I make a clear distinction that the transform mechanism focuses on changing interests (strategy) and not just payoffs in the context of bargaining. The capacity to change of hearts and minds admittedly sets a higher bar for economic interdependence; the achievement of negative peace is more common than positive peace. But if one believed that this is the case, then the transformation mechanism would be observationally equivalent to the constraint mechanism. Thus, the hypotheses I derive from the transformation mechanism focus on changes in China's preferences over territorial disputes to try to get at how growing trade might change their interests in territorial disputes.

2.3 Testing the Commercial Peace in China

The standard large-N cross-national regression research design, with military force as the dependent variable and economic interdependence as the independent variable, is insufficient for distinguishing the effects of the three causal mechanisms outlined above from each other. The standard empirical paper in the commercial peace literature faces a predictable set of research design challenges. Scholars typically use the initiation of a Militarized Interstate Dispute (MID)[14] as a measure of a challenge to the status quo and MID reciprocation represents crisis escalation. Though even this is not true and MID intensity (whether it resulted in fatalities) is used as the sole outcome variable for conflict for scholars who do not use the bargaining theory of war as their baseline model for conflict. It is often extremely difficult to interpret the results of this literature for the following reasons:

1. Because peace is overdetermined, we face the problem of false positives when we fail to observe MIDs between pairs of countries that are not engaged in crisis bargaining but are economically interdependent. And because MIDs are rare events, the bias is the most severe.
2. We also face the problem of false negatives because ultimatums or fait accompli by challengers may not be captured by the MID measure and thus we don't observe those states that backdown in a crisis due to economic interdependence.
3. The datasets are typically set up with dyad-year observations so we have only a very crude understanding of the crisis bargaining process involved. Additionally, we do not have data on what the states are bargaining over, or whether the MIDs observed are truly

[14] The MID data set records all incidents in which states engage in militarized activity towards one another, whether it is threats to use force, shows of force, or actual fighting (Ghosn, Palmer, and Bremer 2004)

linked to competitive negotiation, and some scholars have pointed out - MIDs that are actually incidents should not be seen as.

4. The regression outputs of these reduced-form designs only show that economic interdependence is correlated with the absence of MIDs in a way that is consistent with commercial peace theory. They do not actually test for stipulated causal mechanisms stipulated in the various versions of the theory.

In Figure 5, I diagram the three causal mechanisms to show the limitations of large-n cross-national designs that focused on measuring average treatment effect of interdependence.

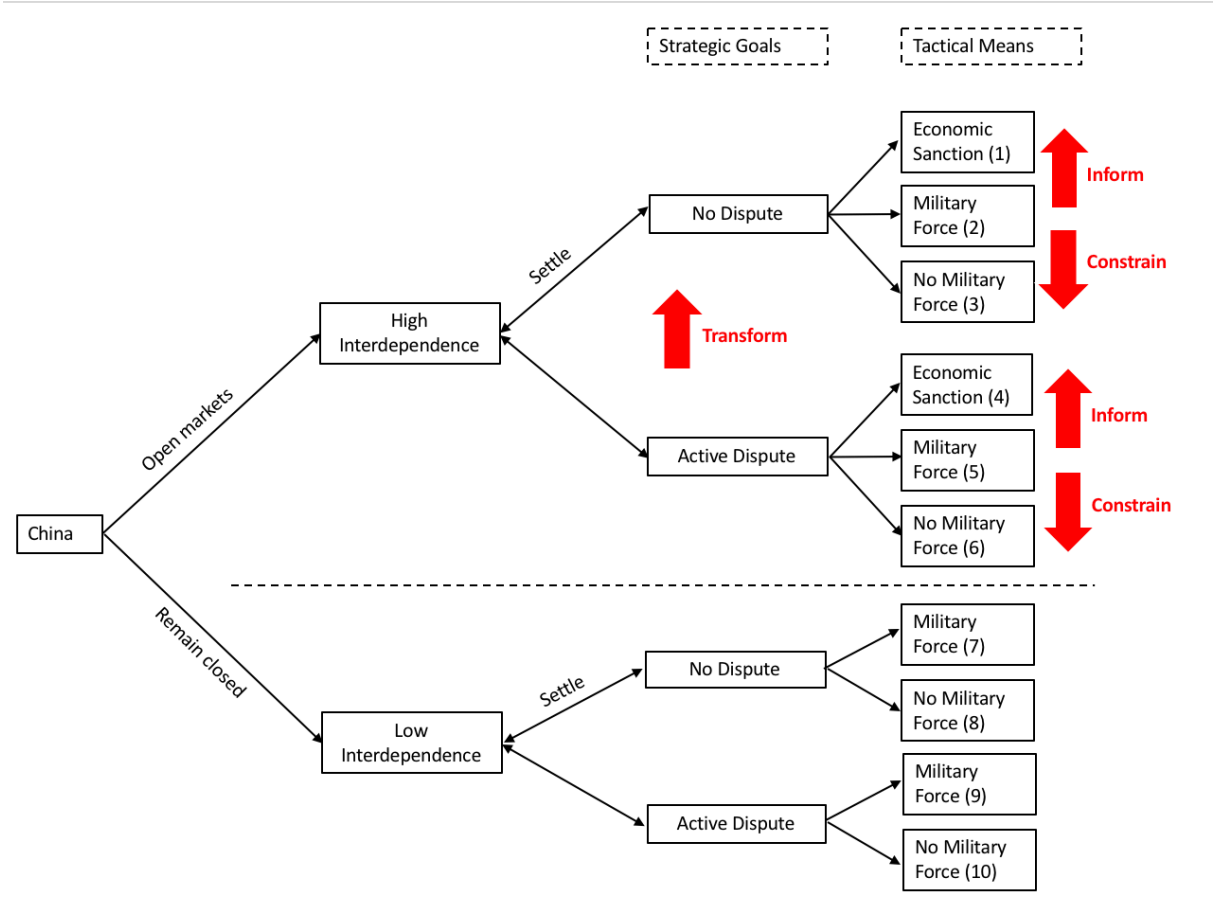

Figure 5 Break Down of Commercial Peace Causal Mechanisms

To summarize my theoretical expectations about the three mechanisms:

- The constrain mechanism predicts that increased economic interdependence will increase the opportunity cost of conflict, enlarging the bargaining range, but have an indeterminate effect on the probability of conflict in equilibrium.
- The inform mechanism predicts that increased economic interdependence will create other means or costly signaling, reducing the need to use military force and increasing the use of economic coercion in equilibrium (substitution).
- The transform mechanism predicts that increased economic interdependence changes how states prioritize disputes such as territorial claims, making them less valuable relative to the gains from economic cooperation. This mechanism operates at the level of strategy and involve the potential for economic ties to transform the preferences or goals of political actors.

In a standard large-n cross-national design, what is being compared is typically the total number of MIDs in dyad years with higher economic interdependence against dyad years with low interdependence. This is illustrated with a dotted line in Figure 6. The results are essentially a ratio measure of all the MID/total dyad years in outcomes 1-6 compared to outcomes 7-10. This comparative static does not tell us anything about which mechanism is driving the results, just a direction of the correlation. It also conflates mechanisms that work at the strategic level (transform) with those that operate at the tactical level (constrain and inform). More problematically, it is agnostic about the underlying causes or processes of conflict, and thus vulnerable to reverse causality (as is reflected in the long running debate between "trade follows the flag" vs "the flag follows trade" in the empirical literature). I believe China's deviation from the predictions of commercial represents a unique opportunity to study the effects of

economic interdependence and overcome each of these barriers. While previous studies of economic interdependence using small-n designs suffered from significant selection problems (Copeland 2014). The reduced-form results from large-n designs do not actually test for stipulated causal mechanisms stipulated in the various commercial peace theories and the use of large data sets that are vulnerable to substantial measurement error (Barbieri and Keshk 2009; Gibler, Miller, and Little 2016). It is also easier to conceptualize an abstract bargaining space containing all issue that matter to a pair of states and much more difficult to operationalize this space empirically and compare issues across countries.

The most important advantage of focusing on China is that we can ex ante identify whether it is engaged in competitive bargaining due to its numerous active territorial disputes. Comparing the object of bargaining across countries over time can feel like comparing apples and oranges, states differ greatly what they bargain over, the value at stake, and how these values compare to the value of trade. But because the lion's share of China's militarized behavior (nearly 90%) are over a delimited set of territorial disputes, I am able to keep one quantity constant. That is to say because the extent of China's territorial claims and the value of the territory do not change significantly over time.[15] This allows me to isolate the effect of economic interdependence and compare how China's bargaining behavior changes as its foreign trade rises. Helpfully, China has engaged in a range of militarized disputes of varying intensity (giving variation on the DV) and its trade dependence varies significantly across countries and also over time (giving variation on the IV). Also it has settled territorial disputes

[15] With some exceptions when it comes to how the UN Convention on the Law of the Sea (UNCLOS) applies to the South China Sea and the discovery of valuable nature resources in cases like the gas fields around the Senkaku-Diaoyu Islands.

with the majority of its neighbors, in many cases dividing the territory, meaning that its territorial claims are not categorically indivisible and can be modeled with the bargaining theory of war. Thus, the bargaining theory of war and military threats model provide a framework to assessing whether and how changes in economic interdependence might impact its propensity to use military force in a foreign policy dispute and what the observable implications of this process might be. This approach also offers a distinct advantage over traditional small-N studies in Chinese foreign policy which select on the dependent variable, that is focus on a noteworthy foreign policy event, and then try to craft explanations for this phenomenon after the fact. At minimum, the design adopted here will explain why China's use of military force does not seem to follow commercial peace theory but I hope that it also creates a chance to refine commercial peace theory by disentangling long standing causal mechanisms whose assumptions have not been systematically tested. Examining the effect of economic interdependence on China's militarized dispute behavior since 1949 allows me to sidestep the usual tradeoffs between small-, medium-, and large-n designs. I have enough observations to conduct a standard large-n cross-national regression and to perform causal process observation medium-n and small-n designs.

2.4 Hypotheses and Research Design

Therefore, I believe that a mixed methods design focusing on China's foreign policy behavior can address some of these challenges that are prohibitively difficult to do in large-n cross-national studies. In this volume, I seek to explain China's threats and use of military force as my outcome of interest and examine how its growing trade interdependence changes how its leaders define the national interest and how it changes their strategic behavior in bargaining over territorial disputes. This chapter has outlined *how* economic interdependence, through

these three mechanisms, can impact both crisis behavior and outcomes that are consistent with the bargaining theory of war and military threats model. I will now generate hypotheses from the three causal mechanisms of commercial peace theory: 1) *constrain, 2) inform, and 3) transform* and derive observable implications that I then use an original dataset of Chinese foreign policy to test using a large-n design, a medium-n design, and small-n case studies. I will test the three sets of hypotheses outlined above in three empirical chapters using a mixed methods design using the same Chinese Foreign Relations (CFR) dataset. The dataset contains information on China's military dispute behavior, use of economic sanctions, territorial disputes, and economic interdependence.

Chapter 3: Large-n Analysis

The purpose of Chapter 3 is to introduce the Chinese Foreign Relations (CFR) dataset and to establish the direction of the relationship between economic interdependence and China's use of military force. This first cut analysis will help establish the basis of comparison against previous research on the commercial peace and provide a plausibility test for which of the mechanisms might be driving the relationship. Regardless of the mechanism, the naive expectation of commercial peace theory is summarized in hypothesis 1a.

Hypothesis 1a: As trade interdependence increases, China will be less likely to initiate a militarized dispute (MID).

However, as I show in the theoretical discussion of the mechanisms that the null hypothesis (1b) is equally likely. The constrain mechanism, in particular, does not predict a decrease in the likelihood of MIDs.

Hypothesis 1b: As trade interdependence increases, China will NOT be less likely to initiate a militarized dispute (MID).

I analyze the effect of economic interdependence and territorial disputes on the initiation of militarized disputes (MIDS) by using the variable constructions and baseline models developed and Oneal and Russett (1999) and Gartzke (2007) to allow for maximum comparability with the existing literature. I estimated coefficients using logit in Stata with robust standard errors. The data are from an original dataset on *Chinese Foreign Relations* (CFR) with information on Chinese territorial disputes, military conflicts, and economic coercion, along with a number of important covariates such towards 31 neighboring countries, including all countries in Asia plus Russia and the United States, from 1949-2016. The purpose of this chapter is to establish in the reduced form estimate for the effect of trade interdependence on China's MIDs in a way that is comparable to the empirical commercial peace literature. These results do not really provide much evidence about which causal mechanism is most persuasive.

But I am able to make a theoretical distinction between a conception of foreign policy where the bargaining space is assumed to be fixed (ie. a discrete piece of territory) and thus is zero-sum, and one where the bargaining space that expands with interdependence (ie. the surplus or future potential of the bilateral relationship). I focus on China's use of military force over territorial disputes, which again accounts for nearly 90% of all cases. In these cases, the

zero-sum assumption is quite reasonable and the primary or salient issue between China and the target country usually is about the sovereign status of that particular piece of territory. The notable exceptions are the militarized disputes between China and the United States, which are much harder to explain in this framework. But in the case studies I relax some of the zero-sum assumption and consider ways that economic interdependence might impact bargaining behavior if the bargaining space was not fixed. I focus on cases where the zero-sum assumption is more defensible (ex. not homeland disputes such as Taiwan).

With this mixed-method research design, I am able to relax the assumption that foreign policy between states is best captured by zero-sum, competitive bargaining in subsequent chapters. I leave room for economic interdependence to operate at the strategic level in resolving the sources of dispute before examining the tactical choices about use of force. After all it was none other than Otto Von Bismarck who said "politics is the art of the possible", implying that international affairs might be better modeled as non-zero sum creative bargaining. This matters because some of the mechanisms that I test, particularly the transform mechanism was not originally formulated with the bargaining theory in mind and authors who work in this tradition envisioned economic interdependence as a force that can potentially shifts states from competition to cooperation. Trading states might view something that is zero-sum, such as a territorial dispute, as part of a larger bargain or deal that they are willing to cooperate with the adversary to achieve. But combining even two different sets of issues into one bargaining space, let's say a territorial dispute and a commercial dispute, would be difficult to measure empirically. Even if we could read the minds of leaders we would at best be able to rank the two ordinally but would be hard pressed to describe them using the same scale of 'utility' when

concessions are made in one of these issues for concessions in the other. To illustrate this issue with a concrete example in Chinese foreign policy, we can consider China's bargaining with the United States over Taiwan. China's long-standing territorial claim over Taiwan is part of the bargaining range between the United States and China. The sovereign status of Taiwan is a zero-sum issue (and arguably an indivisible issue for China) but is potentially part of a grand-bargain between China and the United States (Glaser). How might we assess the relative weight the US places on its commitment to Taiwan and other issues that it cares about (ex. South China Sea access, North Korean proliferation, trade and investment rules, 'global leadership' etc), and how would we model this as economic interdependence between China and the US grows? Besides inferring through observed actions (ie the US makes a concession on South China Sea but not on Taiwan), we have no way of knowing their relative importance to the national interest or to the US president's understanding of that national interest. This is problematic because the observed action is more likely than not the result of a bargaining process. More importantly it would be very difficult to figure out which issue the US was trying to gain leverage on if it was to use military force against China even if it was in the vicinity of Taiwan, it might still be with a larger bargain in mind (ex. the 1955 Taiwan Strait Crisis in the context of the Cold War).

Chapter 4: Transform Mechanism

My aim in chapters 4 and 5 is isolate the effect of economic interdependence and observe how it impacts the choice to use military force as part of crisis bargaining and to evaluate which mechanism best explains this process of instrument selection. As I note earlier, the mixed methods approach I use is the most appropriate design for examining causal mechanisms that large-n cross-national designs struggle with. Trade's most transformative

power might be its ability to move the way leaders think about foreign policy from zero-sum competition to positive sum cooperation. In fact, most policy pronouncements about US-China relations have this transformational tone to them. Chinese leaders regularly invoke the idea that global governance is not a zero-sum game and that trade is a way for countries to develop common interests. By the sheer volume of all manners of exchange between China and the United States ranging from people-to-people, cultural, educational, technological, scientific were all made possible by growing trade and investment flows between the two countries since they restored diplomatic ties in the 1970s. While it would be foolish to dismiss the potential power of the transformation mechanism on the probability of conflict altogether, it is difficult to measure and assess the value of these growing ties. Trade can be thought of as increasing the number of options for leaders to engage in what is known in negotiation as creative bargaining or cooperative bargaining. Although most individual issues being negotiated are zero-sum (ex. the level of a particular tariff), and there is a good deal of horsetrading between the many zero-sum issues, the sum total of all possible issues are not because they are contingent on continued cooperation to produce unforeseen future outcomes (ex. new industries that emerge from global supply chains). This differs from side payments, which could be modeled in the bargaining theory because here trade expands the bargaining space itself and expands the possible realm where agreements can be reached.

But it is important to distinguish deepening cooperation on these other dimensions of the relationship from the resolution of disputes that are directly related to the generation of MIDs. I am interested in measuring the impact on national interests that are created by economic interdependence, and so I cannot make the level or success of exchanges the outcome variable (that would be using one form of exchange to measure another). Instead, I examine the capacity

for economic interdependence to create *positive peace* through the transformation mechanism. I focus on the ability of economic interdependence to achieve transformation on two outcomes: 1) changes in alliance status involving China and its trade partners and 2) the settlement of territorial disputes. The focus on these two variables – alliances and territorial disputes – because they have been shown in the IR literature to be key drivers of militarized interstate disputes (MIDs). The changes in the status of alliances and territorial disputes is also relatively easy to observe and measure, in contrast to more abstract measures of national interests such as strategic posture.

Hypothesis 2a: As trade interdependence increases, China will be more likely to enter into an alliance with the partner country (transform mechanism).
Hypothesis 2b: As trade interdependence increases, China will be more likely to settle territorial disputes with the partner country (transform mechanism).

I will show that China's use of military force is best explained by the status of disputed borders and that the timing of border settlement has nothing to do with economic interdependence. China's use of military force tends to concentrate on a small number of unresolved territorial disputes (the majority of which are maritime disputes as the land borders are gradually settled). This chapter will also include detailed discussion of the diplomatic history of these territorial disputes and how China's claims have evolved over time. These summaries will be grouped into the following sections: Taiwan, South China Sea (Paracels and Spratlys), Indian border, Russian border, Vietnam border, and the East China Sea & Yellow Sea EEZ (Senkaku/Diaoyu & Socotra Rocks). These tests are intended to be a form of causal

process observation because these measures are the observable implications of the transform causal mechanisms I have outlined above.

Chapter 5: Constrain and Inform Mechanisms

While Chapter 4 focuses on the capacity of economic interdependence to transform the national interests at a strategic level, Chapter 5 focuses on its effects at the tactical level. For the first cut of the analysis, I examine whether MIDs are less likely to occur when China is more trade dependent with the target country and whether MIDs are more likely to occur when China has an unresolved territorial dispute with the target country in that particular year. I will also conduct qualitative research into the operational details of these MIDs and the movement of financial markets to assess whether or not the MID was disruptive to business or was followed up by economic sanctions.

If we hold the bargaining space constant over time (operationalized as the division of a piece of disputed territory) and set the dependent variable of interest as the threat or use of military force (MIDs), the constrain and inform causal mechanisms generate the following set of hypotheses with contradictory predictions. The constrain mechanism predicts that economic interdependence should have no effect on the likelihood of military force but the logic of opportunity costs should reduce the likelihood of economic sanctions. The inform mechanism predicts the opposite, that economically interdependent states will be more likely to signal using economic instruments rather than military force.

Hypothesis 3.1a: China is more likely to escalate a dispute using economic sanctions than military force as its trade dependence increases (inform mechanism).

Hypothesis 3.2b: China is more likely to escalate a dispute using military force than economic sanctions as its trade dependence increases (constrain mechanism).

Whether not these hypotheses are correct depend not only on the statistical correlation between interdependence and the outcome variables (military force and economic sanctions) but also on whether or not the structure of opportunity costs are consistent with the predictions of the mechanisms. The constrain mechanism predicts that military force below the threshold of war carries less opportunity cost than economic sanctions while the inform mechanism assumes the opposite. The second half of this chapter will examine the structure of opportunity costs associated with China's military force and economic sanctions.

I compare both the timing and target of China's use of economic sanctions and whether its use of military force generated any economic costs (by looking at fluctuations of stock market indices such as the Shanghai Composite Index [16]) for MIDs where economic interdependence is high. I select on the dependent variable (MIDs) to show whether or not the causal mechanisms specified in bargaining theory interpretations of the commercial peace (constrain and inform) produce observable implications that are consistent with the pattern of conflict that we observe. These results will test the information mechanism's core insight on market-mediate signaling as a substitute for military force.

[16] This is a crude measure of market responses but the best measure I have given the relative infrequency of annual trade data (which I can try to look into more disaggregated customs data if there's enough time) and the fact that China's currency is fixed to the dollar for a large portion of when its economic interdependence is high and is thus will not fluctuate in informative ways in response to external shocks.

*Hypothesis 3.2a: When trade dependence is high, China's use of military force will be associated with negative stock market returns (high military opportunity cost). To be clear, this is a complex contingent claim with stock market returns = f (military force*interdependence)*

*Hypothesis 3.2a: When trade dependence is high, China's use of economic sanctions will be associated with negative stock market returns (high economic opportunity cost). Stock market returns = f (sanctions*dependence). The way you put things is confusing to me because hard to know which is DV and IV*

These tests are intended to be a form of causal process observation because these measures are the observable implications of the transform causal mechanisms I have outlined above. Causal process observation can complement existing panel approaches by showing whether or not the causal process stipulated in the theoretical model is valid or not (Haggard and Kaufman 2012). The method involve first a within-case analysis and coding and then aggregation across the population of cases. In a quantitative model, the effects of structural variables, such as trade dependence are estimated across a heterogeneous set of cases, some of which result in the absence of a militarized dispute as a result of the stipulated causal mechanism and many of which probably do not. The focus on average treatment effects masks the heterogeneity of militarized conflict and its absence (both of which are overdetermined); the variable in question is either significant or not. By contrast, causal process observations do not ask whether the variable in question is significant, but whether the trade dependence of state actors conforms with the causal process stipulated in the theoretical model and result in a reduction of militarized conflict.

Chapter 6: Case Studies

In chapters 4 and 5, I separate the impact of economic interdependence on strategy (transformation of national interests) and on tactics (constrain and inform bargaining behavior). In chapter 6, I attempt to assess the impact of all three causal mechanisms, operating at both the strategic and tactical levels, over time. In this chapter I will select on territorial dispute status and trade dependence to show how changes across these two factors over time impact China's decision to use military force or economic sanctions in its foreign policy. The n here is a territorial dispute in a specific country over two or more phases of trade dependence. The purpose of this case study is to model the impact of trade dependence on the likelihood military force will be used in a particular unresolved territorial dispute.

These case studies will follow a most different case design. I will pick two cases that differ most on common explanations of conflict (controls) that also maximize variation on the key explanatory variables (trade dependence and territorial dispute). The first case will be the Senkaku/Diaoyu Dispute (1972-present) with Japan and the second case is the South China Sea Dispute between China and Vietnam. What is attractive about this set of cases is that the disputants vary on most dimensions that are associated with the probability of military conflict, having very different geographies, level of nationalist animosity in China, level of economic development and structure of trade in target country, strategic and conventional balance of power, alliance status with the US, and regime type. Japan and Vietnam are very different on almost all of these dimensions, yet what they have in common is the fact that they have unresolved maritime disputes with China. I focus on two episodes of militarized conflict within each case, one where economic interdependence is high and the other where it is low. I will

show the logic of Chinese uses of military force in these two cases is also remarkably similar, even as economic interdependence has increased dramatically between the two episodes studied.

Chapter 3 Data and Quantitative Analysis

In Chapter 3 I analyze the effect of economic interdependence and territorial disputes on the initiation of militarized disputes (MIDS) by using the variable constructions and baseline models developed and Oneal and Russett (1999) and Gartzke [17] to allow for maximum comparability with the existing literature. I estimated coefficients using logit in Stata with robust standard errors. The data are from an original dataset on *Chinese Foreign Relations* (CFR) with information on Chinese territorial disputes, military conflicts, and economic coercion, along with a number of important covariates such towards 31 neighboring countries, including all countries in Asia plus Russia and the United States, from 1949-2016. I will experiment with different ways to operationalize the trade dependence variable and consider trade asymmetry as well as trade/GDP. I also conduct a series of robustness checks and also estimate the results using a series of logistic regressions, rare events logit, as well as a multinomial logit.

3.1 Hypotheses

As discussed in Chapter 2 commercial peace theories provide us with three distinct sets of causal mechanisms of how trade can have an effect on the outbreak of conflict: constrain, inform, transform. The naive expectation of commercial peace theory is summarized in hypothesis 1a, the expectation is that trade reduces conflict regardless of which mechanism.

Hypothesis 1a: As trade interdependence increases, China will be less likely to initiate a militarized dispute (MID).

[17] (2007)

But if we hold the bargaining space constant over time (operationalized as the division of a piece of disputed territory), and set the dependent variable of interest as the threat or use of military force (MIDs), then the constraint mechanism suggests that economic interdependence might not reduce the likelihood of MIDs. Instead, it predicts that increased economic interdependence will increase the opportunity cost of conflict, enlarging the bargaining range, but have an indeterminate effect on the probability of conflict in equilibrium. I test these hypotheses using panel data from the dataset on *Chinese Foreign Relations* (CFR).

Hypothesis 1b: As trade interdependence increases, China will NOT be less likely to initiate a militarized dispute (MID).

The purpose of this chapter is to establish in the reduced form estimate for the effect of trade interdependence on China's MIDs in a way that is comparable to the empirical commercial peace literature. The constrain and inform mechanisms assume a fixed bargaining space and lend themselves to this form of testing where the result is the marginal effect of economic interdependence on the predicted probability of conflict. The transformation mechanism operates on a longer time horizon and through the redefinition of national interests, it has less to say about the likelihood about the outcomes of specific militarized disputes. What should still hold is its prediction that the incidents of MIDs should decrease as economic interdependence increases, just not as an outcome of the crisis bargaining process but as a national interests shift to deemphasize conflict over territory. These results do not really provide

much evidence about which causal mechanism is most persuasive, only whether or not the pattern of data is consistent with the mechanisms.

3.2 The Chinese Foreign Relations Dataset

I construct an original dataset on *Chinese Foreign Relations* (CFR) with information on Chinese territorial disputes, military conflicts, and economic coercion, along with a number of important covariates such towards 31 neighboring countries, including all countries in Asia plus Russia and the United States, from 1949-2016. The objective of the CFR dataset is to comprehensive repository of data relevant to the study of Chinese foreign policy that encompasses all existing efforts, easy to extend, and can be kept up to date. This paper uses the territorial disputes and military conflict data from CFR as well as a battery of key covariates.

The Militarized Interstate Disputes (MIDs) v.4 data by [18] from the Correlates of War project is the workhorse dataset for conflict studies. But, as Gibler, Miller, and Little (2018) note, the original MID dataset suffers from an exceptionally high error rate for individual cases in the data. I was frustrated to discover that many of the MIDs involving China are poorly documented, factually inaccurate, or incomplete. MIDs prior to 1990 do not provide reliable sourcing for the events in question and no narratives or specific sources exist for the entries. Additionally, the existing MIDs data ends in 2010. Temporal and geographic coverage of control variables in these datasets were even patchier. Given that China's 'new assertiveness' in foreign policy begins in 2010, this was a real problem for my analysis.

[18] Palmer et al., "The MID4 Dataset, 2002-2010: Procedures, Coding Rules and Description."

Thanks to generous support from the Smith Richardson Foundation, I was able to hire a team of research assistants to 1) verify and document existing cases[19], 2) follow the MIDs, TIES, and ICOW code books to advance coding to 2016 from news databases (such as Factiva, Lexis-Nexus, New York Times) for a subset of cases involving the People's Republic of China from 1949-2016, and 3) update a series of covariates such as bilateral trade and CINC scores. We also cross-reference each entry with qualitative scholarship on Chinese foreign policy by political scientists such as Scobell (2003), Womack (2006), Fravel (2008), Huth (2009), Norris (2016), and Kang (2018) as well as historians such as Zhai (2000), Chen (2010), Smith (2015). The objective of this analysis was to ensure that the *Chinese Foreign Relations* (CFR) dataset can be a useful resource for conducting both quantitative and qualitative analysis of Chinese foreign policy, particularly China's use of military and economic coercion. I also wanted to make sure that this dataset is interoperable with as many of the existing cross-national IR datasets as possible and am exploring ways to use machine learning to automate the data collection process to extend this data.

My team collected data on Chinese military and economic coercion towards 31 neighboring countries, including all countries in Asia plus United States and Russia and excluding microstates with populations under 1 million such as the Maldives and Vanuatu. [20] The selection of these countries is intended to reflect countries where it is reasonable for China

[19] Despite multiple efforts, I was unable to obtain the MID narratives from the Gibler project that will be published in a forthcoming volume, Douglas M. Gibler, Militarized Interstate Dispute Narratives, 1816-2010, Lanham, MD: Rowman and Littlefield Publishers, 2018. I will cross-reference the narratives that my team has generated with his narratives and reconcile any differences later this year.

[20] Full list: Afghanistan, Australia, Bangladesh, Bhutan, Brunei Darussalam, Cambodia, China, Hong Kong, India, Indonesia, Japan, Kazakhstan, Kyrgyzstan, Laos, Malaysia, Mongolia, Myanmar, Nepal, New Zealand, North Korea, Pakistan, Papua New Guinea, Philippines, Russia, Singapore, South Korea, Sri Lanka, Taiwan, Thailand, Turkmenistan, United States of America, Uzbekistan, Vietnam

to credibly threaten both economic and military force or be targeted by economic and military coercion. Economically, China's reach has become global in recently decades but militarily China lacked power projection capabilities to threaten military force far beyond its borders until 2015. While it is building a blue water navy, its operations have been limited beyond the Pacific Ocean. Thus, the list of countries includes all countries with whom China share a land border and other countries adjacent to its maritime claims in the South China Sea where the Chinese navy could feasibly operate. This eliminates false negatives for the dataset where China does not the capacity to engage in military conflict because it lacks the physical capacity (ex. a MID between China and Brazil), in a manner similar to politically relevant dyads (Lemke 1995). I run a series of robustness checks using different operationalization of Asia, the results reported here are not driven by the selection of these 31 countries (see Appendix C).

China's Territorial Disputes

We also collected data on China's territorial disputes from several sources: Fravel (2007, 2008), Huth and Allee (2009), and Hensel, Frederick, and Macaulay (2017). These authors differed on how to delimit disputes that span over multiple features as well as in the dates for dispute onset and settlement. We use the Hensel et al ICOW claim numbers as the baseline and match information on various claims and features to the bilateral level as Fravel. For example, Hensel et al considers individual features of India's border disputes with China and group them into three claim number: 922: Trans-Karakoram Tract, Jammu and Kashmir, Aksai Chin & Eastern Ladakh; 911: Sikkim; and 912: Arunachal Pradesh. We retain these claim numbers for the dataset and do our best to match each MID to the territorial dispute claim number. But we also classify these three claims under "India border", the name used by Fravel. We then

reconcile the start and end dates of these claims using secondary sources. Newer or smaller disputes such as the Scotra Rocks dispute between China and South Korea over the Yellow Sea EEZ and the Nantuna Islands Dispute between China and Indonesia were not included in Fravel's original dataset but are included in ours. Table 1 below shows CFR's summary of China's territorial disputes.

Table 1 Summary of China's Territorial Disputes (1949-2016)

Disputed Area	**Chinese Name (s)**	**Features**	**Claimant (s)**	**Final Settlement**
1.Yellow Sea EEZ	苏岩礁, 黄海	Socotra Rocks	South Korea, North Korea	N/A
2.Spratly Islands	南沙群岛, 中沙群岛, 卡拉扬群岛	Spratly Islands: Kalayaan islands, Scarborough Shoal, Taiping Island, Thitu Island, West York Island	Taiwan, Vietnam, Philippines, Malaysia, Brunei	N/A
3.Paracel Islands	西沙群岛. 永兴岛	Paracel Islands: Woody Island, Lincoln Island, Triton Island, Amphithrite Group, Crescent Group	Taiwan, Vietnam	N/A
4.Natuna Islands	纳土纳群岛	Natuna Islands	Indonesia	N/A
5.White Dragon Tail Island	白龙尾岛	White Dragon Tail Island	Vietnam	N/A
6.East China Sea EEZ	钓鱼岛	Senkaku/Diaoyu Islands	Japan, Taiwan, South Korea	N/A

Table 1 Summary of China's Territorial Disputes (1949-2016), cont.

Disputed Area	Chinese Name (s)	Features	Claimant (s)	Final Settlement
7.Taiwan	台湾省, 澎湖群岛, 马祖岛, 金门	Taiwan, Pescadores Islands, Offshore Islands	Taiwan	N/A
8.India Border	阿克赛钦, 藏南, 锡金邦	Aksai Chin & Eastern Ladakh, Arunachal Pradesh, Sikkim	India	2005[21]
9.Russia border (eastern)	黑瞎子岛, 珍宝岛	Argun River Islands, Amur & Ussuri River Islands	USSR, Russia	1999, 2004[22]
10.Tajikistan border	萨雷阔勒岭	Sarykol Range	USSR, Tajikistan	1999
11.Bhutan border	洞朗地区	Doklam-Sinchulumpa-Gieu	Bhutan, India	1998[23]
12.Kyrgyzstan border	汗腾格里峰, 伊尔克什坦	Khan Tengri & Irkeshtam, Uzengi-Kuush	USSR, Kyrgystan	1998
13.Kazakhstan border	汗腾格里峰	Khan Tengri, Chogan-Obo Valley & Bay-Murza Passes	USSR, Kazakstan	1998

[21] 2005 China and India signed a Principles Agreement in which China relinquished its claims on Sikkim but no progress was made on the other disputed territories

[22] 2004 Russia and China signed an additional agreement to settle the last unresolved disputes over the Amur & Ussuri River Islands after the 1991 boundary agreement and 1998 border protocol

[23] 1998 China and Bhutan signed a Principles Agreement to "maintain peace and tranquility on the Bhutan-China border areas" which did not resolve the status of boundaries in Doklam.

Table 1 Summary of China's Territorial Disputes (1949-2016), cont.

Disputed Area	Chinese Name (s)	Features	Claimant (s)	Final Settlement
14.Russia border (western)	西新疆, 萨雷阔勒岭, 额尔齐斯河	Ili Valley & Lake Zaysan, Sarykol Range, Western Xinjiang, Tannu Tuva	USSR, Russia	1994
15.Vietnam Border	老山, 扣林山, 法卡山	China-Vietnam Border Regions	Vietnam	1999
16.Laos Border		Sino District Tract	Laos	1991
17.Macao	澳門	Macao	Portugal	1987
18.Hong Kong	香港, 九龙半岛	Hong Kong, Kowloon Peninsula	United Kingdom	1984
19.Afghanistan border	瓦罕走廊	Wahkan Corridor	Afghanistan	1963
20.Pakistan border	沙克思干谷地, 查谟 - 克什米尔邦	Trans-Karakoram Tract, Jammu and Kashmir	Pakistan, India	1963
21.North Korea border	长白山	Changbai Mountain	North Korea, South Korea	1962
22.Mongolia border	阿勒泰地区, 呼伦贝尔蒙古	Baytik Mountains & Hongshanzui, Altay Mountains	Mongolia, USSR	1962
23.Nepal border	中尼邊界	Mt Everest & Border Regions	Nepal	1961
24.Burma border	南宛地带, 克钦, 佤邦	Nam-Wan Tract, Wa State Border Regions	Myanmar	1960

The final settlement column in the above table reflects the reconciled settlement date for the disputed border. The date reflects the date when the two countries signed a boundary agreement or a border treaty that delineate the status of the border (with a few exceptions indicated by footnotes). The data show two waves of settlements, in one in the 1960s and another in the 1990s, following the pattern originally described by Fravel (2007). The first wave occur in the wake of domestic instability in China after the failure of the Great Leap Forward and rising tensions with the USSR and India while the second wave involve the reconciliation of borders with post-Soviet states and Vietnam after the collapse of the USSR. The settlement date is important because it is used to code the Territorial Dispute variable used in the analysis.

China's Involvement in Militarized Interstate Disputes

We identified 168 episodes of military coercion, MIDs,[24] (of which 16 are ICB crises and 8 are wars) AND 39 episodes of economic coercion.[25] My analysis also shows that patterns of Chinese military and economic coercion are exceptional because trade interdependence with China is positively correlated with the onset of militarized disputes. Figure 7 shows the five-year running average of the hostility level of MIDs that involve China from 1949 to 2016. Each MID is coded with a hostility level ranging from 1 to 5 (1 = No militarized action, 2 = Threat to use force, 3 = Display of force, 4 = Use of force, and 5=War). The text reflects the crises in the International Crisis Behavior (ICB) dataset mapped onto the MIDs, this leaves out a few wars such as the China-Burma War and more recent crises in the South and East China Seas

[24] I operationalize military coercion as the initiation of a military interstate dispute (MID) by China or targeting China using data from the Correlates of War (COW) Project (citation). I also eliminated some MIDs that seem to be errors (those against Xinjiang, Beijing, Tibet etc)

[25] There is variation on both the key dependent and independent variables over time within this set of countries. All MIDs are restricted to these countries and the majority of TIES (exceptions Norway, Portugal etc)

but establishes the pattern of China's conflict behavior. What is noteworthy is that MIDs involving China decreased in intensity throughout the 1990s and 2000s but have not decreased in relatively frequency, and since 2010 they have been increasing in intensity as well. The modal MID in the 2010s is some kind of show of force, either through naval military exercises (show of force, hostility level 7) or sailing through disputed waters such as near the Senkaku/Diaoyu Islands (coded as a border violation, hostility level 12).

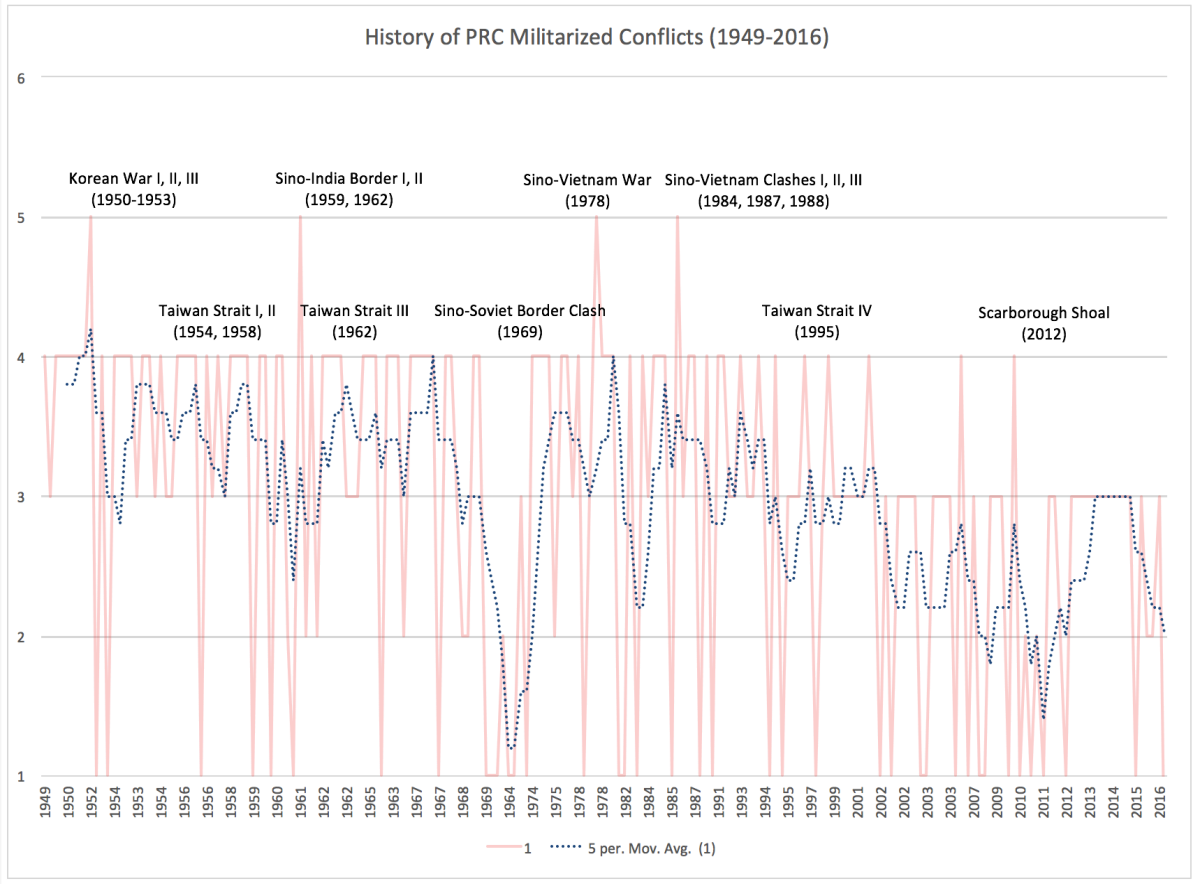

Figure 6 MIDs involving China (1949-2016)

Measuring China's Trade Dependence

To calculate trade interdependence, we use the baseline trade data is from Barbieri et al's [26] *Correlates of War Trade 4.0 Dataset* (1870-2014) and extended to 2016 by using officially reported trade growth statistics. The baseline GDP data comes from Graham and Tucker (2017) *International Political Economy Data Resource* and extended to 2016 using officially reported GDP growth statistics to 2016. The conventional way to measure trade interdependence is as:

$$Trade\ Dependence_i = \frac{Importsij + Exportsij}{GDPi}$$

This variable will generate two measures trade dependence for each dyad year because the importance of bilateral trade for each country is different due to their GDP. Figure 7 illustrates the variations in trade dependence over time in four crucial dyads with whom China engages in the most MIDs: the United States, Japan, Philippines, and Vietnam.

[26] Katherine Barbieri, Omar M.G. Keshk, and Brian M. Pollins, "Trading Data," *Conflict Management and Peace Science* 26, no. 5 (2009): 471–91, doi:10.1177/0738894209343887.

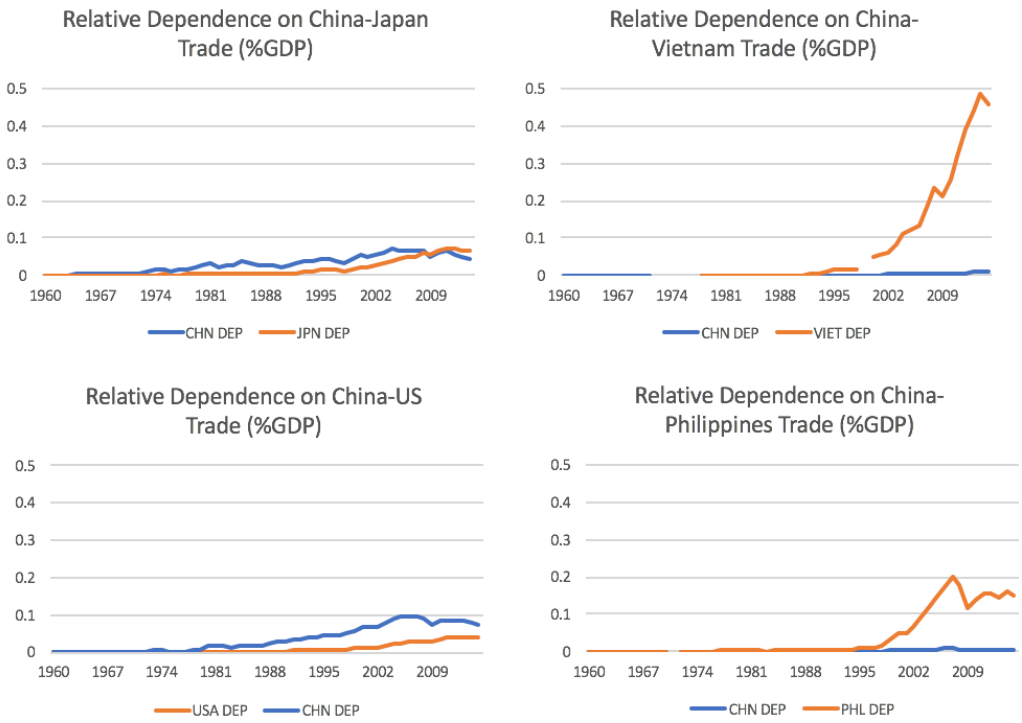

Figure 7 Bilateral Trade Dependence Across Four Crucial Cases

One simple way to assess the face validity of my theory in comparison to the standard commercial peace theories would be to plot China's trade dependence score on the x-axis and target country's trade dependence score on the y-axis and studying whether the distribution of militarized dispute onsets dyad years follow the pattern predicted by my theory or by the commercial peace (see Figure 8).

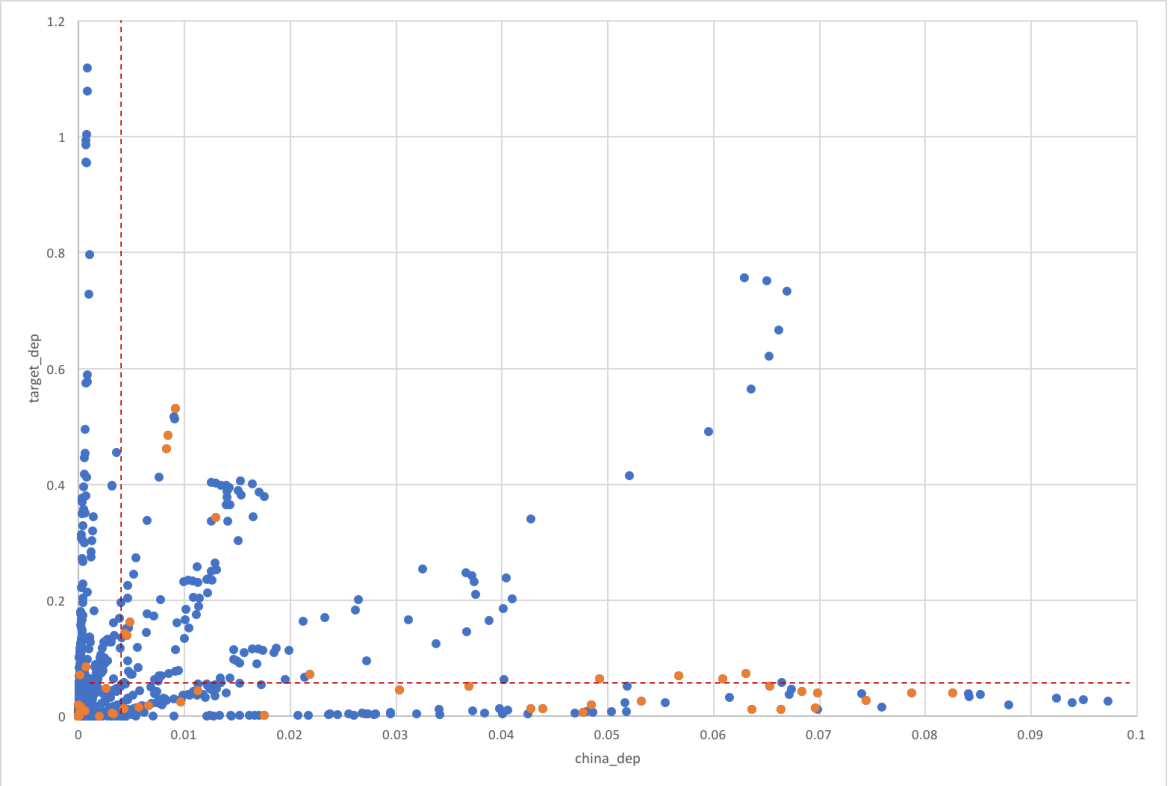

Figure 8 Scatterplot of Dyadic Trade Dependence Scores

Figure 8 shows a scatterplot of China's trade dependence against the trade dependence of the 31 other countries for which I have data in the CFR dataset. The dyad years where China initiated a militarized dispute is shown in orange. The red dashed lines divide the plot into four quadrants corresponding to those in Figure 4 based on the mean value of China's trade dependence (0.0054) and the mean value of target's trade dependence (0.0605). Commercial peace theory would expect that there should be significantly fewer episodes of militarized disputes in quadrant IV (high china_dep) than in quadrant III (low china_dep) but this does not appear to be the case. Indeed, the pattern of MIDs offers support for my theory that increased trade dependence might not constrain military force between interdependent countries. Of course, the sort of descriptive evidence presented in Figure 8 cannot account for factors such as time trends, distance, and relative capabilities that might confound the relationship between

trade dependence and militarized disputes. I take these factors into account in my statistical analysis in the following section.

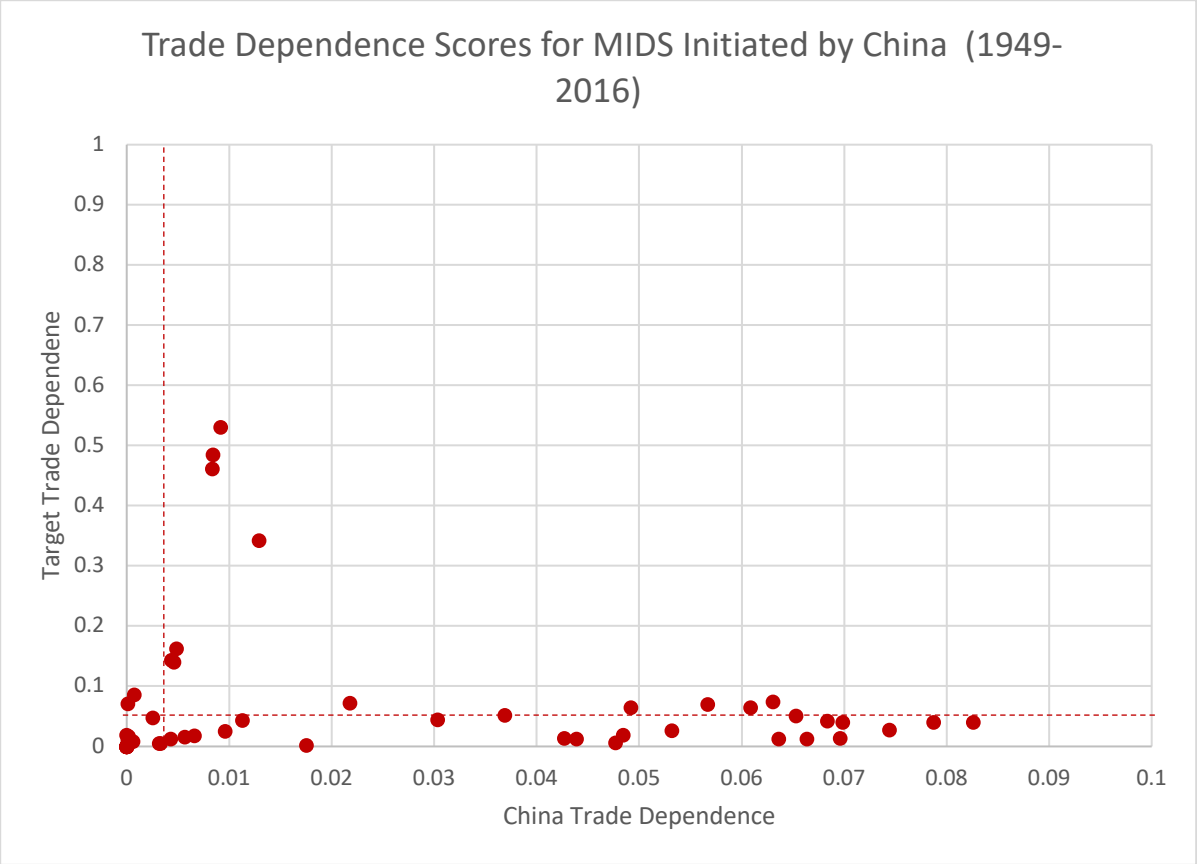

Figure 9 Trade Dependence Scores for MIDs Initiated by China

Figure 9 shows an enlarged version of the China initiated MIDs from Figure 8. Of course, the sort of descriptive evidence presented in Figure 9 cannot account for factors such as time trends, distance, and relative capabilities that might confound the relationship between trade dependence and militarized disputes. The CFR datasets also contain updated correlates to allow me to perform the necessary econometric analysis to control for these factors. The following section of this paper is devoted to presenting the results of this statistical analysis.

3.3 Research Design

I analyze the effect of economic interdependence and territorial disputes on the initiation of militarized disputes (MIDS) by using the variable constructions and baseline models developed and Oneal and Russett (1999) and Gartzke (2007) to allow for maximum comparability with the existing literature. I estimated coefficients using logit in Stata with robust standard errors. I only report a representative sample of the regression results in Tables 2 and 3 and include additional analysis in the various appendixes. In Table 2 I estimate the effect of economic interdependence on MIDs and economic sanctions in separate logistic regressions and in Table 8 I combine the analysis and use a multinomial logistic regression to examine the choice between these foreign policy instruments. The models are all variations of the following:

$$f(k,i) = \beta_{0,k} + \beta_{1,k} dep_{a_i} + \beta_{2,k} dep_{b_i} + \beta_{3,k} gdppc_{b_i} + \beta_{4,k} distance_i + \beta_{5,k} contig_i + \beta_{6,k} dispute_i + \beta_{8,k} affinity_i + \beta_{9,k} regime_i + \beta_{10,k} \ln caprt_i$$

Dependent variables: Militarized Disputes

Because I am interested in the effects of trade interdependence on both China's foreign policy behavior and in the foreign policy behavior of partner countries, I use two sets of dependent variables from the *Chinese Foreign Policy* dataset in my analysis. The first set consists of the initiation of a new militarized dispute by China, coded with the standard dichotomous coding of 1 for the start year of the event and 0 otherwise. These include 92 episodes of militarized disputes. The second set consists of the initiation of a new militarized

dispute against China in a dyad year. These include 76 episodes of militarized disputes. For robustness, I also created lagged versions of both variables.

Independent variable: Trade Dependence

The key independent variable of interest is trade dependence, which is conventionally operationalized as the ratio of bilateral trade over gross domestic product (GDP). I follow this standard operationalization (Country A's trade dependence with country B during year *t* is calculated as: Trade Dependence$_a$ = (Exports$_{ab,t}$ + Imports$_{ab,\ t}$)/GDP$_{a,t}$.) to create two measure of trade dependence measures, one for China and another for its trade partner, for each year. The baseline trade data is from Barbieri et al's [27] *Correlates of War Trade 4.0 Dataset* (1870-2014) and extended to 2016 by using officially reported trade growth statistics. The baseline GDP data comes from Graham and Tucker (2017) *International Political Economy Data Resource* and extended to 2016 using officially reported GDP growth statistics to 2016.

China's trade dependence ranges from 0 to 0.0973 (China with the U.S. in 2006) while partner trade dependence ranges from 0 to 1.2 (Kyrgyzstan with China in 2009). Appendix A reports the summary statistics of all variables used in this analysis. Existing literature and conventional wisdom suggest that as a country's trade dependence on a partner grows, it should be less likely to use military force against that country. But I do not expect trade dependence to decrease the propensity for military force, though I do expect trade dependence to cause a modest decrease the use of economic sanctions. Other key variables in the liberal peace literature are treated as controls in this study because my theory deals exclusively with trade.

China's Territorial Disputes

[27] Barbieri, Keshk, and Pollins, "Trading Data."

In addition to the standard controls, I also control for the presence of an active border dispute during the dyad year (*dispute*) in some models. Border disputes are positively correlated with MIDs (even though most border disputes do not result in conflict, and even fewer result in wars). I establish compares the effect of trade interdependence and border disputes on militarized conflict at the system level and across different regions in a previous chapter. Border disputes can hinder economic integration and increase potential conflict (MIDs). I used the disputed borders variable from Huth and Allee [28] cross referenced with Fravel [29] and Hensel et al (2017) for date of settlement.

Control Variables:

I include the same battery of control variables as previous studies [30] to facilitate comparison of results. I could not include some variables such as major power dyad or alliances because my sample of cases do not offer enough variation on those measures.

Regime type: The liberal peace literature asserts that democracies are less likely to fight each other; other scholars have extended this insight to argue that non-personalist autocracies may also be similarly constrained in the use of military force [31]. I did not use the joint democracy most common in the literature because China remains a single party autocratic regime across the entirety of my dataset. Instead I include a control for regime type (*Regime*)

[28] Paul K Huth and Todd L Allee, *The Democratic Peace and Territorial Conflict in the Twentieth Century*, vol. 82 (Cambridge University Press, 2002).
[29] Fravel, *Strong Borders, Secure Nation: Cooperation and Conflict in China's Territorial Disputes*.
[30] Gartzke, "The Capitalist Peace"; John R. Oneal and Bruce M. Russett, "The Classical Liberals Were Right: Democracy, Interdependence, and Conflict, 1950-1985," *International Studies Quarterly* 41, no. 2 (1997): 267–94, doi:10.1111/1468-2478.00042.
[31] Jessica L. Weeks, "Strongmen and Straw Men: Authoritarian Regimes and the Initiation of International Conflict," *American Political Science Review* 106, no. 2 (2012): 326–47, doi:10.1017/S0003055412000111.

takes the absolute value of the difference between the dyadic Polity IV scores each year. China's Polity score ranges from -9 to -7 and so the *Regime* measure takes on a greater value as the distance between regime types in the dyad increases, ranging from 19 in dyads with full democracies like the United States (10) to 0 with autocracies like North Korea (-9). I also use a dichotomous measure of partner democracy (coded as 1 if Polity>7) for robustness (see Appendix F).

Affinity: Gartkze [32] introduced an affinity index based on United Nations General Assembly voting into the liberal peace literature as an alternative to alliance portfolios, which are highly correlated with military conflict, to control for similarity in national interests between dyads. I use a modified version of s-score data from Voeten et al [33] which ranges from -1 (least similar interests) to 1 (most similar interests) as a control. Modification was necessary to extend the range of this variable since the People's Republic of China took over the United Nations seat from the Republic of China (Taiwan) in 1971 and had diametrically opposed national interests with Taiwan prior to 1971. In order not to lose coverage on the affinity variable from 1949-1971, I manually coded China's diplomatic relations with target countries based on historic records to predict how it would have voted in the UN if it had a seat at discrete values of -1, -0.5, 0, 0.5, and 1. For example, prior to the Sino-Soviet Split in 1960, China and Russia was coded as most similar (1) but downgraded to (-0.5) until 1969 when war between the two communist powers looked eminent (-1) and remained thus until Voeten data for the dyad becomes available in 1972. Countries where the diplomatic history is unclear such as with Laos

[32] Gartzke, "The Capitalist Peace."
[33] Michael A. Bailey, Anton Strezhnev, and Erik Voeten, "Estimating Dynamic State Preferences from United Nations Voting Data," *Journal of Conflict Resolution* 61, no. 2 (2015): 1–27, doi:10.1177/0022002715595700.

and New Zealand are left blank until more research assistant time can be dedicated to the task. I also used an unmodified s-score measure from Voeten for robustness (see Appendix F).

Capabilities: I also control for the balance of power by including a measure of the difference between the active and potential military capability of the dyad (*Capabilities)* by measuring the ratio of composite national capabilities scores (CINC). CINC scores, from the Correlates of War (COW) project, measure a state's share of world capabilities in three dimensions: demographic (total and urban population), economic (energy consumption and iron/steel production), and military (expenditures and total personnel). I construct a standard capabilities ratio score by taking the log of the ratio between China's CINC score and the target country's CINC score. The balance of power becomes more skewed in favor of China as this measure increases in value.

Development: Economic development is widely believed to decrease conflict among rich nations by making conquest of territory less attractive. At the same time, poor countries that lack the material means to project power abroad may engage in fewer conflicts. I follow Gartzke (2007) by including the interaction of target country per capital GDP and contiguity (GDPPC x Contiguity) as control because the declining value of conquest should manifest itself in relations with neighbors rather than power projection overseas. I use the target country's per capital GDP rather than China's because it exhibits a wider range of variation and is less likely to be collinear with China's rising capabilities. I also use a more conventional log of GDPPC of the target country as a robustness check.

Distance and Contiguity: Distance is operationalized as the natural log of the great circle distance between the national capitals (because China is a large country and Beijing is not at its geographical center, a future round of coding aims to update this data with the distance to the nearest regional military headquarters). Contiguity is a dummy variable that is coded 1 if the dyad shares a land border or are separated by less than 150 miles of water. I included these two standard controls for geography.

3.4 Results

The regression results provide evidence consistent with my expectation that trade dependence does constrain, but may actually increase the use of military force in Asia. The status of territorial disputes play an important mitigating role in whether or not trade dependence constrains China's use of military force. I also ran all models using rare event logit [34]; different conceptions of Asia, different operationalization of variables, time and country fixed effects. I include these robustness checks with alternative specifications in the Appendices B-E.

Table 2 lists the results of six regressions, models 1-3 have China's initiation of a militarized dispute as their dependent variable while models 4-6 have China's initiation of an economic sanction as the dependent variable (I will focus on the results for militarized disputes in this Chapter and discuss the results for economic sanctions at greater length in Chapter 5). Model 1 offers the most basic test of my theory against the commercial peace literature, which

[34] Langche Zeng, "Society for Political Methodology Logistic Regression in Rare Events Data Author (s): Gary King and Langche Zeng Reviewed Work (s): Published by : Oxford University Press on Behalf of the Society for Political Methodology Preserve and Extend Access To" 9, no. 2 (2013): 137–63.

predicts that as China's trade dependence with a given country rises, it should engage in fewer militarized disputes and yield a negative and significant coefficient. The results show that the opposite is true, China's trade dependence is positively and significantly correlated with its initiation of militarized disputes. This result holds true after controlling for existence of a territorial dispute, the strongest predictor of conflict behavior in the dataset, in Model 2. Of the standard battery of control variables, only affinity is statistically significant and consistent with the expectation that, as shared national interests increases, the likelihood of military disputes decrease. Regime type, level of development, and capabilities ratio are all not statistically significant correlated with China's use of militarized disputes. Distance and contiguity are not statistically significant, likely because their effect on militarized disputes are contingent on the existence of territorial disputes.

Model 3 introduces an interaction term between territorial disputes and the target state's trade dependence to determine the predicted probability of MID conditional on territorial dispute status. The results show that the coefficient on this interaction term is positive and significant. This means that, for those countries that have an unresolved territorial dispute with China in a given year, the probability for a MID is positive and significant even as trade dependence increases. The coefficient on the target's trade dependence is negative and significant in Model 3, suggesting that for those countries that do not have territorial disputes with China, greater trade is correlated with reduced conflict. China's trade dependence is positively and significantly correlated with MID onset across all models, meaning that the probability of a MID onset remains positive even as China becomes more trade dependent on its neighbors holding relative military capabilities and economic development constant.

Table 2 Logit Regression of Trade Dependence on Initiation of Militarized Disputes and Economic Sanctions by China (1949-2016)

VARIABLES	(1) Military Dispute Onset	(2) Military Dispute Onset	(3) Military Dispute Onset	(4) Sanction Onset	(5) Sanction Onset	(6) Sanction Onset
IV: Trade Dependence						
Target	2.180**	2.013	-24.71***	3.656	3.724	-3.363
	(0.919)	(1.672)	(9.349)	(4.139)	(5.107)	(2.973)
China	32.69**	34.34**	37.62***	51.56***	52.76***	52.06***
	(13.59)	(12.43)	(10.85)	(10.45)	(11.30)	(12.32)
Target* Territorial Dispute			28.13**			8.729
			(11.28)			(7.948)
Controls						
Regime Type	-0.0319	-0.0388	-0.0230	-0.0630	-0.0697	-0.0700
	(0.0618)	(0.0584)	(0.0715)	(0.0900)	(0.0751)	(0.0657)
Affinity	-0.726	-0.971***	-1.108***	-0.978**	-0.700	-0.684
	(0.493)	(0.297)	(0.308)	(0.496)	(0.427)	(0.440)
Capabilities	-1.335**	-0.518	-0.330	-0.759	-0.192	-0.177
	(0.657)	(0.449)	(0.481)	(0.710)	(0.452)	(0.384)
Development	-0.000147***	2.46e-05	0.000145*	-0.00174**	-0.00174**	-0.00225
	(5.39e-05)	(4.42e-05)	(8.69e-05)	(0.000864)	(0.000769)	(0.00149)
Contiguity	0.998*	0.271	0.245	0.846	0.330	0.594
	(0.559)	(0.539)	(0.457)	(0.816)	(1.092)	(1.067)
Distance	-1.413***	-0.165	-0.443	-2.825***	-0.491	-0.612*
	(0.489)	(0.452)	(0.345)	(0.364)	(0.463)	(0.333)
Territorial Dispute		2.407***	1.628***		3.197***	2.701***
		(0.554)	(0.383)		(0.648)	(0.739)
Constant	10.11**	-1.896	0.613	19.86***	-1.630	-0.249
	(4.867)	(4.878)	(3.930)	(4.128)	(5.055)	(3.291)
Observations	871	871	871	871	871	871

Robust standard errors in parentheses
*** p<0.01, ** p<0.05, * p<0.1

Effects of Trade Dependence on Initiation of Militarized Disputes

Figure 10 estimates the marginal effects of China's trade dependence on the probability that it will initiated a militarized dispute, all else equal. [35] The counterintuitive result is that China is nearly three times as likely to initiated a MID at the highest levels of trade dependence as it is in the lowest values, all else equal. This means that as China's trade with a target country makes up a larger share of its GDP, it is *more* likely to use military force against that target, contrary to the expectations of commercial peace theory. In this model, the coefficient on the target's trade dependence is statistically insignificant, meaning that China is not more likely to use force against countries that are more economically dependent on it. The coefficient for territorial dispute is positive and highly significant, meaning that China is much more likely to use military force against countries with which it has an unresolved border dispute.

[35] Table 1 in Appendix E lists the results of six regressions, models 1-3 have China's initiation of a militarized dispute as their dependent variable while models 4-6 have China's initiation of an economic sanction as the dependent variable. Model 1 offers the most basic test of my theory against the commercial peace literature, which predicts that as China's trade dependence rises, it should engage in fewer militarized disputes and yield a negative and significant coefficient. The results show that the opposite is true, China's trade dependence is positively and significantly correlated with its initiation of militarized disputes. Figure 9 is generated from the results of Model 2 which includes territorial disputes as a control.

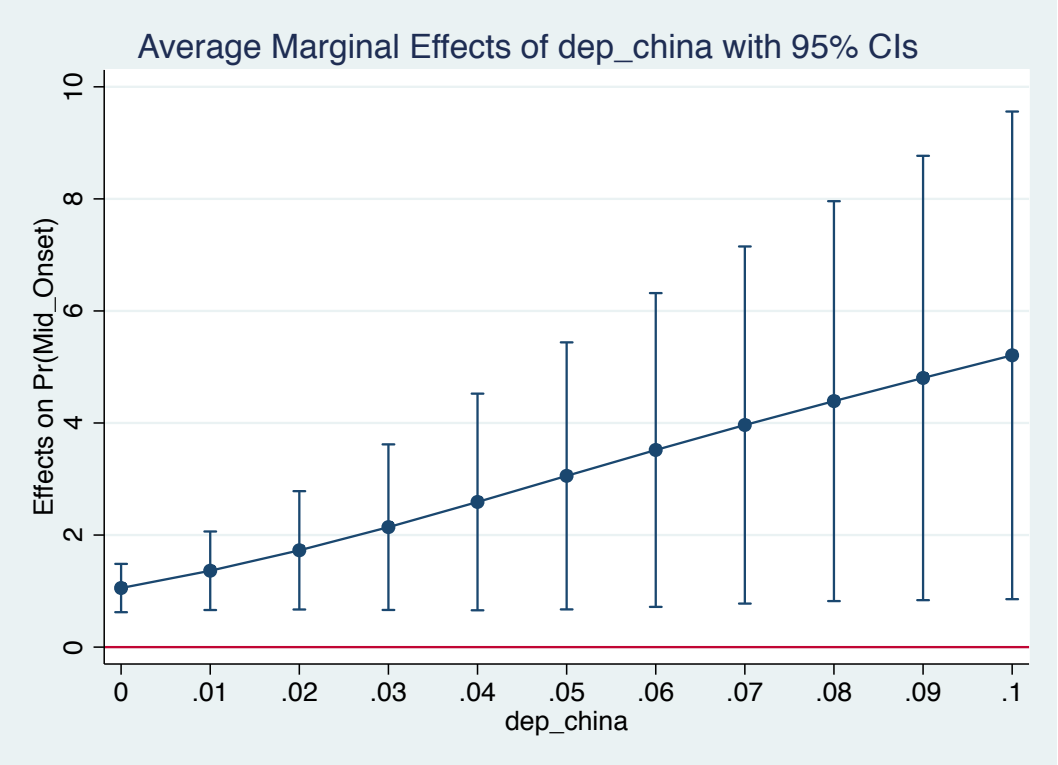

Figure 10 Probability of a Militarized Dispute Initiated by China for Values of the China's Trade Dependence

These results become even stronger when I introduce an interaction term for territorial dispute and target's trade dependence to distinguish the effects of trade dependence across states with which China has settled borders and those with which it has not. When we interact territorial dispute with target trade dependence, the coefficient for China's trade dependence increases and becomes statistically significant at the 99% confidence level. The coefficient on target's trade dependence becomes negative and significant while the coefficient on the interaction term is positive and significant. This means that the probability of China using military force increases particularly when there is a territorial dispute. But as a country's dependence on trade with China increases, the probability of China using military force against that country decreases (in other word commercial peace holds), *if that country does not have a*

territorial dispute with China. These results are telling because they suggest that China's relatively unique pattern of unresolved borders, particularly maritime borders, explains why it is an anomaly in the empirical commercial peace literature. These results are at odds with the naieve commercial peace hypothesis that as trade interdependence increases, China will be less likely to initiate a militarized dispute (MID).

Effects of Territorial Disputes on Initiation of Militarized Disputes

Figures 11 show the marginal effects of China's economic dependence on its use of militarized disputes by territorial dispute status. The red lines show the estimated marginal effect of trade on the dependent variables when there is an active territorial dispute between China and the target country in that dyad year and the blue line shows the results when there is not.

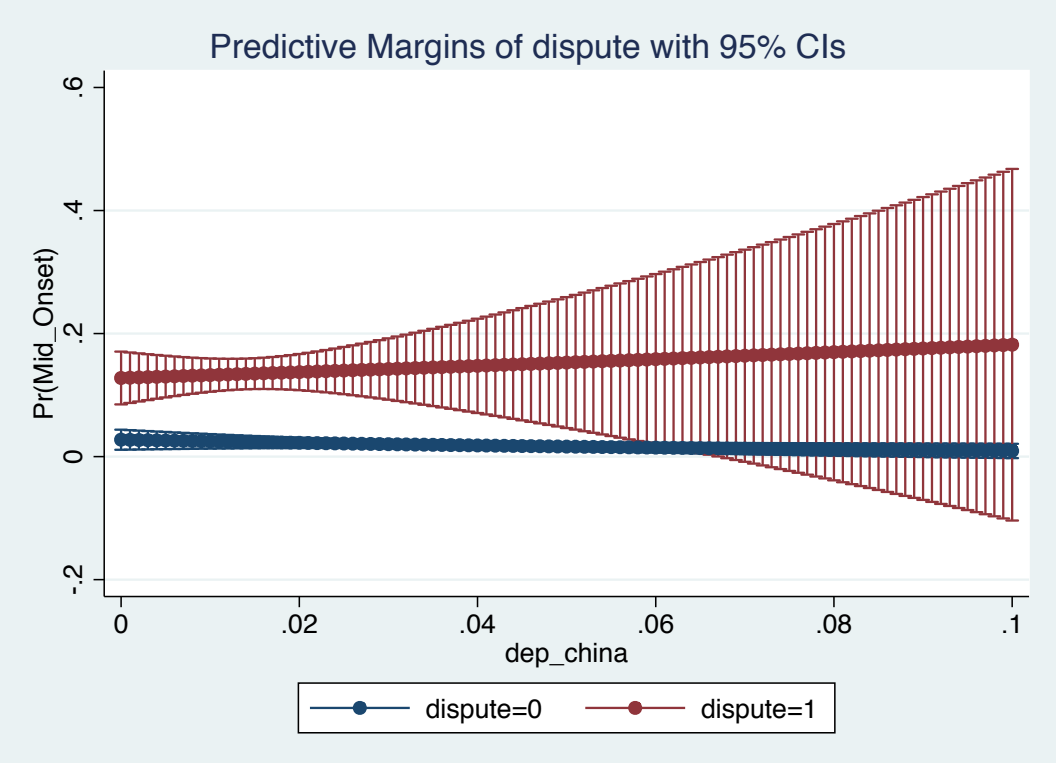

Figure 11 Territorial Dispute Status and Military Signaling Results

Figure 11 clearly shows that China is more likely to use military force in ongoing territorial disputes. It lends support for hypothesis 1b*: As trade interdependence increases, China will NOT be less likely to initiate a militarized dispute (MID)*. When it is involved in a territorial dispute, China is not less likely to constrain its use of military force as trade dependence with the partner country increases. If anything, it is more likely as the slope of the line is slightly positive but not statistically significant at the 95% confidence level.

Effects of Trade Dependence on Use of Military Force Targeting China

The theory I develop in Chapter 2 is a general theory of commercial peace, the mechanisms should apply to the pattern of MIDs that target China as well as those that are initiated by China. This set of cases are important to consider because conflicts of territorial disputes are an ongoing series of tit-for-tat actions and it is very difficult to determine which country is the revisionist actor in each incident without considering the whole.

Table 3 show results from the same six regressions from Table 2 except with the target's initiation of a militarized dispute or economic sanction against China as the key dependent variable. Models 1-3 have the initiation of a militarized dispute against China as their dependent variable while models 4-6 have the initiation of an economic sanction against China as the dependent variable.

Table 3 Logit Regression of Trade Dependence on Initiation of Militarized Disputes and Economic Sanctions Against China (1949-2016)

VARIABLES	(1) Military Dispute Onset	(2) Military Dispute Onset	(3) Military Dispute Onset	(4) Sanction Onset	(5) Sanction Onset	(6) Sanction Onset
IV: Trade Dependence						
Target	5.388***	4.945***	6.146*	-87.90***	-99.45***	-82.5***
	(1.453)	(1.876)	(3.144)	(30.34)	(34.94)	(22.55)
China	1.086	4.167	5.164	63.92***	70.17***	82.88***
	(35.59)	(26.61)	(26.96)	(20.31)	(22.18)	(22.14)
Target* Territorial Dispute			-2.164			-64.62
			(4.237)			(82.45)
Controls						
Regime Type	-0.0713	-0.0523	-0.0601	0.397***	0.429***	0.419***
	(0.0754)	(0.0590)	(0.0695)	(0.0502)	(0.0579)	(0.0827)
Affinity	-0.877**	-0.652*	-0.679*	18.96***	18.59***	18.61***
	(0.342)	(0.335)	(0.381)	(2.800)	(2.378)	(2.341)
Capabilities	-1.716**	-0.946*	-0.978	-5.512***	-6.353***	-5.554***
	(0.721)	(0.574)	(0.624)	(1.118)	(1.255)	(1.662)
Development	-3.58e-05	-8.50e-05	-5.02e-05	0.000724***	0.000774***	0.00102
	(0.000141)	(0.000184)	(0.000189)	(0.000201)	(0.000297)	(0.000641)
Contiguity	0.303	0.670	0.542	-5.974***	-5.322***	-5.503***
	(0.996)	(0.919)	(0.868)	(1.084)	(0.968)	(1.173)
Distance	-0.497	-0.632	-0.524	2.721***	1.905*	2.217**
	(0.764)	(0.699)	(0.731)	(1.020)	(0.996)	(1.075)
Territorial Dispute		2.178***	2.370***		-1.895***	-0.691
		(0.675)	(0.637)		(0.611)	(1.696)
Constant	3.797	2.060	1.208	-43.11***	-35.02***	-38.84***
	(6.918)	(6.045)	(6.142)	(8.709)	(8.151)	(8.962)
Observations	766	766	766	766	766	766

Robust standard errors in parentheses
*** p<0.01, ** p<0.05, * p<0.1

These results are largely consistent with my theory and the direction of effects in Table 3 with several important exceptions. Models 4-6 show that greater trade dependence of the target (note that in these models "target" is the initiator of coercion against China) is negatively and significantly correlated with initiation of an economic sanction (TIES) against China. China's trade dependence appears to be positively and significantly correlated with the initiation of sanctions. Models 1-3 show that target's trade dependence on China is positively and significantly correlated with initiation of militarized disputes (MIDs). This is more consistent with the expectations of my constrain mechanism (Hypothesis 1b), as dependence on trade with China increases, countries find it more difficult to use economic sanctions against it but no less difficult to use military force. These results do not support the predictions of the inform mechanism that increased economic interdependence will create other means or costly signaling, reducing the need to use military force and increasing the use of economic coercion in equilibrium.

3.5 Summary

This chapter offers a first cut of the analysis using a new dataset on Chinese Foreign Relations (CFR) to test if the relationship between economic interdependence and militarized disputes conform to the reduced form expectations of the three competing mechanisms of the commercial peace: constrain, inform, and transform. The evidence suggests that economic engagement and integration may not yield an unambiguous and monotonic between the two variables. At the very least, the evidence contradicts the naive commercial peace hypothesis that economic interdependence reduces conflict.

The very complexity of economic interdependence ensures contrasting effects in different circumstances. For example, states sometimes substitute economic tools for military power, while at other times they are constrained from doing so. In other contexts, nations may even resort to military violence at lower intensities to avoid economic confrontation, where commerce is profitable or extensive. The results show conclusively that China is NOT less likely to use military force as its economic interdependence increases, lending support to *hypothesis 1b: As trade interdependence increases, China will NOT be less likely to initiate a militarized dispute (MID).* But it does not provide enough evidence to distinguish the inform mechanism from the constrain mechanism. We also do not know whether the lack of an effect is due to the failure of the transform mechanism, which seems likely given the association of MIDs with unresolved territorial disputes. In the following chapters, I will attempt to separate and observe the individual effects of these competing mechanisms.

Chapter 4 Does Interdependence Transform National Interests?

In this chapter, I focus on examining the capacity for economic interdependence to create *positive peace* through the transformation mechanism. I am interested in the capacity of economic interdependence to redefine the national interest and resolve the underlying causes of conflict. This is a hard test of the transformation mechanism. But since my ultimate theoretical goal in this dissertation is to understand the effects of economic interdependence on conflict, it is necessary to identify measures would lead to conflict in the absence of economic interdependence and not just indicators of cooperation. Negative peace is overdetermined and the effects of economic interdependence on the numerous ways states cooperate on this end of the spectrum has been exhaustively studied. Additionally, these outcomes are endogenous to China's choice to undergo economic liberalization. It is thus difficult to say who is socializing whom or who is transforming whom economically once the process of economic engagement begins. Trade tends to beget more trade and investment more investment, driven purely by market actors and independent of state interests. Therefore coordination on economic or regulatory policy is not a good measure of the transformative effects of economic interdependence. When we examine political indicators, we find little doubt that economic engagement has made China more willing to engage diplomatically with its neighbors and has embraced East Asian regionalism (Shambaugh 2005, Ba 2006) and the WTO's multilateral trade principles (Ikenberry 2008, Branstetter and Lardy 2006). It was initially a recipient of massive amounts of economic and technical assistance from Japan (Smith 2016) and the United States (Lampton 2001) during the early stages of its development and is now a major source of global development aid (Bräutigam 2011, Strange, Park, Tierney, Fuchs, and Dreher 2017, 2018). These are all important and positive developments but it is important to highlight that

these positive political externalities of economic engagement can and did occur without the elimination of the causes of conflict – in China's case, these are ongoing territorial disputes and the Cold War alliance structure in East Asia. It is also important to note that transformation of national interests on the negative peace of the spectrum is often conflated with the potential for transformation on the positive side of the spectrum due to the prominence of liberal theories in this literature (eg. domestic economic liberalization will beget peaceful foreign policy, not to mention domestic political transformation -- democratization). I put this notion to the test in this section by examining the capacity for economic interdependence to generate positive peace by eliminating the causes of conflict.

In Chapter 2, I introduced the following ordinal scale for national interests ranging from subordination to dialogue along which economic interdependence can be expected to operate (see Figure 4). The scale is arrayed based on the degree of sovereignty that would have to be given up in order to achieve the outcome where subordination to another country would require the greatest amount of sacrifice while dialogue would require the least. Based on the bargaining theory of war, nations generally prefer a negotiated settlement short of war to actually paying the cost of fighting. Thus, the avoidance of war is the status quo ante between nations and should not be viewed as the success of the success of the transformation mechanism. This is a major theoretical departure from previous work on the commercial peace so I will elaborate further on this point. What I am arguing is that two nations can avoid war without economic interdependence transforming their interests in any way just by virtue of the costliness of war itself. The absence of war is therefore overdetermined. This is why my scale is centered on avoiding war as the neutral outcome, with everything to the left requires the sacrifice of some

degree of sovereignty and everything on the right requiring little or no sacrifice of sovereignty[36]. Another distinction is that everything to the left of the spectrum can be considered positive peace (elimination of the causes of conflict) while everything to the right of the right of the spectrum can be characterized as negative peace (the absence of war). For the transform mechanism to work, economic interdependence must contribute towards the elimination of the sources of conflict.

4.1 Measuring National Interests

I focus on the ability of economic interdependence to achieve transformation in China's settlement of territorial disputes. I do not focus on complete subordination, which I define as the ceding of authority over its foreign and defense policy to another state[37], because there is only one debatable incidence of this in my data set: the return of Hong Kong in 1997[38]. In many datasets Hong Kong is treated as a separate political entity as China even after its sovereignty was transferred over from the United Kingdom back to China in 1997. Trade interdependence between mainland China and Hong Kong were extremely high in the 1980s and 1990s and the British decision to return of Hong Kong was influenced by some economic considerations such

[36] The scale is a gross simplification of reality and the relative positions between the various ordinal categories can be debated (ex. whether policy coordination "easier" than economic or military assistance and which requires a greater sacrifice of sovereignty probably depend on the specifics of policy involve). The general point here is that national interests can be arrayed along some scale and that the transformation mechanism is stronger at one end of this scale than the other.

[37] I borrow this definition from Lake (2009)'s work on hierarchy. It should also be noted that my definition of the negative peace spectrum extends from alliances on one end to subordination (what Lake refers to as protectorates) on the other end. A future extension of this work would be to theorize more systematically about how economic interdependence might influence the willingness of states to trade off some portion of their sovereignty for protection from external security threats. What is unique about the data presented here is that China remains the largest security threat for most of its neighbors even as their economic dependence on China grows. Therefore, it does not appear that these states are willing to relinquish their sovereignty as economic interdependence increases.

[38] The transfer of Macau in 1999 is arguably another case but neither Macau nor Portugal are in my dataset.

as the preservation of its existing trade privileges and Hong Kong's capitalist system. But the politics of the negotiation process were driven in much larger part by political considerations such as Beijing's uncompromising stance on the status of 'unequal treaties' (Hong Kong as a homeland territorial dispute), Chinese nationalism both in mainland China and Hong Kong, as well as the lack of British resolve to use military force to hold on to Hong Kong as it did in the 1982 Falklands War (Pye 1983, Yahuda 1996, Flowerdew 1998). It is important to note that Deng's adamancy on the issue of Chinese sovereignty was the driving force behind the negotiations for the 1984 Joint Declaration, Beijing was willing to compromise on the terms of "one country, two systems" but not on the sovereign status of Hong Kong. Therefore, the subordination of Hong Kong to mainland China should not be read as a case of the transformative effects of economic interdependence, but rather of a resolved actor prevailing over a less resolved actor and a political compromise to preserve economic relations as part of the transfer of sovereignty.

I also do not focus on China's "assertiveness" or willingness to use military force, because this is a really difficult latent measure to observe. It can be proxied with a study of the open source material on Chinese military doctrine or strategic culture (Johnston 1998, Goldstein 2005, Swaine 2000), but that will reveal a consistent willingness to use military force when the circumstances call for it. We cannot know for certain the intention of Chinese leaders in foreign policy making, but based on their statements and behavior, we can be reasonably sure that the level of assertiveness does not seem to vary with growing economic interdependence. Johnston (2015) makes a convincing case that the perception of China's "new assertiveness" was the result of a meme that spread through Western media coverage in 2010 and did not reflect a meaningful shift in Chinese diplomacy toward sovereignty and territorial integrity issues. I will

therefore focus on two measures of changing national interest that would be easy to observe and could plausibly vary with economic interdependence.

Territorial Disputes

I will instead focus on China's settlement of territorial disputes. The prediction of the transformation mechanism would be that China is more likely to settle territorial disputes with major trade partners as economic interdependence increases. I collect data on China's territorial dispute settlement from Fravel (2008) and Frederick, Hensel, and Macaulay (2017)'s *Issue Correlates of War Territorial Claims Data* for inclusion into the *Chinese Foreign Relations* (CFR) dataset with a few minor updates. I examine whether the negotiations for the settlement of territorial disputes were influenced by considerations of economic interdependence. In Table 5 I document all of the PRC's territorial disputes and whether they have been settled or not, the year of settlement, the trade dependence of both parties, and my analysis of whether they constitute support for the transformation mechanism. These data suggest that trade dependence is not a major factor in China's settlement of territorial disputes. China often negotiated non-aggression pacts as part of or soon after agreements that settled border disputes.

Table 4 shows that contrary to the expectation of the transformation mechanism, China's settlement of territorial disputes are almost entirely with poor land-locked countries with which it engages in negligible amounts of trade while all of its unsettled territorial disputes are with major trade partners. Only three cases out of more than of thirty territorial dispute settlement dyads can be interpreted to offer some evidence in favor of the transformation mechanism, these are negotiations over the eastern sector of the Indian border in 2005, the

settlement of the eastern Russian border in 1999, and the settlement of the Vietnamese land border in 1999. This section will examine each case in greater detail.

Table 4 Economic Interdependence and China's Territorial Settlement

Claimant (s)	Disputed Area	Features	Final Settlement	China's Trade Dependence	Partner's Trade Dependence	Support for Transform Mechanism
South Korea, North Korea	1.Yellow Sea EEZ	Socotra Rocks	N/A	South Korea: High	South Korea: High	No
Taiwan, Vietnam, Philippines, Malaysia, Brunei	2.Spratly Islands	Spratly Islands: Kalayaan islands, Scarborough Shoal, Taiping Island, Thitu Island, West York Island	N/A	Taiwan: High, Vietnam: High, Philippines: High	Taiwan: High, Vietnam: High, Philippines: High	No
Taiwan, Vietnam	3.Paracel Islands	Paracel Islands: Woody Island, Lincoln Island, Triton Island, Amphithrite Group, Crescent Group	N/A	Taiwan: High, Vietnam: High	Taiwan: High, Vietnam: High	No
Indonesia	4.Natuna Islands	Natuna Islands	N/A	Medium	High	No
Vietnam	5.White Dragon Tail Island	White Dragon Tail Island	N/A	High	High	No
Japan, Taiwan, South Korea	6.East China Sea EEZ	Senkaku/ Diaoyu Islands	N/A	Japan: High	Japan: High	No
Taiwan	7.Taiwan	Taiwan, Pescadores Islands, Offshore Islands	N/A	High	High	No

Table 4 Economic Interdependence and China's Territorial Settlement, cont.

Claimant (s)	Disputed Area	Features	Final Settlement	China's Trade Dependence	Partner's Trade Dependence	Support for Transform Mechanism
India	8.India Border	Eastern Ladakh, Arunachal Pradesh, Sikkim	2005*	High	High	Mixed
USSR, Russia	9.Russia border (eastern)	Argun River Islands, Amur & Ussuri River Islands	1999, 2004*	Medium	Medium	Mixed
USSR, Tajikistan	10.Tajikistan border	Sarykol Range	1999	Low	High	No
Bhutan, India	11.Bhutan border	Doklam-Sinchulumpa-Gieu	1998*	Low	Low	No
USSR, Kyrgystan	12.Kyrgyzstan border	Khan Tengri & Irkeshtam, Uzengi-Kuush	1998	Low	High	No
USSR, Kazakstan	13.Kazakhstan border	Khan Tengri, Chogan-Obo Valley & Bay-Murza Passes	1998	Low	High	No
USSR, Russia	14.Russia border (western)	Ili Valley & Lake Zaysan, Sarykol Range, Western Xinjiang, Tannu Tuva	1994	Low	Low	No

Table 4 Economic Interdependence and China's Territorial Settlement, cont.

Claimant (s)	Disputed Area	Features	Final Settlement	China's Trade Dependence	Partner's Trade Dependence	Support for Transform Mechanism
Vietnam	15.Vietnam Border	China-Vietnam Border Regions	1999	Low	High	Mixed
Laos	16.Laos Border	Sino District Tract	1991	Low	High	No
Portugal	17.Macao	Macao	1987	Low	High	No
United Kingdom	18.Hong Kong	Hong Kong, Kowloon Peninsula	1984	High	High	No
Afghanistan	19.Afghanistan border	Wahkan Corridor	1963	Low	High	No
Pakistan, India	20.Pakistan border	Aksai Chin, Trans-Karakoram Tract, Jammu and Kashmir	1963	Low	Low	No
North Korea, South Korea	21.North Korea border	Changbai Mountain	1962	Low	Low	No
Mongolia, USSR	22.Mongolia border	Baytik Mountains & Hongshanzui, Altay Mountains	1962	Low	Low	No
Nepal	23.Nepal border	Mt Everest & Border Regions	1961	Low	Low	No
Myanmar	24.Burma border	Nam-Wan Tract, Wa State Border Regions	1960	Low	Low	No

The Russian Border

The Sino-Soviet border is divided into two sections: the Western sector, which separates Xinjiang, the Chinese province, and the Soviet Republics of Kazakhstan, Kyrgyzstan, and Tajikistan, and the Eastern sector, which separates north-eastern Siberia from Manchuria. Chinese claims in the Eastern sector date back to the Treaty of Nerchinsk signed between the Qing Empire and the Russian Empire in 1689 while Russian claims are based on a series of treaties that were imposed upon China by the Tsarist government during the 1860s as part of the "scramble for China" following the Opium Wars. The USSR exercised effective control over the territories at the end of World War II and the China-USSR border along with Mongolia were demilitarized and left unguarded during the period of alliance in the 1950s (Fravel 2008). As part of the growing Sino-Soviet Split in the 1960s, Beijing announced that former governments had been forced into signed unequal treaties, thereby publicly mentioning the possibility of revising the frontiers. Moscow accused Beijing in 1963 of "systematically violating" the border it shared with the Soviet Union and the two sides were involved in a series of military clashes along both Eastern and Western sectors of the border throughout the 1960s. At the height of these tensions, Western sources estimated the number of troops on the Sino-Soviet border at this time at nearly 40 Soviet divisions… and between 50 and 60 Chinese divisions, or more than 600,000 men, engaged in a prolonged stand-off (Fravel 2008). Large scale fighting broke out in the Eastern Sector in 1969 in the Zhenbao Island (or Damansky Island) Incident when an ambush by PLA forces set off months of fighting along that border that nearly brought the two nuclear armed nations to full-blown war and resulted in hundreds of casualties (above the threshold of war set by the definition of the Correlates of War Project).

The collapse of the Soviet Union and the end of the Cold War brought about a new opportunity to settle these long-standing territorial issues between China and Russia. In 1991, the treaty concerning the east section of the Sino-Russian border was concluded; the treaty was ratified in 1992 and later implemented in 1997 and settled a 4,300 square kilometer section along the Ussuri and Amur rivers (the majority of the disputed territory)[39]. In 2004 a final border agreement on the status of a few remaining river islands in the Eastern Sector was finalized. In 1994 negotiations began to settle the Western Sector disputes bordering Xinjiang with the Russia, Kazakhstan, Kyrgyzstan, and Tajikistan; these agreement was implemented in 1998[40]. As noted in the earlier section, these border agreements made possible the first Sino-Russian Strategic Agreement and the formation of the SCO in 1996.

But as Figure 12 shows, Sino-Russian trade was quite low for most of the critical period of negotiations prior to 1993/1994 and only increased dramatically after Jiang and Yeltsin agreed to open up additional border crossings in 1993. However efforts to negotiate a settlement of the disputed borders took place in multiple rounds of talks 1960-1964, 1969-1978, 1987-1991 between China and the USSR during which economic interdependence was low[41]. The final round of talks that began under Gorbachev when "border negotiations proceeded in a friendly atmosphere" of Sino-Soviet normalization and working groups of experts from both countries started joint aerial photography of the disputed areas along both the Western and Eastern Sectors. The expert opinion of these working groups laid the basis for not only the

[39] Joint Declaration by the People's Republic of China and the Russian Federation, adopted at Beijing on 25 April 1996 http://www.un.org/documents/ga/docs/51/plenary/a51-127.htm

[40] Ibid.

[41] Cheng Yang, "Sino-Russian Border Dynamics in the Soviet and Post-Soviet Era: A Chinese Perspective", Conference Paper for 7th Berlin Conference on Asian Security, July 1-2, 2013. https://www.swp-berlin.org/fileadmin/contents/products/projekt_papiere/BCAS2013_Yang_Cheng.pdf

Agreement on the Eastern Part of the Sino-Soviet Border in March 1991 (before the collapse of the USSR), which was later approved by the newly independent Russia in February 1992, but also for the terms of the Sino-Kazakhstan, Sino-Kyrgyz, and Sino-Tajikistan Border Agreements that were later approved in 1994.[42] In 1993, China's trade dependence on Russia was low at 0. 38% and Russia's trade dependence on China was low as well at 0.73%. The evidence weigh in favor of border resolutions creating political momentum for bilateral economic development rather than the transformation of national interests by deepening trade integration.

Figure 12 China-Russia Trade and Conflict

The Indian Border

The pattern of territorial settlement of the various sectors of the disputed border with India reflect a similar pattern of "trade following the flag" as the Russian case. China's border dispute with India is also separated into a western sector and an eastern sector. In the west, the

[42] Ibid.

dispute involve features including the Trans-Karakoram Tract, Jammu and Kashmir, and Aksai Chin (sometimes considered the central sector) and in the east the dispute involve features such as Eastern Ladakh, Arunachal Pradesh, Sikkim, and Doklam. Figure 13 shows a map of most of these disputed features (Doklam is not labeled and is located in the thin strip of land where China, India, and Bhutan meet along the western border of Bhutan; Sikkim is also not labeled and is located where India meets China in the same strip of land). The origins of the dispute can be traced to the collapse of the Qing Empire and the collapse of Chinese power in Tibet in 1911 and the expansion of British influence in the region. The British convened the Simla Conference in 1913 to demarcate Inner Tibet (where China will maintain suzerainty) and Outer Tibet (where British India will exercise sovereignty) at the so-called McMahon Line (Hoffman 1990). After India gained independence in 1947, it claimed the McMahon Line as the demarcation between what is now the Indian state of Arunchal Pradesh and southern Tibet. China withdrew from the Simla Conference and has never acknowledge the validity of the McMahon line. So when PLA forces reestablished Beijing's effective control over Tibet in 1950 and over Aksai Chin in 1951, the competing territorial claims along the eastern Indian border as well as over the Ardagh-Johnson Line (another British proposal where Beijing did not agree but the local government in Xinjiang signed to during the chaotic final years of the Qing Empire which classified the strategically important Aksai Chin plateau as part of British India) in the western sector became a source of conflict for the newly independent India and China.

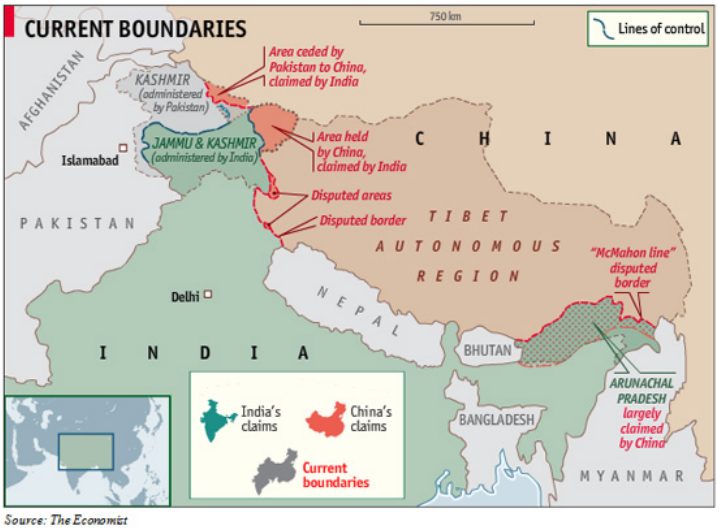

Figure 13 Map of China-India Border Disputes

China views control over Aksai Chin as crucial because the territory linked Xinjiang and Tibet; the Indian government aware of Chinese activity as early as 1951 but chose to ignore it due to the fact that Aksai Chin was too remote for effective Indian jurisdiction and was judged to hold few natural resources and that Sino-Indian relations in the 1950s were marked by the Five Principles of Peaceful Coexistence (two of which, ironically, were mutual non-aggression and mutual respect for sovereignty). However, Beijing's 1957 announcement of its road-building activities in Aksai Chin makes it impossible to for India to continue ignoring China's presence (Hoffman 1990). A proposal by Zhou Enlai to settle the border issue by recognizing Indian control over Arunachal Pradesh and Chinese control over Aksai Chin was rejected by Jawaharlal Nehru in 1957 and again in 1960 (Garver 2011). Sino-Indian relations continued to deteriorate after the failed Tibetan Uprising in 1959 (when the Dalai Lama successfully sought asylum in India) and would culminate in the 1962 Sino-India Border War. The PLA would score a decisive victory in that conflict and China unilaterally imposed the proposed "east-west swap" as the terms of peace. Numerous clashes would occur along the disputed border regions

between the two countries throughout the 1960s and 1970s even after the normalization of diplomatic relations in 1976.

In 1988, following a particularly tense standoff in Arunachal Pradesh in 1985-1987, Rajiv Gandhi became the first Indian Prime Minister to visit China in three decades and met with Deng Xiaoping to de-escalate the crisis and the two countries set up a joint working group to settle border issues. Chinese premier Li Peng would pay a return visit to India in 1991 and once again pledged to settle the territorial disputes but after six-rounds of negotiations of the working group, no progress was made on border issues when the two sides signed a cross-border trade agreement in 1993 along with a face-saving Maintenance of Tranquility Agreement (Fravel 2008). This would be augmented by a Confidence Building Measures Agreement in 1996 when Jiang Zemin became the first Chinese head of state to visit India. Finally, China and India agreed to a Principles Agreement in 2005 that repudiated the use of force to settle the border issue but did not reach consensus on the issue of final settlement (exception for Sikkim, over which China withdrew its claims in 2003 as a goodwill gesture in negotiations during Prime Minister Atal Behari Vajpayee's state visit).[43] These agreements are notably much less comprehensive and more vague than the Sino-Soviet border agreements negotiated in the 1990s.

The question therefore remains whether growing economic interdependence was the cause of or the consequence of these incremental moves towards settlement of the Sino-Indian border disputes. Following the 1993 agreement, bilateral trade began to accelerate rapidly, from

[43] Indian Ministry of External Affairs, "Agreement between the Government of the Republic of India and the Government of the People's Republic of China on the Political Parameters and Guiding Principles for the Settlement of the India-China boundary Question" http://www.mea.gov.in/bilateral-documents.htm?dtl/6534/Agreement+between+the+Government+of+the+Republic+of+India+and+the+Government+of+the+Peoples+Republic+of+China+on+the+Political+Parameters+and+Guiding+Principles+for+the+Settlement+of+the+IndiaChina+Boundary+Question

$265 million in 1991 to $1.8 billion in 1997 to over $19 billion in 2005. Since 2001, China's trade with India has grown more rapidly than its trade with any of its top 10 trade partners.[44] The percentage share of India's trade with China went up from 0.18% in 1991 to around 7% of India's total trade in 2005. Similarly, China's trade with India grew from only 0.05% in 1991 to 1.25% in 2005. In terms of trade dependence, the relationship went from low for both countries in 1991 to high for both countries by 2005. But what both the 1993 Maintenance of Tranquility Agreement and the 2003 agreement by both sides "to cultivate economic ties without being constrained by unresolved border disputes" [45] show is that economic integration is proceeding without waiting for the political settlement of territorial disputes. These agreements should not really be interpreted as evidence of the transformation mechanism working to resolve political disagreements over the disputed border in a way that would create positive peace. Instead, they are face-saving measures designed to allow trade and cooperation to continue despite the lack of resolution of the intractable border issues (therefore on the negative peace side of the spectrum). An optimist would still see these dynamics as a positive development because leaders on two sides seem to be actively trying to avoid military conflict over border issues as economic interdependence increases. But a pessimist would point to the 2017 standoff between China and India troops in Doklam (eastern sector) as evidence that MIDs will likely continue to occur until a final settlement over the disputed border can be reached.

[44] "China and India: Greater Economic Integration," *China Business Review,* September 1, 2009. https://www.chinabusinessreview.com/china-and-india-greater-economic-integration/
[45] Ibid.

The Vietnam Border

The land border dispute between China and Vietnam differ somewhat from the Russian and Indian border disputes in that it is a direct result of combat operations and not rooted in conflicting historical claims. Beijing had initialed supported the communist government in Hanoi during the First and Second Indochina Wars, first against the French and then against the Americans (Chen 2010). But the Sino-Soviet Split in early 1960s resulted in China and Soviet Union both contending for "Communist orthodoxy" in East Asia, and in turn, led to North Vietnam becoming the key player in the region that both Beijing and Moscow wished to patronize. The new government in Hanoi eventually chose the Soviet Union as the primary cooperative partner over China by the mid-1970s due to two reasons: 1) the establishment of diplomatic relations between China and the United States in 1971 was read in Vietnam as a signal of ideological betrayal and 2) Hanoi's desire to wield its power as a major actor in Southeast Asia became a source of tension in its interactions with Beijing (Womack 2006). In June 1978, Vietnam joined COMECON, the Soviet-led Council for Mutual Assistance, with both sides signing a treaty of friendship and cooperation in in the following November. But it was Vietnam's invasion of Cambodia in December 1978 that prompted Beijing to intervene militarily to teach Hanoi a lesson. The overthrow of PRC-backed Khmer Rouge was seen by Beijing as an overt provocation and challenge to China's influence in Southeast Asia and also an opportunity to signal its resolve to the Soviet Union.

On February 17 1979, China massed some 300,000 troops, with of thousands of aircrafts and tanks, along Sino-Vietnamese land border. It then dispatched around 80,000 active forces along three invasion routes into Vietnam and fought a short, bloody, and indecisive war against 75,000 to 100,000 battle-hardened Vietnamese veterans (Womack 2010). After a month of

fighting, Chinese forces withdrew to positions along the mountainous border after attaining its desired outcome of capturing provincial capitals for five of the six border provinces of Vietnam after heavy losses. Both sides claimed victory at the end of the conflict and settled in for a long stand-off along the border. Beijing did not intend to occupy or permanently conquer Vietnamese territory with this campaign. But in the decade that followed, the two sides fought multiple skirmishes along the land border to capture strategic points along in the mountainous terrain.

Cross-border trade between China and Vietnam had all but stopped during the war and in the long siege that followed. It took until the end of 1988 for Hanoi to scale down the troops deployed along the border area, as the end of Vietnam's Cambodia invasion resulted in China decreasing both the quantity of troops deployed and the frequency of artillery shelling at the border (Womack 1994). By November 1988, the Vietnamese politburo issued a document allowing its border provinces to resume trading with China. Beijing and Hanoi normalized diplomatic relations in November 1991. By 1992, a variety of Vietnamese foodstuffs and commodities were being exported to China (with crude petroleum accounting for 62% of Vietnamese exports that year) for a total value of $66 million. Though the numbers were not recorded, Chinese consumer goods also began flooding into the Vietnamese market. This influx of Chinese imports prompted Vietnam to enact an import ban on seventeen categories of goods from September 1992, which specifically aimed at limiting Chinese consumer goods, ranging from electronic parts to household products. Hanoi wished to turn around the trade deficit by protecting its domestic manufacturing sectors by doing so. However, as the lack of competitive Chinese products left discontent consumers seeking higher-quality commodities via illicit means, which consequently led to smuggling activities quickly evolving out of authority's hand, the ban was sharply reduced to only three categories of good by April 1993 (Womack 2010).

Chinese exports to Vietnam quickly dominated latter's consumer markets and contributed to a trade imbalance ever since 1995. But China's exports to Vietnam only constitutes a rather tiny portion of its foreign trade in total. The total trade volume between China and Vietnam experienced a nearly six-fold increase from $109 million in 1989 to $584 million in 1992. However, the $584 million trade with Vietnam merely accounted for 0.04% of China's total trade in 1992. By comparison, trade with China accounted for more than 7% of Vietnam's total trade that year. As a share of GDP, China's trade with Vietnam would not rise to a high value of trade dependence until 2009 but Vietnam has been highly dependent on trade with China since 1993-1994. It is against this context of highly asymmetric economic interdependence that the China-Vietnam Land Border Treaty was negotiated and signed in December 31, 1999.

At first glance, this border treaty appears to lend support to the transformation mechanism. Increasing economic interdependence seems to have been a driver of the Sino-Vietnamese land border settlement. But there are several important caveats we must make to this naive interpretation. First, the decision for the settlement of the land border dispute began at the same time as normalization when economic interdependence was low for both sides. Negotiations took eight years (1991-1999) to complete and involved dozens of rounds of meetings between experts and government officials from both sides, the final settlement used the latest technologies to settle minor disputes along the entire 1300km border and will be implemented by 12 joint working teams tasked with demarcation using some 2000 border markers.[46] Thus, while the conclusion and implementation of the treaty took place at a time

[46] "China and Vietnam Sign Land Border Treaty," Ministry of Foreign Affairs of the PRC, http://ph.china-embassy.org/eng/xwdt/t538851.htm

when economic interdependence (particularly Vietnam's trade dependence on China), the causal arrow should be reversed – the political settlement of the border dispute led to the rapid increase in trade that we observed in the 1990s. Second, while the land border was settled, China and Vietnam were engaged in an escalating set of maritime disputes over disputed features in the Spratly and Paracel Islands as a result of the 1996 ratification of UNCLOS. These maritime disputes in the SCS would be the source of many MIDs in the subsequent years and will be the focus on the Vietnam case study in the next chapter. Thus, when economic interdependence seemed to be transforming national interests to settle one set of territorial disputes, China and Vietnam were actively escalating another set of disputes in the South China Sea.

4.2 Summary

Figure 14 summarizes the results of economic interdependence on alliance formation and territorial dispute settlement in my dataset by tabulating the number of dyad years in each outcome category. The expectation of the transform mechanism is that trade should lead to two comparative statics: 1) for high interdependence cases, the transformation of national interests should shift countries from the bottom row (cause of conflict) to the top row (source of peace) and 2) the high interdependence cases (top) should be have a lower causes of conflict than low interdependence cases (bottom).

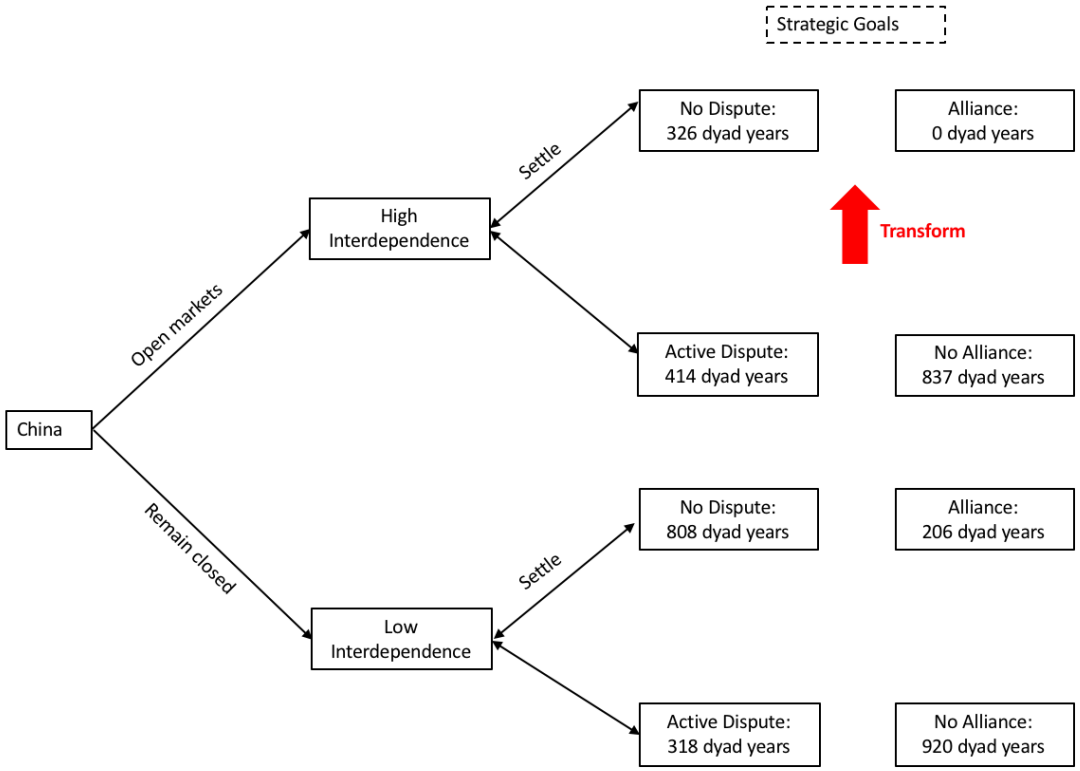

Figure 14 Summary Statistics of the Transform Mechanism

Neither of these expectations were met. If we look at alliances, there are 0 dyad years where China had an alliance with a highly interdependent trade partner and 837 dyad years where it did not. Of the 206 dyad years where China did have an alliance, all were with low interdependence partners. This suggests that trade did not produce a transformative alignment in either China's or the partner country's alliance formation behavior. The territorial dispute settlement results follow a similar pattern. China was no more likely to have an active territorial dispute with high interdependence partners (414 = 21%) than not (326 = 17%). The rates of active territorial disputes are not higher for low interdependence partners (318=16%) and the

cases where there is low trade and also no territorial disputes is the modal outcome (808= 41%) but this is largely driven by geography. We can safely reject both transform hypotheses.

Hypothesis 2a: As trade interdependence increases, China will be more likely to enter into an alliance with the partner country (transform mechanism).
Hypothesis 2b: As trade interdependence increases, China will be more likely to settle territorial disputes with the partner country (transform mechanism).

The failure of economic interdependence to eliminate the underlying causes of conflict is significant because alliances and territorial disputes are major drivers of militarized interstate disputes (MIDs). As I noted earlier in this chapter, the vast major of Chinese uses of military force in foreign policy can be explained by its dissatisfaction with the status quo in ongoing territorial disputes and the Cold War alliance structure in East Asia. The two previous sections on the potential of economic interdependence to transform national interests on settlement of territorial disputes and the formation of military alliances were unpromising. It should not be surprising, therefore, that the final test for the effects of the transformation mechanism on China's assertiveness in foreign policy. The expectation is that China should be less assertive or aggressive in its foreign policy towards countries with which it is more trade dependent.

Table 5 divides all of the militarized disputes involving China by trade dependence and territorial dispute in that year. Each case is a country year where a militarized dispute (MID) occurred (ex. Taiwan 1995). If the MID occurred in a year before the territorial dispute was settled in a treaty or boundary agreement, it is placed in the "territorial dispute" column. The

rows are created by taking the mean value of China's trade dependence in the year when the MID occurs, if China is more trade dependent on the target country in that year it is classified as high and low if otherwise. I group the MIDs by the disputed feature that they are fought over. For example, the United States is shown to be involved in a MID in 1995 over Taiwan. This reflects the deployment of the Carrier Group Seven (USS Nimitz) and Carrier Group Seven (USS Independence) to the Taiwan Strait during the 1995-1996 Strait Crisis as a show of force. This MID was over a disputed territory (Taiwan) even though the United States is not a claimant in that dispute. And it occurred in a year when China was highly trade dependent on the United States. I **bold** (and label) those disputes that are higher in intensity. This list was generated from the International Crisis Behavior (ICB)'s list of militarized crises cross-referenced with secondary sources such as Fravel (2008) to add events that are comparable to ICB cases but are not included in that dataset. For example, I bold the Senkaku/Diaoyu Standoff in 2012 even though it is not coded as an ICB crisis because it fulfills each of the criteria that ICB uses to define a crisis: "an event which leads decision makers to 1) perceive a threat to basic values, 2) time pressure for response and 3) heightened probability of involvement in military hostilities." Similarly, ICB includes the 1959 border standoff between China and India after China begins the construction of the Aksai Chin road in disputed territory as a crisis. However, it does not include a very similar standoff in the Sumdorong Chu Valley between China and India in 1987 after India granted statehood to Arunachal Pradesh, which China claims as South Tibet. Even though it is not included in the empirical data used in the analysis I also include the 2017 standoff between China and India in the Doklam region of their shared border with Bhutan in this table.

Table 5 Militarized Disputes Involving China by Trade Dependence and Border Status

	Territorial Dispute	Not Territorial Dispute
High Trade Dependence	Taiwan: **Taiwan 1995 (Taiwan Strait IV)**, Taiwan 1993, 1994, 2001, 2002, 2004, 2005, 2007; Australia 2001, United States 1995, 2000 Spratly Islands: **Vietnam 2014 (Chinese Oil Rig)**, Vietnam 1996, 1998, 2003, 2010, 2011, 2012, 2013, 2015; **Philippines 2012 (Scarborough Shoal)**, Philippines 1998, 2016; Indonesia 1996, Malaysia 2014 Paracel Islands: Vietnam 2002, 2011, 2012, 2014, 2016 Senkaku/Diaoyu Islands: **Japan 2012 (Senkaku/Diaoyu Standoff)**, Japan 1978, 1995, 1999, 2004, 2005, 2009, 2010, 2011, 2013, 2015, 2016; United States 2013 Yellow Sea EEZ: South Korea 2010 India border: India 1954, 2003, 2005, 2007, 2009, **India 2017 (Doklam Standoff)*** Russia border (eastern): USSR 1960; Russia 1994 Mongolia border: Mongolia 1999 North Korea border: North Korea 1993, 1995, 1997, 2003, 2010	United States **2001 (EP3 Incident)**, 1993, 1994, 1998, 1999, 2002, 2009, 2013, 2014, 2016 Russia 1993, 2009 Japan 2002

Table 5 Militarized Disputes Involving China by Trade Dependence and Border Status, cont.

	Territorial Dispute	Not Territorial Dispute
Low Trade Dependence	Taiwan Strait: **Taiwan 1949 (Chinese Civil War),1954, 1955 (Taiwan Strait I)**, **1958 (Taiwan Strait II)**, **1962 (Taiwan Strait III)**, Taiwan 1950, 1951, 1952, 1953, 1956, 1957, 1959, 1963, 1965, 1966, 1988, 1991; United States 1958 Paracel Islands: **Vietnam 1974 (Seizure of Cresent Group)** Spratly Islands: South Vietnam 1950, 1959, 1961, **Vietnam 1988 (Occupation of Spratly Islands), 1995 (Occupation of Mischief Reef)** Yellow Sea EEZ: South Korea 1955, 1960 India border: **India 1959 (China/India Border I), 1962 (China/India Border II)**, **1967 (Nathu La Clashes)**, **1987 (Sumdorong Chu Standoff)**, India 1963, 1965, 1966 Vietnam border: **Vietnam 1979 (Sino/Vietnam War), Vietnam 1984 (Sino/Vietnam Border I)**, **Vietnam 1987 (Sino/Vietnam Border II),** Vietnam 1981, 1983 Laos Border: Laos 1961, 1979 Russia border (eastern): **USSR 1969 (Ussuri River),** USSR 1966, 1967, 1968, 1969, 1978, 1980, 1986 Mongolia border: Mongolia 1965, 1973, USSR 1974 Burma border: Myanmar 1956, 1959, 1965 Nepal border: Nepal 1959, Nepal 1960	**South Korea 1950, 1951 (Korean War I, II, III),** 1955, 1976, 1985 United States 1953, 1954, 1964, 1966, 1967

A few patterns immediately jumps out of this qualitative analysis that was not apparent in the statistical analysis from Chapter 3. First, nearly all (84%) of the MIDs involving China can be attributed to an unresolved territorial dispute while only 16% are unrelated. Many of

these such as the 2001 EP3 Incident between China and the United States and the 2009 incident between Russia and China in which the Russian coast guard sank a Chinese merchant ship that attempted to flee port after a dispute over the cargo contained in the ship are accidents. Though others are more serious and are motivated by strategic competition, particularly between China and the United States over the latter's network of alliances in East Asia. These include the MIDs related to the Korean War (1950-1953) in which over 50,000 American servicemen and as many as 200,000 Chinese volunteers died fighting on the Korean peninsula. These also include the 2009 USS Impeccable Incident when several Chinese vessels and aircraft harassed the US surveillance ship Hainan Island and the 2013 USS Cowpens Incident in which a Chinese warship nearly collided with the US cruiser in the South China Sea. These incidents were shows or uses of force to impede the right of US naval vessels to operate in what China sees as its Exclusive Economic Zone without permission rather than over the status of a particular disputed feature.

Second, the number of MIDs between China and countries with which it is trade dependent (51%), such as the United States after 1976 or Japan after 1972, is comparable to the number of MIDs with countries with which it is less trade dependent or not trading at all (49%), such as the United States prior to 1972 or Vietnam before 1999. However, the majority of the higher intensity MIDs (73%) and all of the wars that involve China are with adversaries which China is less trade dependent or not trading at all. Only 27% of serious MIDs are involve trade dependent targets and none of these involve the deliberate use of deadly violence. Military force was used as a threaten or intimidate the target but escalation was carefully controlled. In none of these cases was the real economy significantly impacted or trade flows disrupted by the MID. This is very much consistent with the stability-instability mechanism and with the regression

results presented in Chapter 3 but not consistent with the expectations of the transformation mechanisms. Causal process tracing of this mechanism reveals that it is highly unlikely that growing economic interdependence can transform national interests enough to elimination of the causes of conflict and contribute to positive peace. This is not to say that the effects of economic interdependence to create negative peace such as greater policy coordination (including on security issues) outcomes is not important. My point is merely that we should not conflate the potential for economic engagement to transform national interests and contribute to negative peace in non-zero sum, cooperative domains with its potential for transforming national interests in more difficult zero-sum contests such as territorial disputes or military alliances.

Chapter 5 Does Interdependence Constrain or Inform Bargaining?

Chapter 5 examines how economic interdependence operates within a zero-sum bargaining setting (operationalized as the division of a piece of disputed territory). We have already established that trade does not make China any more likely to compromise on territorial sovereignty. The analysis in this chapter will focus on whether economic interdependence changes how China bargains, particularly whether or not it is less likely to use military force. The constrain mechanism predicts that economic interdependence should have no effect on the likelihood of military force but the logic of opportunity costs should reduce the likelihood of economic sanctions. The inform mechanism predicts the opposite, that economically interdependent states will be more likely to signal using economic instruments rather than military force.

5.1 Choosing Between Military Force and Economic Coercion

The key insight of the constrain mechanism is that economic interdependence between countries increases the opportunity cost of actions that risk disrupting these ties. What is unclear is what classes of actions at which thresholds would cause disruptions to bilateral economic ties. We are reasonably sure that the outbreak of war is above this threshold but we are less confident about uses of military force short of war. For trade to act as a barrier to conflict at these lower intensities, commercial losses anticipated from fighting must be large relative to the overall cost of fighting. Relatively few bilateral trade relationships are substantial enough to accomplish this and we can use market data to observe the disruptive effects of conflict

directly. We can then compare the size of these disruptions to those caused by economic sanctions and arrive at a better understanding of the opportunity costs of these two instruments.

The inform mechanism produces a different set of expectations about the structure of opportunity costs under economic interdependence. Scholars like Gartzke (2007) have argued that competing through economics rather than warfare makes the use of force unnecessary if the economic costs incurred and imposed are sufficiently informative. If interdependence informs, then trading states should tend to substitute non-militarized for militarized conflict, doing more to reduce the intensity of disputes than to lower frequency. "Interdependent and economically integrated states face the prospect of economic losses if the leaders of these states pursue competitive political goals. Costly signaling through economic interdependence suggests that it is not the possession of economic linkages, but the differential willingness of competitors to relinquish their trade benefits in a competition demonstrate resolve in almost the same way as states that are willing to fight. Interdependent states can "fight" through their economic linkages, so that they sometimes are able to avoid more costly military action" (Gartzke 2003, p. 103). This logic is compelling but assumes that economic interdependence creates higher opportunity costs for use of military force than for economic coercion because the substitution of one for the other only makes sense if this is the case.

While economic interdependence gives states the means to signal using economic coercion (to fight economically rather than militarily), it also makes the use of economic sanctions more costly. As discussed in the previous section, economic interdependence creates opportunity costs for using economic coercion because the closer one's own economy is integrated with that of another country, the more economic sanctions against that country would

hurt own's own economic interests. Indeed, this piece of insight is so blindingly obvious that it has been ignored by most scholars of economic sanctions. The economic sanctions literature has focused on topics like whether or not whey work (Pape 1997; Elliott 1998; Baldwin and Pape 1998) to how and when do they work (Martin 1994; Drezner 1999; Lacy and Niou 2004; Drezner 2011; Hovi, Huseby, and Sprinz 2005; Ang and Peksen 2007; Cox and Drury 2011) to how long they last. Rarely have this literature considered economic interdependence as a scope condition that constrains the use of economic sanctions in the first place.

I hope to fill these two blind spots in our theoretical understanding about the ease with which sanctions can be an effective substitute for military force by empirically testing the observable implications of this mechanism. Gartzke and his co-authors have used the same dyad year datasets that typically has MIDs as a dependent variable to test their theory. MIDs where military force was not used are considered non-militarized. This is problematic because a non-militarized MID is not necessarily validation of the 'competing through economics' hypothesis. A military threat such as putting forces on alert or mobilization of troops (which carries incremental military costs) would be coded as a level 2 or 3 MID even though there is no economic dimension to this move. Evidence of lower intensity conflicts is not the same thing as evidence of economic competition. There's no doubt that interdependent states engage in economic competition, but unless states are fighting trade war in lieu of real wars, this cannot be used as evidence to support this theory.

But if anything we see the opposite, China has deepened economic cooperation with long standing political rivals and generally refrains from taking actions that would roil economic markets (like linking threat of tariffs to gain political leverage on other issues or encouraging nationalist consumer boycotts), but it has increased its use of military and

paramilitary force to increase its bargaining leverage in the South China Sea. The quantitative analysis from Chapter 3 suggest that it is improbable that China is substituting economic sanctions for military force since both are increasing as economic interdependence increases. This is because economic statecraft is difficult even in economies with large state-owned sectors due to the principal-agent relationship between the state and its firms (Norris 2016). Effective sanctions also require international cooperation (Martin 2001) to be effective and the compliance of multinational companies. China still lacks the authority and centrality in the global economic system to be able to achieve either of these easily as is evidenced by its troubles getting multinationals to be more compliant with its "One-China Policy". In fact, the political costs that economic coercion accrue can be greater than military coercion and they make for unwieldy tools in costly signaling.

While the observable implications of the information mechanism, the substitution or lack thereof of economic coercion for military coercion as economic interdependence increases, is relatively straightforward; evidence of the causal process is extremely difficult. The decision to use one set of foreign policy instruments over another is fundamentally an elite driven process. In the ideal world, I would want to obtain transcript evidence on the Chinese decision making process and hope to show that leaders at different times considered both sets of instruments but ultimately decided to pursue one but not the other due to considerations related to economic interdependence. I do not have this kind of elite level access to policy makers but will instead measure the opportunity costs associated with uses of military force and economic sanctions using share stock market data. This type of analysis will lend insight into the constrain and inform mechanisms that the regression analysis presented in Chapter 3 cannot accomplish.

Measuring China's Use of Economic Coercion

Following the code book for the TIES dataset, I expanded the data with cases of economic coercion involving China. Economic coercion was operationalized as the threat or imposition of economic sanctions (defined as total economic embargo, partial economic embargo, import restrictions, export restrictions, blockade, asset freeze, termination of foreign aid, travel ban, and suspension of economic agreement) involving China and one of the 31 countries of interest that can be identified in *Lexis Nexus, Factiva*, or the *New York Times*. I adopted relatively lax criteria for inclusion into the dataset: if two reputable sources mention the event, then we include it. China's use of economic coercion is complicated because the government denies allegations that it is intervening in the economy for political reasons and does not have a transparent process like that of Office of Foreign Asset Controls (OFAC) in the United States Department of the Treasury. Thus, the uncertainty around whether or not a sanctions episode has occurred or is in fact intended as economic coercion (that it was politically motivated) is the subject of some debate. Nevertheless, this criterion most closely approximates the approach adopted by the TIES team and also biases against my theory.[47]

This effort identified 39 episodes of economic coercion (both threats and imposition) in which China was the initiator (see Table 6). In the majority of these cases, the primary issue was over trade practices that are part of routine trade disputes rather than cases of economic coercion (using trade to change political behavior). In these cases, sanctions are threatened to compel the target state to alter a trade practice or to punish a target state for engaging in protectionist measures, trade restrictions, or devaluations. This is why there appears to be a

[47] CFR v1.0 also accepted the original TIES data on China without trying to modify it, partly because the documentation for these cases were missing and partly because we can't afford to throw them out because there aren't that many cases.

dramatic drop in the frequency of TIES targeting China in the 2000s compared to the 1990s. After China joined the WTO in 2001, the U.S. and Japan had the option of going through the WTO dispute mechanism rather than relying on unilateral trade actions against China.[48] There also appears to be a trend that Chinese economic sanctions became more frequent after its economic engagement with the world grew in the 1990s and 2000s.[49]

Table 6 Economic Sanctions Initiated by the PRC (1949-2016)

	1950s	1960s	1970s	1980s	1990s	2000s	2010s	Total
USA	0	0	0	1	5	1	1	8
JPN	0	0	0	1	0	3	2	6
ROK	0	0	0	0	1	0	4	5
RUS	0	1	1	0	1	1	0	4
PHIL	0	0	0	0	0	0	4	4
VIET	0	0	1	0	2	0	0	3
DPRK	0	0	0	0	0	0	2	2
Other	1	2	0	0	3	0	1	7
Total	1	3	2	2	12	5	14	39

However, setting aside trade practices related to sanctions that are questionable examples of economic coercion, only sixteen sanctions initiated by China remain. Of the China-initiated sanctions: one was a trade restrictions imposed on Russia as part of the Sino-Soviet

[48] To date there are 15 cases involving China brought to the WTO, these are not yet included in CFR v1.0
[49] There are many problems with the TIES data and coding rules: 1) Imperfect measure because cost of sanctions very difficult to calculate and often missing. 2) Whether an actual sanction has taken place is difficult to know because China does not have an announced sanctions policy. 3) Conservative measure because false positives such as bananas ban and Fukushima fish ban are included here (low intensity, not necessarily coercion but just economic restrictions)

split, one was suspension of diplomatic ties with Myanmar after Anti-Chinese riots expelled ethnic Chinese in 1967, one was a blockade of Vietnam following the Sino-Vietnamese Border War in 1978, and another was an unspecified sanction against Vietnam in 1994. One is the ongoing standoff with South Korea over THAAD, and one was related to Philippines banana restrictions in 2012. The remaining three cases involved Japan: one was the suspension of some economic agreements after the removal of Hu Yaobang in 1987, one was the rare earths embargo case in 2010, and one was the suspension of seafood imports after the Fukushima disaster in 2014. I need to check whether how the two the enforcement about sanctions against North Korea: Beijing supported UN Security Council Resolution 1718 in 2006 and Resolution 2375 in 2017 against Pyongyang's nuclear program. These are actually good examples because the willingness to use economic coercion involved some degree of pain from domestic Chinese firms and was meant to serve a clear policy purpose.

I also collected data on sanctions targeting, of which there were a total of 26 cases. Setting aside trade practices related sanctions, there remains 10 politically motivated sanctions targeting China, half are U.S. initiated efforts to put pressure on China to improve its human rights in the 1990s. The rest are three sanctions from Russia to contain Beijing's political influence and destabilize the regime after the Sino-Soviet split, one embargo by the U.S. after the Korean War, and one export restriction by Japan to control the proliferation of missile and satellite technology to China. The small number of 'true' economic coercion cases make statistical analysis difficult. One alternative measure is to code each country-year in which a sanction is still in effect as a 1. This would capture ongoing efforts such as the EU weapons embargo, for example, or US sanctions after 1989. However, many sanctions episodes involving China do not have clear end dates reported in the media.

Reduced Form Results

If commercial peace operates through the constrain mechanism, then we should expect higher opportunity costs to result from militarized disputes (MIDs) between more economically interdependent countries than those that are less interdependent. Moreover, we would be interested in observing the cost of that action both on the economy of the target country (because their commercial actors are more likely to be linked to one's own interests) as well as the economy of the initiator. But as discussed in the theory section, I anticipate that most militarized disputes (MIDs) will escalate to a high enough intensity to disrupt commerce between the disputants. If trade enables the inform mechanism, then we should expect that economically interdependent countries are more likely to use economic sanctions (TIES) and less likely to use MIDs. These expectations produce these two hypotheses about the correlation between economic interdependence and the onset of MIDs and TIES. Whether not these hypotheses are correct depend not only on the statistical correlation between interdependence and the outcome variables (military force and economic sanctions) but also on whether or not the structure of opportunity costs are consistent with the predictions of the mechanisms.

Hypothesis 3.1a: China is more likely to escalate a dispute using economic sanctions than military force as its trade dependence increases (inform mechanism).
Hypothesis 3.2b: China is more likely to escalate a dispute using military force than economic sanctions as its trade dependence increases (constrain mechanism).

I expect that economic sanctions will a much more pronounced impact on interdependent economies, so that even the threat or perception of sanctions might trigger a

market response. My argument is that increasing economic interdependence is more likely to constrain economic coercion than military coercion. I build on the regression analysis in Chapter 3, and show the results of economic interdependence on sanction onset in models 4-6.

Table 7 Logit Regression of Trade Dependence on Initiation of Militarized Disputes and Economic Sanctions by China (1949-2016)

VARIABLES	(1) Military Dispute Onset	(2) Military Dispute Onset	(3) Military Dispute Onset	(4) Sanction Onset	(5) Sanction Onset	(6) Sanction Onset
IV: Trade Dependence						
Target	2.180**	2.013	-24.71***	3.656	3.724	-3.363
	(0.919)	(1.672)	(9.349)	(4.139)	(5.107)	(2.973)
China	32.69**	34.34**	37.62***	51.56***	52.76***	52.06***
	(13.59)	(12.43)	(10.85)	(10.45)	(11.30)	(12.32)
Target* Territorial Dispute			28.13**			8.729
			(11.28)			(7.948)
Controls						
Regime Type	-0.0319	-0.0388	-0.0230	-0.0630	-0.0697	-0.0700
	(0.0618)	(0.0584)	(0.0715)	(0.0900)	(0.0751)	(0.0657)
Affinity	-0.726	-0.971***	-1.108***	-0.978**	-0.700	-0.684
	(0.493)	(0.297)	(0.308)	(0.496)	(0.427)	(0.440)
Capabilities	-1.335**	-0.518	-0.330	-0.759	-0.192	-0.177
	(0.657)	(0.449)	(0.481)	(0.710)	(0.452)	(0.384)
Development	-0.000147***	2.46e-05	0.000145*	-0.00174**	-0.00174**	-0.00225
	(5.39e-05)	(4.42e-05)	(8.69e-05)	(0.000864)	(0.000769)	(0.00149)
Contiguity	0.998*	0.271	0.245	0.846	0.330	0.594
	(0.559)	(0.539)	(0.457)	(0.816)	(1.092)	(1.067)
Distance	-1.413***	-0.165	-0.443	-2.825***	-0.491	-0.612*
	(0.489)	(0.452)	(0.345)	(0.364)	(0.463)	(0.333)
Territorial Dispute		2.407***	1.628***		3.197***	2.701***
		(0.554)	(0.383)		(0.648)	(0.739)
Constant	10.11**	-1.896	0.613	19.86***	-1.630	-0.249
	(4.867)	(4.878)	(3.930)	(4.128)	(5.055)	(3.291)
Observations	871	871	871	871	871	871

Robust standard errors in parentheses
*** p<0.01, ** p<0.05, * p<0.1

Contrary to my expectation, sanction onset is also positively and statistically correlated with China's trade dependence. Figure 15 uses the estimates from Model 6 to generate predicted probability of China initiated sanction across all possible values of China's trade dependence and target trade dependence. The trade dependence of the target does not have a statistically significant relationship with the likelihood that China initiates a sanction. This seems counterintuitive because one might expect sanctions to be used where they would have the most impact, but the results here are driven by the small number of cases that are very heterogeneous in terms of target trade dependence. Additionally, the variable only measures observed sanctions, and the scholarship on sanctions (Drezner; Lacy and Niou) explain why the shadow of sanctions might be effective in the cases of high trade dependence so that actual sanctions never have to be used. It should be noted that a very small number of events are driving these results, which are estimated with all the observations of economic sanctions to boost statistical power. For robustness, I did rerun the results with only political sanctions and the direction of the relationship is the same but the results lose statistical significance.

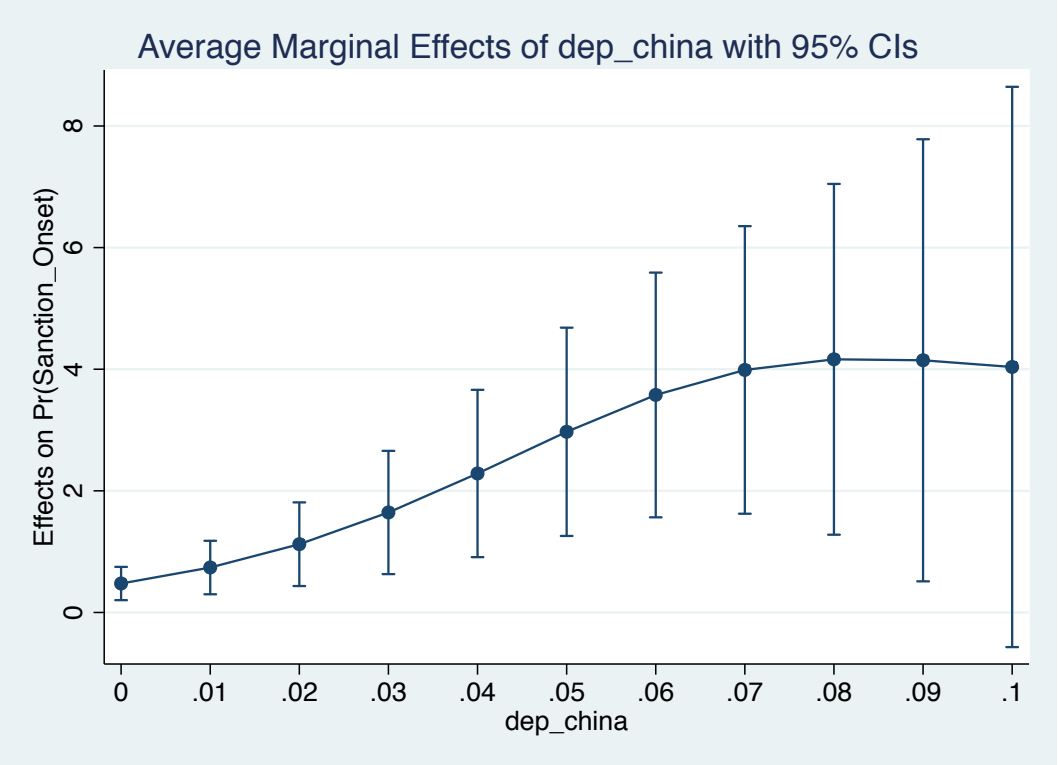

Figure 15 Probability of an Economic Sanction Initiated by China for Values of the China's Trade Dependence

Nonetheless, these results appear to be consistent with *Hypothesis 3.2b: China is more likely to escalate a dispute using military force than economic sanctions as its trade dependence increases (constrain mechanism).* When combined with the results on the initiation of militarized disputes, it does not appear to support the underlying mechanism behind the inform mechanism. It seems improbably that China is substituting economic sanctions for military force since both are increasing as economic interdependence increases. More work is needed to study the relationship of militarized disputes and economic sanctions within the same framework.

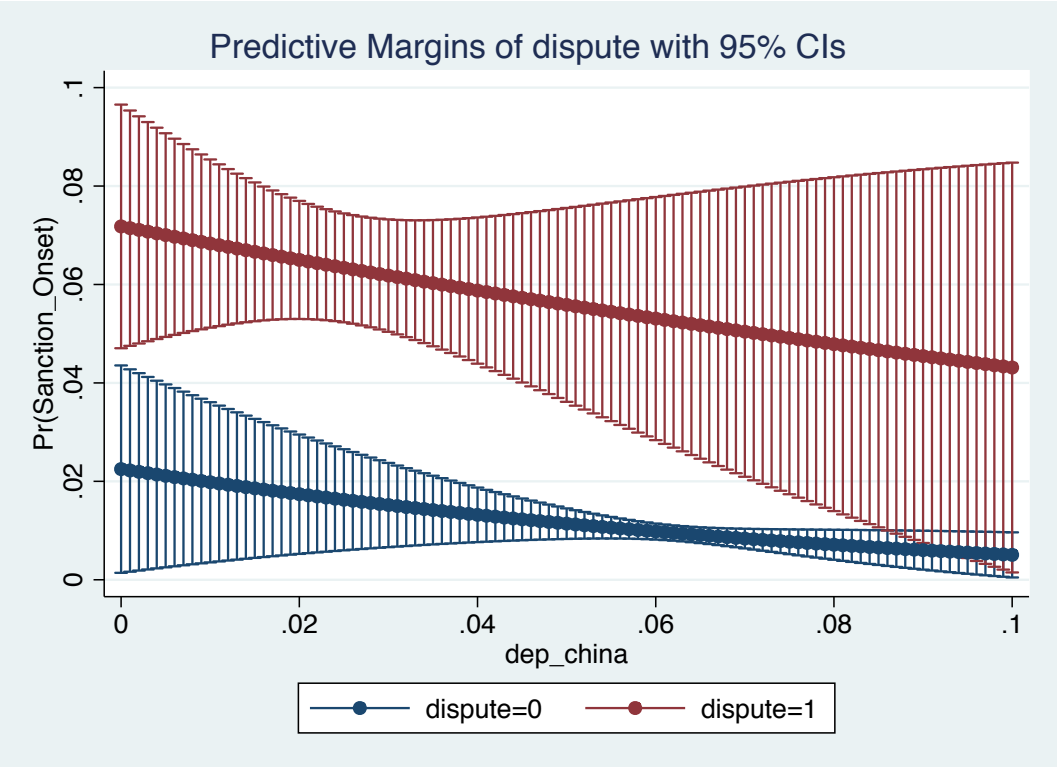

Figure 16 Territorial Dispute Status and Economic Signaling Results

Figure 16 show the predicted probability of sanctions onset by territorial dispute status. These results point to the status of territorial disputes as the key driver for China's use of coercion in foreign policy. Economic interdependence has a negligible effect when we take this key variable into consideration. Instead, ongoing territorial disputes may actually increases the probability of militarized disputes, regardless of economic integration, while decreasing the likelihood that economic sanctions are used. It should be noted that China uses military force in its foreign policy nearly ten times as often as it uses economic sanctions. This too suggests that the substitution of economic coercion for military force (hypothesis 3.2b) is unlikely as trade dependence increases. It is true that economic interdependence increases the cost of fighting, regional trade networks would be severely disrupted if fighting was to break out in the South China Sea. However, all of China's military actions related to these disputes fall well

short of war. They are calculated shows of force that are intended to deter, not to conquer. Bargaining theory, particularly Slantchev's military threats model, helps explain why military force of this sort remains an attractive foreign policy tool even as trade dependence increases. It also explains why, in zero-sum bargaining over territory, economic interdependence may constrain of military brinksmanship, precisely because both sides are trying to avoid war. The utility of signaling with military force lies in the fact that it is easier to calibrate and cause less collateral damage than the use of economic sanctions. Military signals allow Chinese leaders to achieve foreign policy goals specific to the status of the territorial dispute but not endanger the rest of the relationship with its economic partners.

As a more direct test of the substitution mechanism, I also estimate the predicted probability of the initiation of military and economic coercion by China using a multinomial logit regression. This has the advantage of capturing both key independent variables using the same model rather than dealing with them in separate regressions. I create a categorical variable to store the various measures of coercion which is coded 0 if no form of coercion was used, 1 if economic sanctions were imposed, 2 if a minor MID was initiated, and 3 if a major MID was initiated in that dyad year. This is my dependent variable for the large-n analysis. Each of the individual measures of coercion are binary, but taken together the various measures of coercion are mutually exclusive. All military disputes are either major or minor, and if both economic sanctions and militarized dispute were initiated during the same year (which occurred in 10 dyad years) the observation was coded as 1 in a separate variable (4 – Both) and recoded as N/A (.) for the other categories.

Table 8 display the results of a multinomial logit model with year fixed effects and robust standard errors to estimate the effects of trade dependence on type of coercion used. The dependent variable is divided into discrete categories and the multinomial model can estimate the effect of the explanatory variables for each of the different types of coercion used using none (0) as the baseline category.

Table 8 Multinomial Logit Regression of Trade Dependence on Choice of Military and Economic Coercion by China (1949-2016)

	(1)	(2)	(3)	(4)
VARIABLES	N/A	MID	TIES	BOTH
China Dependence		-7.867	-18.99	10.38
		(15.25)	(25.71)	(34.53)
Target Dependence		-2.181	-12.26	-27.67
		(2.708)	(13.42)	(21.62)
Territorial Dispute		2.391***	1.783	4.196
		(0.597)	(1.170)	(4.164)
Regime Type		-0.0819*	-0.132	-0.430
		(0.0438)	(0.0964)	(0.264)
Affinity		-2.325***	-2.398*	-6.475**
		(0.620)	(1.271)	(3.244)
Capabilities		-1.096**	-2.502*	-2.506
		(0.426)	(1.407)	(2.138)
Development		3.09e-05	0.000120	-0.000345
		(6.30e-05)	(0.000141)	(0.00169)
Contiguity		-0.405	-2.130	-1.571
		(0.615)	(1.327)	(3.222)
Distance		-0.737	-1.313	-5.481
		(0.540)	(1.003)	(3.555)
Time Trend		0.0827***	0.121**	0.262***
		(0.0292)	(0.0588)	(0.0924)
Constant		1.874	6.704	36.06
		(4.626)	(8.964)	(31.92)
Observations	893	893	893	893

Robust standard errors in parentheses
*** p<0.01, ** p<0.05, * p<0.1

The results show that economic interdependence does not have statistically significant with either the predicted probability for the use of military force or economic sanctions. Again territorial dispute status emerges as the single most significant predictor for China's initiation of MIDs. These results are not add much more insight beyond . There is also a concern that the categories do not fulfill the independence of irrelevant alternatives (IIA) assumptions. I conduct a series of IIA tests on the data and find this to be true (see Appendix E). That is the availability of other instruments do effect the probability that China would choose to use military force or economic sanctions.

5.2 Measuring Opportunity Cost in the Constrain and Inform Mechanisms

The reduced form results show that China is NOT constrained in its use of military force or economic sanctions as its economic interdependence increases. But what this sort of large-n can only provide us is the correlation between economic interdependence and militarized disputes and economic sanctions and not the causal mechanisms that underlie this relationship. This section will separately assess whether the structure of opportunity costs for MIDs and TIES support the constrain or inform mechanism. This analysis will consist of a crude form of causal process observation by showing whether or not the causal process stipulated in the theoretical model is valid or not (Haggard and Kaufman 2012). The method involve first a within-case analysis and coding and then aggregation across the population of cases. In a quantitative model, the effects of structural variables, such as trade dependence are estimated across a heterogeneous set of cases, some of which result in the absence of a militarized dispute as a result of the stipulated causal mechanism and many of which probably do not. The focus on average treatment effects masks the heterogeneity of militarized conflict and its absence

(both of which are overdetermined); the variable in question is either significant or not. By contrast, causal process observations do not ask whether the variable in question is significant, but whether the trade dependence of state actors conforms with the causal process stipulated in the theoretical model and result in a reduction of militarized conflict.

I adopt a research design where I select on the dependent variable (MIDs) to identify cases where it would be most likely to observe the opportunity cost mechanism at work. These would be the cases with the highest intensity of conflict and the highest values of economic interdependence (Goertze's 1,0 falsification cell); each case is the onset of a MID or a TIES from my dataset. These cases also represent the causal mechanism cell (1,1) for my theory, in which interdependence generates greater opportunity costs associated with economic coercion than military coercion.[50] I will measure opportunity costs as the abnormal returns on investment on the national stock market index of the target country on China (the Shanghai Composite Index). I operationalize this variable using data from Reuters Datastream which contains daily measures of the equity index with values converted to U.S. dollars to allow comparison across different indices valued in local currencies. I apply a rational expectation model of stock market returns to study the effect of the crises on valuations. Methodologically, I borrow the event study approach commonly used by economists to study the impact of terrorism on financial markets (Chen and Siems 2004; Drakos 2004; Abadie and Gardeazabal 2008), revise the model

[50] A bigger problem for this research design is the fact that the competing mechanisms predict the absence of an event, that in equilibrium MIDs or TIES or both should NOT happen due to anticipated opportunity costs. My research design can only reveal the presence or absence of opportunity for MIDs and TIES that we observe. TIES in particular are very rare, as are higher intensity MIDs. However, we can still gain valuable insights from this exercise even if we anticipate that these observations are right-censored. If an observed MID at a relatively high intensity is observed, then we can infer that the constraint mechanism is unlikely to work on MIDs below that threshold. Similarly, if we observe a TIES then we can assume that constraint is unlikely to stop economic sanctions of lower intensities. We can then compare the two thresholds and speculate about the room this leaves for higher intensity actions that would generate greater opportunity costs.

to apply to interstate conflict. I use stock valuation over traditional measures such as trade or investment flows because it contains near real-time information about how the conflict is perceived by the market to impact all other aspects of the nation's economy, through all the possible channels (ex. disruption of supply chains, canceling of contracts, consumer boycotts etc). It is an efficient aggregator of these different channels and available at a higher frequency than trade data (which is most often annual, sometimes quarterly) and investment data (which suffers from a high degree missingness). But equity index data also has some constraints, namely it requires a functional stock market. Also, only relatively developed economies are likely to have stock markets but this is not a problem for my case selection strategy. The two causal mechanisms produce the following hypotheses about the structure of opportunity costs:

Hypothesis 3.2a: When trade dependence is high, China's use of military force will be associated with negative stock market returns (high military opportunity cost).

Hypothesis 3.2a: When trade dependence is high, China's use of economic sanctions will be associated with negative stock market returns (high economic opportunity cost).

The Shanghai Composite Index (SSE) is only available after 1990.[51] Therefore, I am looking for the highest intensity incidents of militarized disputes and economic sanctions that

[51] The SSE is an index of all stocks traded on the Shanghai Stock Exchange. The Shanghai Stock Exchange (SHSE) and the Shenzhen Stock Exchange (SZSE) are the two stock exchanges operating in mainland China. The SHSE differ from SZSE in regard to their listing rules. The difference is often compared with the difference between the NYSE and NASDAQ in the United States. Listing in SHSE is associated with emerging from state ownership of the equity by already established companies, while listing in the SZSE usually means an initial public placement for a company that would otherwise remain privately owned. It is possible to determine whether a listed Chinese firm is engaged in B2B or B2C production using descriptions from the Chinese equivalent of 10-K filings (Nianbao, or annual report submitted to the Chinese SEC-equivalent which requires disclosure of all main business segments).

occurred after this point that target countries with which China has a high degree of economic interdependence. I tried to select for cases where the same country experienced both MIDs and TIES, but at different times, to construct a clean event window. Though I am not selecting cases based on the level of economic interdependence, comparison across events and across countries is possible with this design. The size of opportunity costs should scale with the degree of economic interdependence and may even vary based on factors such as the asymmetry of the trading relationship. Therefore, this design allow us to examine whether or not opportunity costs are functioning in the constraint mechanism as theorized but also allow comparison across countries and levels of economic interdependence. My analysis will focus on China's use of MIDs and TIES towards three countries: Japan, Taiwan, and the Philippines. These three countries were selected because they are highly economically interdependence with China, were targeted both by MIDs and TIES, and have stock market index data going back to 1990. I also considered South Korea (which was targeted by economic sanctions over THAAD but was not targeted by MIDs after 1990), India (which experienced MIDs with China but no cases of TIES since 1990), and Vietnam (whose stock market data only goes back to 2000 and also was not targeted by TIES since 1990s). Table 9 summarizes the six events, two per dyad that were selected to test the constraint mechanisms. The motivation behind the use of force, whether military or economic, in each of these cases was a dispute over sovereignty. I will provide more background on each of these cases and discuss how I identified the timing of the event later in this section.

Table 9 Selection of Cases for Event Study of Opportunity Costs

Target country	Event Type	Event Date	China's Trade Dependence	Partner's Trade Dependence
Taiwan	1) Taiwan Strait Crisis (MID)	July 21, 1995	High	Medium
Taiwan	2) Suspension of official exchanges and tourists (TIES)	May 20, 2016	High	Very High
Philippines	3) Mischief Reef Occupation (MID)	February 8, 1995	Low	Medium
Philippines	4) Banana ban and tourist warning (TIES)	May 4, 2012	Medium	High
Japan	5) Rare earths metals embargo (TIES)	September 22, 2010	Very High	Very High
Japan	6) Nationalization of Senkaku Islands (MID)	September 11, 2012	Very High	Very High

The event study methodology is commonly used in finance to identify abnormal returns to firms from a specific, unforeseen event. If investors respond positively or negatively to an event, we can expect to observe abnormal stock returns around the event date. This methodology has been widely used in the business and finance literature to study mergers and acquisitions but have been applied by some economists to political connections (Fisman 2001) and but has been seldom used by political scientists. The efficient markets hypothesis is at the core of event study methodology (Fama et al 1969). The hypothesis states that as new information becomes available, it is fully taken into consideration by investors and "priced into" the stock price of individual firms based on investor assessment of that firm's ability to withstand the impact of the event. Therefore, significant positive or negative stock price changes can be attributed to specific events. In the case of my study, I am assuming that investors can accurately assess the impact of various events in the escalation of tensions

between China and its trade partners on current and future economic performance of listed firms on national equity indices.

Since stock prices are random variables and behave stochastically. It is hard to evaluate the impact of a particular event on a collection of stocks systematically without establishing a standard of normal returns. The finance literature uses the following market model to assess normal returns.

$$r_{it} = \alpha_i + \beta_i r_{mt} + \varepsilon_{it}$$

This simply means the normal return for any national stock index (i) over time (t) can be best approximated by adding up the country-specific constant (α_i) plus the product of some country-specific coefficient (β_i) and the return of the market (r_{mt}) plus some error term (ε_{it}). Given this definition of normal returns, abnormal returns (the error term) can be represented as.

$$\hat{\varepsilon}_{it} = r_{it} - \hat{\alpha}_i - \hat{\beta}_i r_{mt}$$

Using time series equity data it is simple to estimate $\hat{\alpha}_i$ and $\hat{\beta}_i$ during a defined time window (t) for each index from the observed returns r_{it} by running a regression based on model (1). The exchange indexes provide a good measure for market returns r_{mt}. The S&P 500 was chosen as a proxy for a global benchmark of economic performance and reflects the weight of the U.S. macroeconomic policy on the performance of regional economies. I use an estimation window of 100 calendar days (70-80 trading days) leading up the event to obtain measures for estimate $\hat{\alpha}_i$ and $\hat{\beta}_i$. I then construct an event window of 5 trading days around each of the six events and predict what the cumulative abnormal returns ($\hat{\varepsilon}_{it}$) associated with that event relative to the performance of the S&P 500 index.

Event Study Results

Table 10 displays the results from the event study analysis of the six events listed in Table 9, I will describe each event in greater detail in the analysis below. I calculate both the abnormal returns associated with the event itself (1-day abnormal returns) as well as a more standard measure of cumulative returns over a 5-day window (1 day prior and 3 days after the event) that is commonly used in this type of studies. The advantage of a larger number of observations means that we can increase the degrees of freedom associated with the measure and a narrower confidence interval but there's a trade off because if the window is too large then we can't be confident that the abnormal returns are due to the event selected or to other developments in the economy. Hence the 5-day window results for China and the target country are the measures of opportunity costs that we should pay attention to. Unfortunately, with the exception of the impact of the 1995 Taiwan Strait Crisis on the TAIEX, none of the results displayed here are statistically significant at the 95% confidence interval.

Table 2 Abnormal Returns Generated by MIDs and TIES

Event Type	China: 1-day Abnormal Returns	China: 5-day Abnormal Returns	Target:1-day Abnormal Returns	Target: 5-day Abnormal Returns	Support for Constraint Mechanism
1995 Taiwan Strait Crisis (MID)	-.00091	0.0346026	.0030776	**-0.0362654***	Mixed
1995 Mischief Reef Occupation (MID)	-.0100371	0.0505654	.0068995	0.0377431	No
2012 Senkaku Nationalization (MID)	-.0046068	0.0106066	-.0010706	0.0264443	No
2012 Banana Export Ban (TIES)	.0074271	-0.0095622	-.0029397	-0.0113668	No
2010 Rare earths metals embargo (TIES)	.0067202	0.0153667	.0001848	0.0157315	No
2016 Suspension of tourists (TIES)	.0054979	-0.0055318	.0032689	0.0200684	No
2011 Fukushima Disaster (Control)	-.0121186	-0.0072366	-.0615625	**-0.1827077***	No

*Indicates 95% Confidence Level

The results reported represent the difference between the observed returns of that index over the event window compared to an estimate of its performance based on the performance of the benchmark index (S&P 500) and the stock's historical correlation with the benchmark. These abnormal returns represent a counterfactual of what performance would be without the disruption caused by the event. I calculate the t-statistic associated with each of these estimates to determine whether the returns reported are statistically significant within a 95% confidence interval. Only the 1995 Taiwan Strait Crisis produced a statistically significant 3.62% decline in returns, all other measures were not statistically significant at the 95% level.

To ensure that these null results are not due to an error on my part, I include the abnormal returns generated by the Fukushima Disaster in 2011 as a control/proof of efficacy for the method. The results show a statistically significant 18.27% decline in the NIKKEI's performance in the 5-day window around the March, 11 2011 incident. Similarly (but not included in Table 10), I calculated that Trump's threat to escalate the trade war with China with tariffs on some $450 billion Chinese exports on June 19 generated a statistically significant 5.28% decline in the performance of the Shanghai Composite Index. These significant results gives me confidence that the null results for the events studied in this section are more likely to have some basis in reality. Indeed, compared to the real destruction caused by Fukushima or the potential disruption of a US-China trade war, the MIDs and TIES studied in these event studies are not of a sufficient threshold to generate abnormal returns at the national level. I include a table in Appendix A of various robustness checks with different sized event windows as well as the t-statistics for each of these estimates.

Recall that these events were selected because they represent the highest intensity events observed for MIDs and TIES. I therefore interpret these results as an indication that MIDs below the level of intensity of the 1995 Taiwan Strait Crisis are unlikely to generate sufficient opportunity costs to constrain their use. Note also that even in the case of the Taiwan Strait Crisis, only the TAIEX and not the SSE experienced a decline. For the constraint mechanism to work, it is important that the initiator must also experience or anticipate some opportunity costs for their actions. But this seems unlikely to be the case for the vast majority of the kinds of foreign policy actions that China has taken or that states take in general. Most uses of military force and economic sanctions fall well short of the threshold where they will have a detrimental impact on the interdependent economies.

This makes sense since most MIDs and TIES are intended to be signals of resolve rather than instruments of punishment. They are meant to poke at the adversary rather than bludgeon each other to death. This is why China's use of economic coercion seem to be calibrated to target relatively narrow sectors of the adversary's economy (tourists, bananas, rare earths) rather than sectors where supply chains are more tightly integrated and could generate greater opportunity costs when disrupted such as electronics manufacturing. Beijing also does not explicitly acknowledge the existence of these sanctions as official policy and thus leave a degree of plausible deniability that shield it from domestic political pressure (some would argue that it is intended to divert international criticism, but if this was the strategy it has definitely backfired). As China's economic interdependence with the world increases, it is both more capable of using economic sanctions for leverage (as I will discuss in greater detail in the next section) but also constrained from doing so at a high-level because of the opportunity costs they would inflict domestically.

By contrast, economic interdependence (even in very high levels like that of China and Japan) does not seem to constrain most of the types of MIDs that we observe. MIDs short of war serve practical strategic purposes, as we see in the case of China's occupation of Mischief Reef. The results in this section suggest that the majority of these MIDs do NOT generate opportunity costs in the way that is consistent with the constraint mechanism. This is why economic sanctions are relatively rare compared to MIDs and have a fairly unsuccessful track record. The Philippines did not back down from the Scarborough Shoal dispute due to China's banana ban and restrictions on tourists, instead it took its case to international arbitration. The Arbitral Tribunal convened pursuant to the United Nations Convention on the Law of the Sea (UNCLOS) rendered an Award in 'The South China Sea Arbitration (The Republic of the Philippines versus The People's Republic of China) on July 2016 that was unfavorable to Beijing's position. Similarly, China's attempt to divert tourists away from Taiwan did succeed in creating some domestic pressure on Tsai, but there is no indication that Taiwan has become any more ready to acknowledge the "One China" principle as a result; rather than trying to woo back Chinese tour groups the island has ramped up its efforts to attract tourists from Japan and Southeast Asia instead. Finally, as I will discuss in Chapter 5, there is reasonable evidence to suggest that the rare earths "embargo" was not really intended as economic coercion but even if it was, it badly backfired. Not only did it turn Japanese domestic and business opinion against China in a dramatic way and strengthened the hand of nationalists like Tokyo's governor Shintaro Ishihara but it also accelerated efforts by policymakers and firms to divert policy and investments away from China to reduce vulnerability. As I will discuss in the next section, the economic sanctions literature teaches us that they are often instruments of last resort to be used when other policy tools are not readily available. I think my results show that the majority of

MIDs are not constrained by opportunity costs and thus should remain attractive policy instruments for economically interdependent countries. [need to add paragraph about what cases are meant to illustrate]

Taiwan Cases

Case #1: The 1995-1996 Taiwan Strait Crisis was longest lasting and highest intensity militarized dispute that China was involved in since the end of the Cold War. It was triggered by the United States granting a visa for Taiwan's President Lee Teng-hui to visit Cornell University in June 1995 over the objections of Chinese officials but the underlying issue was the unsettled sovereign status of Taiwan (and Beijing's perception that Lee was working towards independence for Taiwan). I chose July 21, 1995 as the start date of this event for the purposes of the event study because that marked the beginning of a series of military exercises, including the test firing of surface-to-surface missiles, in the Taiwan Strait between July 21 and 26. Beijing maintained pressure on Taiwan with additional exercises in August, September, and October of 1995 and massed troops in the coastal provinces facing Taiwan.[52] These actions failed to intimidate Lee but succeeded in alarming Washington; the U.S. would deploy a carrier battle group (USS Nimitz) to the Taiwan Strait in December 2995 followed by a second one (USS Independence) in March 1996. China would conduct live fire exercises only 25 miles off the coast of Taiwan at the height of the crisis in March 1996 ahead of Taiwan's first democratic presidential elections. Lee won the election on March 23, 1996 and the crisis ended when China stopped military exercises soon thereafter.

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[52] Keesings Lexis-Nexis Federation of American Scientists, "Taiwan Strait: 21 July 1995 to 23 March 1996," http://www.fas.org/man/dod-101/ops/taiwan_strait.htm
Robert Sutter, "China Policy: Crisis Over Taiwan, 1995-A Post-Mortem," CRS Issue Brief. Washington DC: Congressional Research Service, December 1995.

By 1995, the level of economic interdependence between mainland China and Taiwan was already quite high. Commercial peace theory would predict that the opportunity cost of conflict should be high in this case and that we should observe negative returns in both equity markets during the crisis. Even though trade with mainland China was illegal through much of the 1980s and 1990s, Taiwanese businessmen (*taishang*) and investments made up a substantial share of early FDI into China. *Taishang* could not obtain visas from the government in Taipei, they could not fly directly into China, and there was no mechanism for finance. But China was desperate for capital and local governments welcomed these Taiwanese businessmen especially if they were from the same home province. These early *taishang* became some of the most successful firms in real estate and consumer goods in China, including brands like *Foxconn* owned by Hon Hai Precision Industry, *Kangshifu instant noodles* owned by Tian Tsing International Group and laptop makers Asus and Acer. China as heavily dependent on Taiwan economically in the early 1990s but in 1992 China was only Taiwan's 26th most important trading partner with $748 million in total trade. But by 1995, bilateral trade had expanded to such a degree that the two economies can be considered interdependent based on my data.

Figure 17 describes the equity index data used for the analysis in this section. The Taiwan Capitalization Weighed Stock Index (TAIEX) is shown in blue and the Shanghai Composite Index (SSE) is shown in gray and I've converted the valuations of both to U.S. dollars to facilitate ease of comparison to the S&P 500. I also plot the duration of the Strait Crisis in faded red and use a solid red line to denote the event that I will focus on for the event study analysis. This plot reveals the sizable impact that the crisis had on the TAIEX, which appears to struggle for the duration of the crisis and recover after its resolution in March 1996.

The SSE also appears to have declined later on during the crisis when U.S. involvement increased.

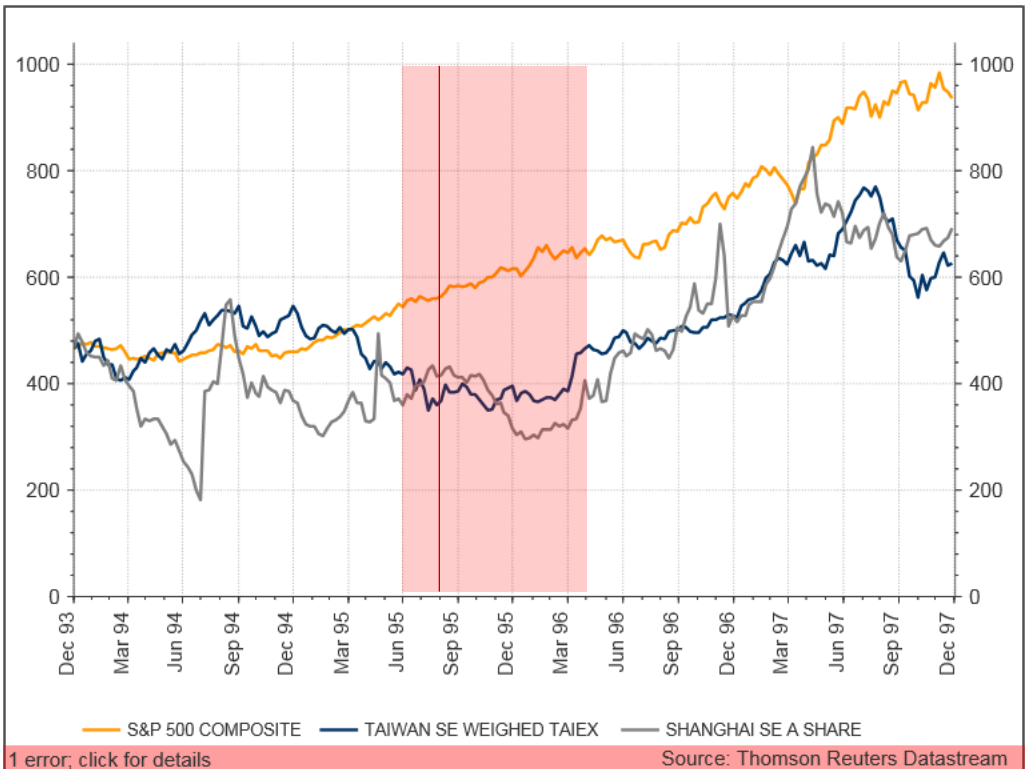

Figure 17 TAIEX and SSE Index during the Taiwan Strait Crisis compared to the S&P 500

Case #2: Despite coming to the brink of war during the 1995-1996 and the failure to achieve any sort of political understanding that is satisfactory to both sides, the economic relationship between China and Taiwan would deepen and broaden during the turbulent years of the Chen Shui-bian administration and achieve a breakthrough during Ma Ying-Jeou's presidency. By 2002 total trade with China was worth $18.5 billion, making it Taiwan's 4th largest trading partner. The two sides would sign the Economic Cooperation Framework Agreement (ECFA) in 2010 and bilateral trade would increase to over $121.5 billion in 2012.

By 2016, China was indisputably Taiwan's most important trading partner – Taiwan's largest export destination and second largest source of imports - representing over 21 percent of total trade (40 percent of trade including Hong Kong). However, the two sides were no closer to achieving agreement of Taiwan's sovereign status and political relations deteriorated with the January 2016 election of president Tsai Ing-wen—whose Democratic Progressive Party (DPP) is seen as pro-Taiwanese independence and deeply distrusted by Beijing.

President Tsai refused Beijing's overtures to publicly endorsed the so-called "92 consensus" and as a result China has decided to suspend all high level contacts with Taiwanese authorities since Tsai's inauguration on May 20, 2016. I have selected this date as the beginning of the 2016 crisis because media reports would quickly emerge after this date that Beijing was putting pressure on Chinese tourism companies to reduce the flow of visitors to Taiwan and denying party members and public sector employees permission to travel there. In 2015, China was the biggest source of international visitors to Taiwan. But in the two months after Tsai's inauguration, Chinese group tours to Taiwan dropped by 30%.[53] This constitutes an economic sanction by the TIES coding rules and generated some political pressure at home for Tsai. On September 12, some 10,000 tourism industry workers protested Tsai's Cross-Strait policy in Taipei fearing that the number of Chinese tourists in organized tours will drop by half, from two million in 2015 to one million in 2016. Eventually, in 2016 the number of Chinese tourists dropped by 16 percent or 670,000 visitors (from 4.2 million to 3.1 million) but this gap was filled by visitors from other Asian destinations.[54]

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[53] Ian Rowen, "The End of China-Taiwan Rapprochement Tourism," *China Policy Institute Analysis*, July 25, 2016. https://cpianalysis.org/2016/07/25/the-end-of-china-taiwanrapprochement-tourism/.

[54] Cabestan, Jean-Pierre. "Beijing's Policy towards President Tsai Ying-wen and the Future of Cross-Strait Relations." *Whitehead J. Dipl. & Int'l Rel.* 18 (2017): 55.

Philippines Cases

Case #3: China's occupation of Mischief Reef in February 1995 constituted one of the other more provocative MIDs that it has engaged in since the end of the Cold War. While it did not involve the large-scale display of force seen in the Taiwan Strait Crisis, this crisis constituted one of the few incidences when Chinese forces seized new territory. China and the Philippines have long disputed the sovereignty of the Spratly Islands in the South China Sea along with Vietnam, Malaysia, and Brunei. Mischief reef consists of a some rocks that lie above water level at low tide around a large lagoon. On February 2, a Philippines fishing vessel discovered that Chinese forces, including eight ships, had occupied Mischief Reef and constructed several permanent structures[55]. The action was perceived as another stage of the advancement of Chinese territorial claims into the region, and raised fears that the Chinese were prepared to use force in posting claims to shipping lanes there. On February 8, President Fidel Ramos denounced the Chinese actions as a violation of international law and issued a formal diplomatic protest to the Chinese government. I date the crisis event to this official diplomatic demarche. Beijing responded that the structures it built on the Reef where shelters by Chinese fishermen, not for any military purpose. The Philippines responded with a show of military force by dispatching warships and fighter planes on February 15 to the area but did not further escalate the crisis. Since 2015, China has engaged in a massive land reclamation project at Mischief Reef and constructed an airfield and multiple structures there.

The noteworthy thing is that in 1995, the level of economic interdependence between China and the Philippines were still relatively modest. It's trade with China only accounted for

[55] Keesing's Record of World Events, Vol. 41, 1995, pp. 40412; 40458. New York Times, 19 Feb. 1995, p. A9

$250 million of exports (1.9% of total exports) and $950 million imports (5% of total imports). This means that, by the logic of commercial peace, opportunity cost of conflict should be relatively lower than the other cases of high or very high economic interdependence. This should also mean that the 1995 Mischief Reef occupation should generate the lowest amount of abnormal returns in the equity index, particularly compared to the 2012 Scarborough Shoal standoff when economic interdependence between China and the Philippines became much higher.

Case #4: The Scarborough Shoal is a disputed piece of territory situated between the Macclesfield Bank—a submerged South China Sea feature claimed by China—and the Philippine island of Luzon. The standoff began on April 8, 2012 when Filipino sailors attempted to arrest Chinese fishermen for poaching protected marine species at the shoal. Two unarmed China Marine Surveillance (CMS) vessels appeared and interposed themselves between the fishing boats and the Filipino naval vessel, a Hamilton-class cutter recently acquired from the U.S. (and the largest ship the Filipino navy), to prevent arrest or confiscation.[56] The Philippines replaced the cutter with a coast guard vessel two days later in a bid to ease tensions, while China deployed an armed Fisheries Law Enforcement Command (FLEC) ship, beginning a standoff that would last over two months. Both countries lodged diplomatic protests with the other, claiming the Scarborough Shoal to be part of their territory.[57] In June 16, an approaching typhoon gave the Philippines cover to withdraw its coast guard ships from the shoal and for China to withdraw some of its civilian ships involved in the standoff. But Beijing soon sent

[56] Charles Thayer, "Standoff at Scarborough Shoal: Implications for US-China Relations," China US Focus, May 9, 2012.
[57] Ibid.

other ships to the disputed area, maintaining a continuous presence throughout 2012 and 2013 with no sign of withdrawal.

I am using the Scarborough Shoal case as an example of an economic sanction (TIES) rather than as a MID. As a MID this event is less intense than the 1995 occupation of Mischief Reef since no permanent structures have been constructed on the shoal itself. But the case has received far more attention because it triggered the so-called "banana war" or banana ban that is one of the most often cited examples of growing Chinese economic statecraft (Poh 2017). China was the largest market for Philippines banana exports in 2012, accounting for around half percent of total banana exports.[58] Chinese customs officials had quarantined thousands of boxes of Filipino bananas in the weeks following the outbreak of the standoff in the Scarborough Shoal, leaving them on the docks to rot. The total number of boxes of bananas exported to China would drop by more than half from 1.5 million boxes to some 710,000 boxes during the week of April 15-21 (Lim 2014). Exports rebounded the week after but would drop off even more steeply the following week of April 30-May 6 from starting May 4 777,000 boxes to 92,000 boxes (Lim 2014). By June the total volume of bananas exported to China would be just 5% of what was shipped to China in the month prior to the outbreak of the territorial dispute. I date the start of the TIES event to May 4, 2012 but since the banana ban was acknowledged by Beijing as declared policy, the exact start date is difficult to pin point. I wanted to pick a date further away from the outbreak of the MID in April to distinguish the market responses to the undeclared economic sanctions. However, I did also experiment with other event start dates and windows and the results seem robust to different specifications.

[58] "Banana Exports to be Hit by Scarborough Dispute-Industry Insider". *Philippine Daily Inquirer*, May 3, 2012;

As mentioned earlier, the Philippines was highly trade dependent on China in 2012. China was the Philippines largest export market (23% of total exports) and largest import partner (13% of total imports). In 2012 bananas accounted for 1.7% of total exports and were worth about $277 million, this is down from 2.0% of total exports or $289 million in 2011 but not substantially so. Electronic devices and components such as computers and integrated circuits account for a much larger share (over 70%) of Filipino exports to China. By contrast China is much less trade dependent on the Philippines in 2012; the Philippines constitute only 0.45% of China's total exports (worth $9.5 billion) and 1.2% of imports (worth $16.8 billion). We can therefore expect the opportunity cost of this economic sanction to weigh much more heavily on the smaller Philippines economy than on China. Figure 18 describes the equity index data used for the analysis in this section. The Philippines Stock Market Index (PSEi) is shown in blue and the Shanghai Composite Index (SSE) is shown in gray and I've converted the valuations of both to U.S. dollars to facilitate ease of comparison to the S&P 500. I also plot the duration of the Scarborough Shoal standoff in faded red and use a solid red line to denote the event that I will focus on for the event study analysis. In contrast to the case of the TAIEX during the Strait Crisis, the PSEi does not appear to be sensitive to the developments around Scarborough Shoal and rallies for much of 2012.

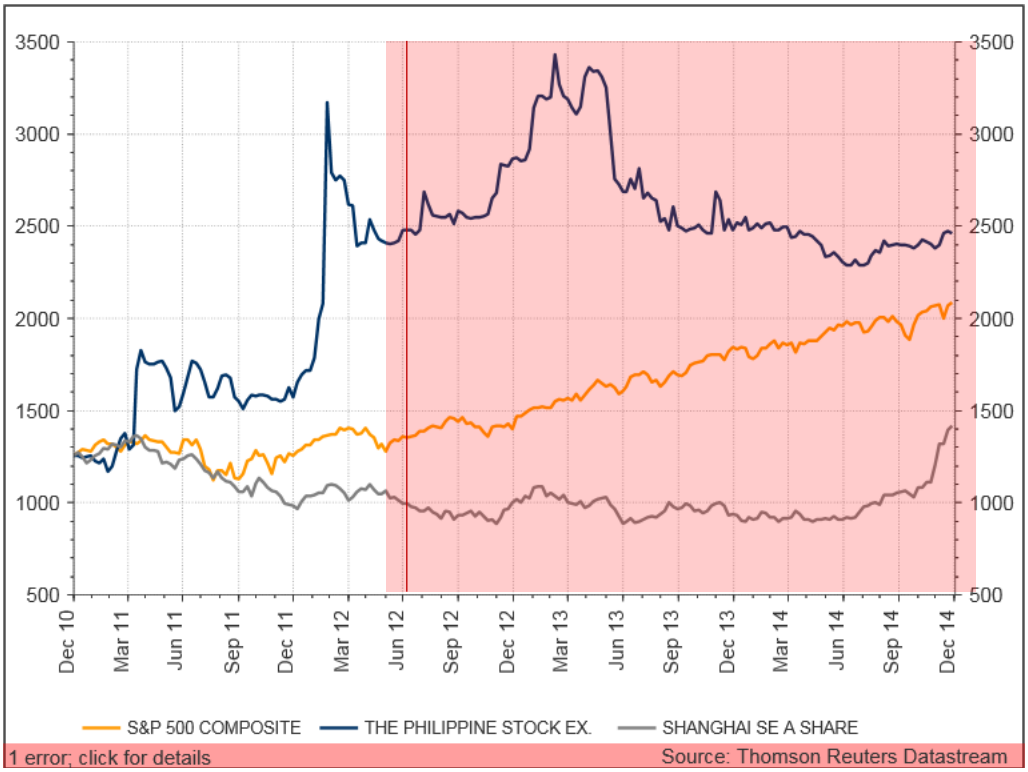

Figure 18 PSEi and SSE Index during the Scarborough Shoal Standoff compared to the S&P 500

Japan Cases

Case #5: My next case is China's imposition of a rare earths export ban or embargo in 2010, allegedly in retaliation for the arrest of a Chinese fishing trawler captain and his crew in the disputed waters around the Senkaku/Diaoyu islands by the Japanese Coast Guard on September 7, 2010. In 2010, Chinese mines provided more than 90% of the global supply of rare earth metals[59] and China's decision to suspend rare earth metal exports to Japan (and later that year to the US and EU) sparked global concern.[60] The dominant narrative that emerged in

[59] This is a generic term for metals in Group 3 of the periodic system. They are used in a range of advanced products such as hybrid vehicles, computer parts, smart phones, wind turbines, solar panels, energy-saving domestic electronics and guided missiles.

[60] See NYT reporting: http://www.nytimes.com/2010/09/23/business/global/23rare.html?pagewanted=all&_r=0

the press and among policymakers is that the 'embargo' was a blatant attempt by Beijing to use economic coercion to force the Tokyo to release the arrested Chinese fishing captain.

This is a TIES case for me rather than a MIDs case and will be examined in much greater detail in Chapter 5. For the purposes of the event study analysis, I take the start date of the event as September 22, 2010 when the *New York Times* reported on the export restrictions. This headline generated widespread concern that China was beginning to use economic sanction to gain political leverage over Japan in the negotiation. Also, the Chinese government arrested four Japanese citizens, accusing them as "entering into the military zone and recording the military targets illegally" on the same day.

China had been highly dependent on trade with Japan since the 1980s. In 2010, the Japanese economy had become highly dependent on trade with China. China became Japan's largest trading partner in 2008; since 1995 increased shipments to China have accounted for nearly half of the overall growth in Japanese exports. Imports from Japan accounted for 14% China's total imports in 2010 (worth $150 billion) and 10% of China's total imports in 2012 (worth $148 billion). China exported $142 billion worth of goods to Japan in 2010 (8.1% of total exports) and this figure increased to $175 billion in 2012 (8.3% of total exports). This means that the opportunity cost for economic as well as military conflict are very high for both countries. This was true in 2010 and would remain largely true in 2012.

Case #6: In 2012, the Japanese government decided to nationalize the disputed Senkaku/Diaoyu islands to prevent the right-wing governor of Tokyo from purchasing the island from private owners. This decision triggered the largest wave of anti-Japanese demonstrations to occur since relations with Japan were normalized in 1972. No economic

measures similar to the rare earth metals export restrictions was attempted, in fact the government discouraged consumer boycotts (through censorship) and local governments dispatched police to protected Japanese businesses and factories (after all local officials work very hard to court foreign investment and depend on these to create jobs in their region). Instead Beijing chose to use military force to establish facts on the water to contest Tokyo's decision. Authoritative Chinese media sources made it clear that the official government position is that the Diaoyu Island is that it is a zero-sum dispute over territorial sovereignty.

The 2012 Senkaku/Diaoyu Dispute represents a case of MIDs for my analysis I mark the start date of the event on September 11, 2012 when the nationalization decision was finalized. Unfortunately, this date is not a clean cut-off because there was substantial build up to the decision. In the second half of 2012, the Japanese Ministry of Defense reports 47 Chinese ship incursions into or near the territorial waters of the Senkaku/Diaoyu islands and the Japan Air Self-Defense Force (JASDF) scrambled fighters 160 times in response to Chinese aircraft in the same vicinity.[61] In October 2012, seven PLA warships return from exercises in the western Pacific, and became the first-ever PLA warships to transit through Japan's contiguous zone when they passed south-southeast of Yonaguni Island. This was a clear show of military force meant to signal unambiguously China's resolve over the Senkaku/Diaoyu islands and would be coded as a level-3 MID. The fact that massive anti-Japanese protests occurred across China along with calls for consumer boycotts on Japanese goods also complicate this event as a MIDs treatment; it is difficult to separate the opportunity costs created by China's use of military force from the effect of these demonstrations. According to Wallace and Weiss (2014), protesters took to the streets in 208 of China's 287 prefectural cities. JETRO reports show a

[61] http://media.hoover.org/sites/default/files/documents/CLM41MS.pdf

decline in Japanese investment and sales for Japanese firms in the final quarter of 2012, but both have recovered in 2013 despite elevated tensions generated by China's creation of an Air Defense Identification Zone (ADIZ) over the East China Sea in 2013 and increases in air and sea patrols in disputed waters since 2012.

Figure 19 describes the equity index data used for the analysis in this section. The Nikkei 225 Stock Average (NIKKEI) is shown in blue and the Shanghai Composite Index (SSE) is shown in gray and I've converted the valuations of both to U.S. dollars to facilitate ease of comparison to the S&P 500. I also plot the duration of the onset of the rare earths embargo in 2010 and the Senkaku nationalization crisis in 2010 with solid red lines to denote the event that I will focus on for the event study analysis and shade the period following September 2010 with the because the dispute sovereignty of the Senkaku/Diaoyu Islands was a persistent feature in Sino-Japanese relations during this entire period. In contrast to the case of the TAIEX during the Strait Crisis, the NIKKEI does not appear to be sensitive to the developments and escalations in the Senkaku/Diaoyu dispute, at least not at the monthly level of data shown in the figure. The event study analysis using daily stock data will allow us to better estimate the opportunity costs associated with these events.

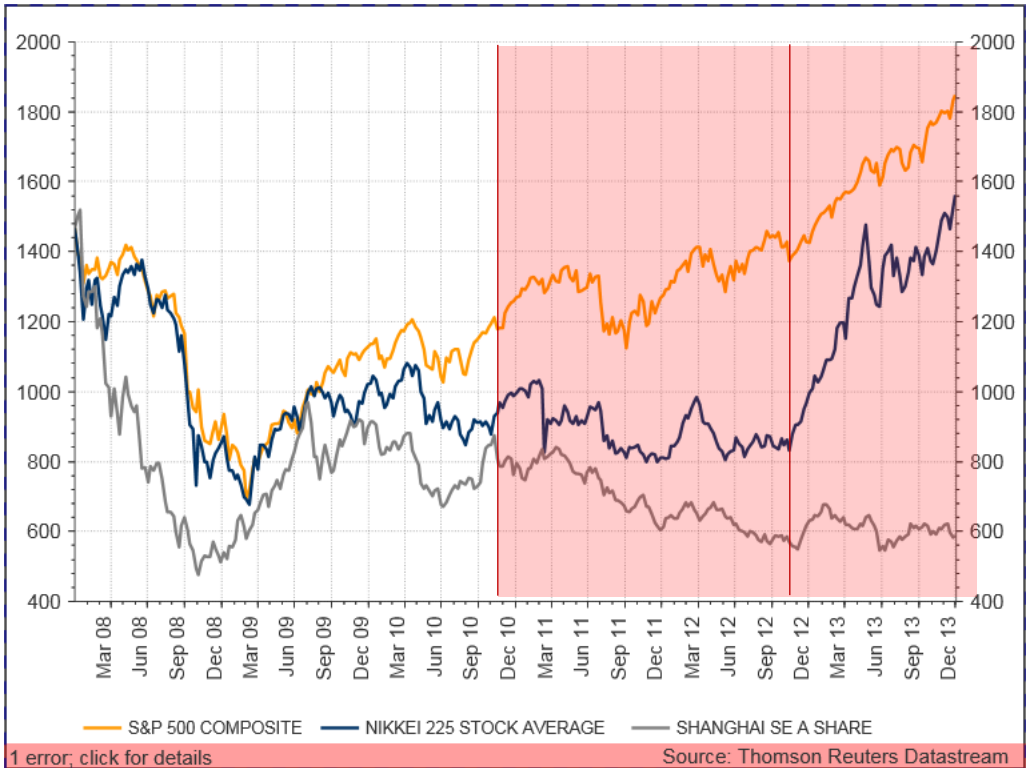

Figure 19 NIKKEI and SSE Index during the Senkaku/Diaoyu Island Dispute compared to the S&P 500

There are some draw backs with the research design used in this section that I would like to acknowledge. First, I acknowledge that national level indices are crude aggregate measures of opportunity cost. Industry or even firm level event study analysis will probably show a bit more variation in terms of the effects of economic sanctions in particular, for example fruit producers will be disproportionately harmed by the banana ban and tour companies would be harmed by the restrictions on Chinese tourists. More interestingly, it is possible to identify Chinese firms that would be harmed by the externalities of these policies, perhaps grocery stores chains that sell bananas or airlines that fly tourists overseas. An alternative design might seek to study these cross-sectional within country to the same event. However, I have decided to save these avenues of inquiry for a future project and focus my attention at state-level strategic

decision making in this dissertation. I am interested in how economic interdependence constrain the decisions made by top leaders in the conduct of foreign policy. I do not have a theory of domestic politics to explain how interests of those narrowly targeted by economic sanctions or even industries that might be more harmed by MIDs (maybe sectors transoceanic shipping or maybe firms with greater degree of exposure to the target state) than others might then mobilize domestically to put pressure on political leaders. I've found in my fieldwork that most firms do not have a strong position on foreign policy; but even if I can solve this problem of identifying the likely members of such a domestic coalition, I would still be faced with a daunting aggregation problem of figuring out how these groups might or might not influence the relevant policymakers to translate their preferences into foreign policy outcomes. I think the simplification of national level interests and the identification of thresholds is an important first approximation at the strategic thinking under conditions of economic interdependence. My results are consistent with a growing body of work (Davis and Meunier 2014; Vekasi 2019) that show that economic linkages are fairly robust to political and military conflict.

5.1 Summary

Figure 20 summarizes the breakdown of militarized disputes (MIDs) and economic sanctions (TIES) in my dataset into ten outcome categories based on the level of economic interdependence and the status of borders (as a proxy for whether or not a zero-sum dispute exists in that dyad). I select on the dependent variable (MIDs and TIES) to show whether or not the causal mechanisms specified in bargaining theory interpretations of the commercial peace (constrain and inform) produce observable implications that are consistent with the pattern of conflict that we observe in my dataset. The constrain mechanism would predict that, given an

active territorial dispute, the level of economic interdependence should not constrain China's use of military force in bargaining. This means more MIDs in outcomes 5 and 9 compared to outcomes 2 and 7. The inform mechanism would predict that, as higher levels of economic interdependence, China should be more likely to use economic sanctions than military force in bargaining. This means more TIES in outcomes 1 and 3 than in outcomes 11 and 12 while at the same time fewer MIDs in outcomes 2 and 5 compared to outcomes 7 and 9.

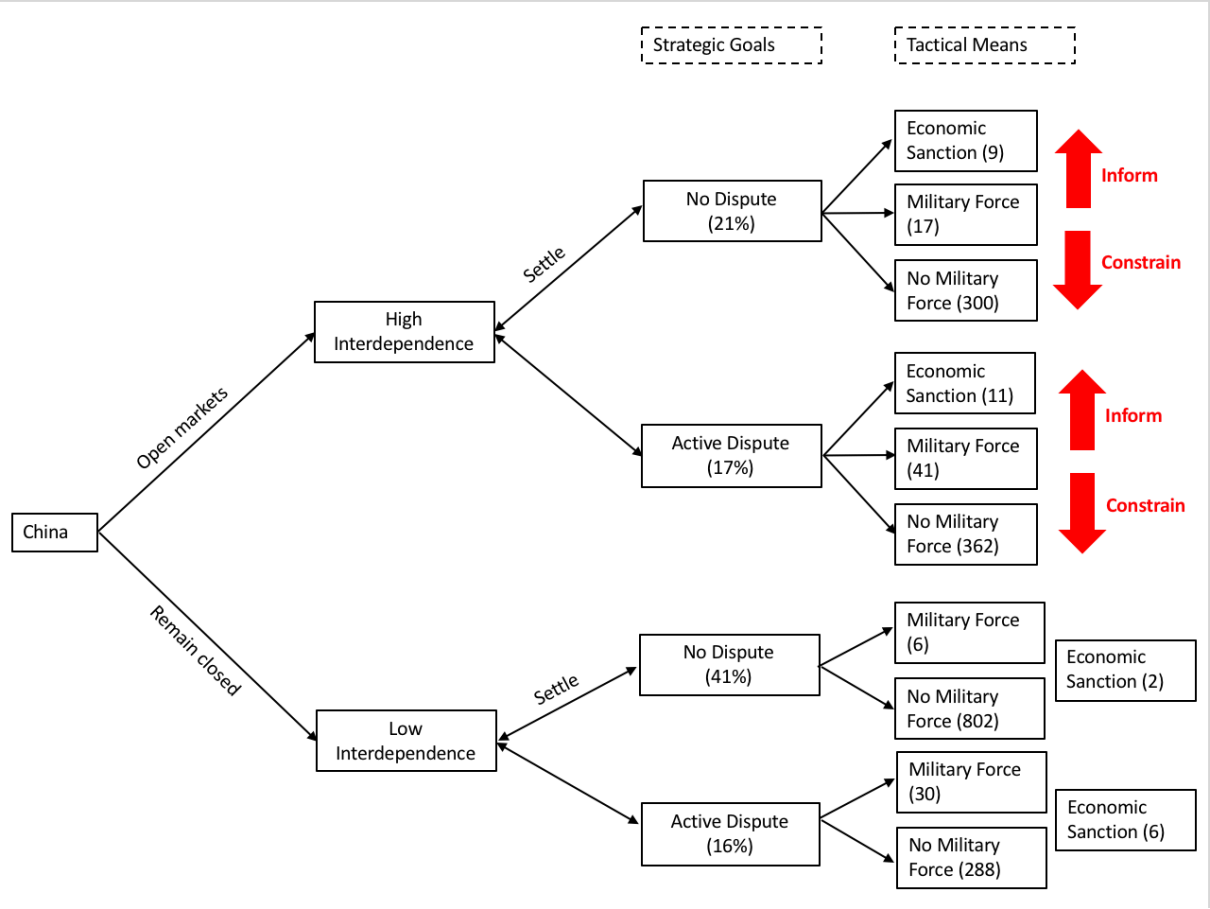

Figure 20 Breakdown of Militarized Disputes and Economic Sanctions

These results fully support the constrain mechanism and only partially support the inform mechanism. China is much more likely to use military force in active territorial disputes regardless of the level of economic interdependence: 41 MIDs (high) compared to 30 MIDs

(low). China does appear more likely to use economic sanctions when economic interdependence is high (20 TIES) compared to when it is low (8 TIES) but this does not appear to be the result of substitution of economic sanctions for militarized disputes. There are actually more MIDs in high interdependence dyads (58 MIDs) than in low interdependence dyads (36 MIDs).

The infrequency of economic sanctions and their limited scope also reflect the degree that economic interdependence constrains their use in foreign policy. In the next chapter, I will explore whether China is more or less likely to use economic rather than military instruments in similar disputes at different levels of economic interdependence. My ultimate goal is not to show whether one mechanism and the hypotheses that derive from it have greater explanatory power than the other. Instead, I apply a synthetic approach and hope to uncover scope conditions for when each of these three major causal mechanisms might drive national strategy and help explain foreign policy outcomes. I want to move away from the rigid notion that there is only one relationship between interdependence and security and toward a framework where several effects can occur at different time intervals and intensity levels.

Chapter 6 Maritime Disputes with Japan and Vietnam

My country case study chapters are designed to allow for comparison *across* crises (one with high economic interdependence, and one with low economic interdependence) and study the dynamics *within* crises to establish scope and scale conditions for the inform, constrain, and transform mechanisms. I seek to understand how these processes complement or contrast with one another by examining how economic interdependence affect China's short-term *strategy* during the crisis (whether and why it favors military force or economic sanctions) as well as how it transforms longer-term *interests* (whether it prefers peaceful settlement of territorial disputes over armed conflict). My first case study is of two crises in Sino-Japanese relations over the Senkaku-Diaoyu Islands dispute in 1978 and 2010. I compare Chinese foreign policy goals and behavior in these two cases that differ in their relative levels of economic interdependence (China's trade dependence on Japan is much higher in 2010 than in 1978) but are similar along many other important dimensions (ex. geography, regime type, alliances), and most crucially are the same in that they are both over the same territorial dispute. If the logic behind China's use of military force is largely similar across these two cases that differ in terms of economic interdependence, it is then likely to attribute that similarity to territorial disputes. I also take note to consider whether the considerable differences in relative military capabilities between China and Japan (a variable that is statistically significant in the statistical model) proves to be a critical factor in the conduct and outcomes of these two disputes. Table 6.1 summarizes how the key variables of interest differ across these two Japan cases. I do not include columns that show the constants between the two cases: different regime types (China is autocratic and Japan is democratic in both), same alliances (Japan is a U.S. military ally),

nuclear weapons (China is a nuclear power in both), development (Japan is more developed than China), and same geography in terms of contiguity and distance.

I compare the Japan case studies with a pair of Vietnam cases studies on disputes in the South China Sea in order to get variation across the controls across the comparison of these two countries that differ in most ways except one. If I find that the logic of using military force is remarkably similar across the four sets of cases, despite variation on the degree and structure of economic interdependence and the differences across Japan and Vietnam on the key control variables (ex. regime type, alliances, development, and relative capabilities), then by Mill's method of difference, I can conclude that these similarities are the product of the one thing that is held constant across all four cases: the unresolved territorial dispute. The case studies and descriptive data referenced are drawn from the same Chinese Foreign Relations (CFR) dataset that is used in the large-n and medium-n chapters; the common unit of analysis across all these chapters is the initiation of a MID by China in a given year.

I begin the chapter by providing some context about the origins of the territorial dispute and the evolution of economic interdependence. I then introduce and analyze the two case studies: 1978 (medium level trade interdependence) and 2010 (high level of trade dependence). My analysis will show that economic interdependence operates at the strategic level by making economic coercion less appealing but does not constrain the use of military force. Military force is not any less appealing as trade increases nor does Beijing seem more interested in substituting economic coercion for military force; I will spend a large part of the 2010 dispute case study to challenge the conventional wisdom that the rare earths embargo ushered in new era of Chinese economic coercion. But I also show that, even though it is hard to dismiss the idea that trade transforms how leaders define their national interests over the medium- and long-run, it is also

difficult to find proof that such a transformation of interests create sufficient impetus to compromise on or resolve territorial disputes. In fact, the comparison of the two Japan cases reveal the possibility that the transformation mechanism might bring stability at high levels of conflict -- making war unthinkable-- but create instability at lower levels of conflict – by incentivizing risky military behavior short of that threshold.

Table 11 Comparative Statics on Japan and Vietnam Case Studies

	Territorial Dispute	Military Balance (China/Target)	Bilateral Trade Volume	China's Trade Dependence	Target's Trade Dependence
1978 Dispute with Japan	Yes (Deter)	Weak	Low	Medium	Low
2010 Dispute with Japan	Yes (Compel)	Strong	High	High	High
1994 Incident with Vietnam	Yes (Deter)	Medium	Medium	Low	Medium
2014 Incident with Vietnam	Yes (Deter)	Strong	High	High	High

6.1 Japan Cases: Senkaku/Diaoyu Dispute

The origin of the territorial dispute over the Senkaku/ Diaoyu Islands can be traced back to the conclusion of World War II in the Pacific theater. The Senkaku/Diaoyu Islands[62] refer

[62] Among them, the Uotsuri-shima/Diaoyutai Island is the largest island, taking 3.81 km^2. The other islets are Kuba-shima/ Huangweiyu, Kitakojima/ Beixiaodao, Taisho-jima/Chiweiyu, Minami-kojima/Nanxiaodao, Okino Kitaiwa/ Chongbeiyan, Okino Minamiiwa/ Chongnanyan, Tobise/ Feilai.

to a chain of eight tiny islets in the East China Sea, situated to the northeast of Taiwan and southwest of the city of Naha, Okinawa (see Figure 21).

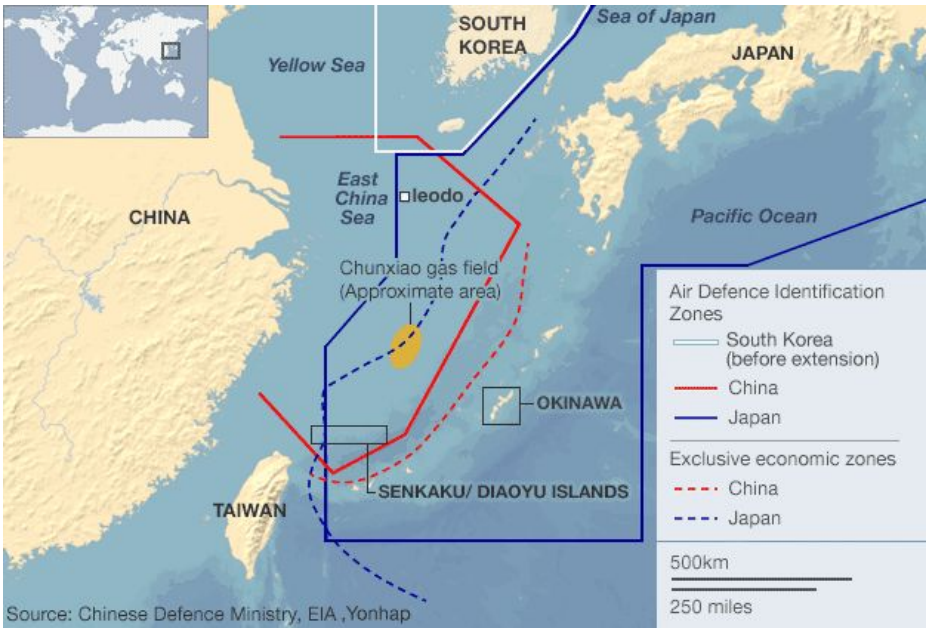

Figure 21 Map of the Senkaku/Diaoyu Islands Dispute

Japan claims the islands were initially discovered and incorporated into the Okinawa Prefecture by the Japanese government in January 1895. As the defeated country, the Japanese Empire transferred administrative authority over all of the Ryukyu Islands (also referred to in Japanese as the Nansei Islands) to the United States as part of the San Francisco Peace Treaty of 1951. Article 3 of the treaty acknowledged United States' authority over the "Nansei Shoto south of 29 degrees north latitude (including the Ryukyu Islands and the Daito Islands)" and the Senkaku/ Diaoyu Islands were included as a section of the Ryukyu Islands. They remained under U.S. administration until 1972 when the U.S. returned control over the Ryukyu Islands to Japan, in accordance with the "Treaty Between Japan and the United States of America Concerning the Ryukyu Islands and the Daito Islands", also known as the Okinawa Reversion

Treaty, signed on June 17th, 1971 (Blanchard 2000). The official Japanese government position over the sovereignty of the Senkaku/Diaoyu islands is based on the Okinawa Reversion Treaty. The official statement from the Ministry of Foreign Affairs also makes reference to the Article 2 of the Treaty of Shimonoseki signed in April 1895 (three months after the islands were first discovered and incorporated into Okinawa), which did not include Senkaku/ Diaoyu Islands in the list of territories ceded to the Japanese Empire by the Qing Empire following the First Sino-Japanese War, in order to counter the Chinese argument that the islands are part of Formosa (Taiwan).

The People's Republic of China (PRC) contests Japan's sovereignty over the islands and claims they are part of the Republic of China (Taiwan), which is part of China. The Chinese position is rooted in the legal argument that since the San Francisco Treaty was signed without the participation of the PRC, Beijing has never acknowledged the treaty, with reference to Prime Minister Zhou Enlai's statement in 1951. According to the State Council's report, the earliest discovery and exploitation of Senkaku/ Diaoyu can be traced to the Ming Dynasty in the 15th century. The report also contends that China has practiced a long term administration over the islands during both Ming and Qing Dynasties, attempting to refute Japanese claims of "early discovery" in 1851. The reports asserts that all these documentation supports Senkaku/ Diaoyu Islands to be included as part of the island of Formosa (Taiwan). With specific reference to the Article 8 of the Potsdam Declaration, China suggests that the islands should be grouped with islands belonging to the Republic of China (Taiwan), whose sovereignty the PRC in term contends.

The earliest incident of open conflict surrounding Senkaku/ Diaoyu Islands can be traced back to July 1970, when the Japanese ambassador initiated a diplomatic protest that

Taiwan's proposed exploitation of oil by the China Petroleum Company near the Senkaku/ Diaoyu Islands is a violation of Japan's territorial claims (Hoppens 2015). That September, a flag of ROC was erected on the islands by a group of Taiwanese protestors, yet they were dispelled by the Japanese authority. As a result, a social movement conducted by Chinese youths in Hong Kong, Taiwan, and overseas Chinese community was activated, leading to various nationalist protests claiming sovereignty of the Diaoyu islands as Chinese territory. Both the ROC and PRC initially chose to downplay the territorial issue for different reasons. However, once initiated, the territorial dispute over these islands would remain a major source of conflict between China and Japan. In 1996, the establishment of United Nations Convention on the Law of Sea (UNCLOS) further raised the stakes of the dispute by granting maritime exclusive economic zones (EEZs) beyond the traditional twelve nautical miles of coastline.

I will examine two cases involving the Senkaku/Diaoyu dispute, each case is a crisis between China and Japan. The first case occurred in April 1978 when hundreds of Chinese fishing vessels appeared in the waters around the Senkaku/ Diaoyu Islands, which was interpreted as a collective protest against Japan's position on the territorial dispute during the negotiation process for the Treaty of Peace and Friendship with Japan. The second case occurred in September 2010, when the arrest of a Chinese fishing boat captain by the Japanese Coast Guard triggered a stand-off between the two nations. The territorial dispute over the Senkaku/Diaoyu islands is a constant across both cases while the level of economic interdependence will vary greatly.

Economic Context: Sino-Japanese Economic Engagement

The degree of economic interdependence between China and Japan was limited during the early Cold War but quickly accelerated after the normalization of relations in 1978. There had been considerable commerce between China and Japan since the 19th Century when Japan was incorporated into the Western treaty port system that regulated access to the Chinese market. It should be mentioned that after the treaty port system was abolished in 1949, there was a considerable amount of trade between the two countries[63]. However, the Korean War erupted in 1950 and immediately drew the two countries into different camps, in which China was playing a role as the direct belligerent while Japan was serving as a base critical base and supportive ally of the U.S. military, leading to a sharp decline in trade. Additionally, the U.S. implemented a sweeping set of economic sanctions against the PRC following its entry into the Korean War and created the Office of Foreign Assets Control (OFAC) at the Treasury Department to block trade and financial transaction with all Chinese and North Korean entities.

Even before the formal 1953 Korean Armistice Agreement brought a cessation of hostilities to the Korean War, the PRC and Japan established a limited connection with each other through informal channels. Starting from June 1952, when the first private trade agreement was signed, a series of unofficial agreements was concluded by bilateral representatives under the name of individuals and non-governmental organizations, including the residents trade mission signed in 1953, the third private trade agreement was signed in May 1955, and the fourth private trade agreement in 1958. Although all these agreements did not enjoy any official status, the influence from the governments were still visible (Lee 2013). For

[63] Estimated by the Japanese Ministry of Foreign Affairs at $58.96 million USD or roughly 0.19% of PRC GDP and 0.42% of Japan's GDP in 1950, much higher than the levels of economic interdependence even than in the 2000s (below 0.1% for both countries)

instance, in the 10th article of the fourth private trade agreement, it was agreed on that the trade representatives of both sides can be provided with diplomatic privileges, which can never be achieved without the support of the two governments. Beyond economic benefits, Beijing was trying to mix its political demand for concession in its communication with the unofficial but influential negotiators, such as requiring commitments from the Japanese government to accommodate China in certain policy areas, especially its position to Taiwan. Yet these efforts were impaired by the failure of the Great Forward Leap in China and the damage the policy caused on the PRC economy. It was not until the 1960s that the economic relationship experienced a breakthrough, marked by the trade memorandum signed in Matsumura Kenzo's visit to Beijing, invited by Zhou Enlai, in September 1962. Since the memorandum, trade with China was supported by the prominent members of the governing LDP and was partially financed by the national Export-Import Bank, it enjoyed a semiofficial status which was different from ever agreements previously signed (Lee 2013). As a consequence, a bilateral trade accelerated from 1963 to 1967 until the outbreak of the Cultural Revolution dampened PRC enthusiasm for foreign trade and heightened political tensions with Japan.

The major turning point in the Sino-Japanese economic relationship occurred in 1970s, impacted by the Nixon Shock in July 1971, which was developed from the pragmatic need for strategic adjustment in Japan's Cold War position. In the following year, Japan took steps to normalize its diplomatic relationship with China to catch up with the pace of United States. In return, to reduce potential threat posed by its deteriorating relations with the Soviet Union, China was also willing to improve its relationship with Japan. Hence, a plethora of important treaties and agreements has been signed since 1972. The ten-articles trade agreement signed in January 1974, the nineteen-article agreement and accompanying three-article annex signed in

April 1974, the Governmental agreement on Maritime transport signed in November 1974, and the eight-article fisheries agreement and two lengthy annexes signed in August 1975, have together established a comprehensive foundation and normative framework for the Sino-Japan trade (Lee 2013). In February 1978, a Long Term Trade Agreement was signed, where Japan would export its industrial machinery and technology to China while China would pay the bill with its natural energy resources, especially the petroleum in Daqing, in return. The two sides negotiated terms for the Treaty of Peace and Friendship between Japan and the PRC throughout 1978 and signed the treaty in August. That December, at the summit meeting between Prime Minister Masayoshi Ohira and Hua Guofeng, working-level governmental consultations was annually set up as a normalized channel China became the recipient of Japan's first postwar governmental loan (Lee 2013). Japanese official development assistance (ODA) would to a massive amount of loans and grants to fund construction programs in China into the 2000s.

The effect of the economic agreements signed in the late 1970s was remarkable: starting in 1978, bilateral trade between China and Japan experienced a tremendous increase, as visualized in Figure 22. According to the *China Foreign Relations (CFR)* data , the total trade amount had grown nearly three hundred-fold from 0.95 billion USD in 1980 to 280 billion USD in 2010. The rapid rise refers to an increasingly intensified and strengthened economic interdependence between the two countries. Beginning in the 1980s, integrated global supply chains allowed China to become the factory for Japanese and other foreign manufacturers. Around 60-70 percent of goods China imports from Japan are parts and components that China (or the subsidiaries of foreign MNCs based in China) need to make its own exports (Katz 2013). China has been highly dependent on trade with Japan since the 1970s. My data shows that, until

around 2009, bilateral trade accounted for a larger share of China's GDP than Japan's. In the 2010s, the Japanese economy also became highly dependent on trade with China. China became Japan's largest trading partner in 2008; since 1995 increased shipments to China have accounted for nearly half of the overall growth in Japanese exports. In 2015, China was the largest market for Japanese exports, accounting for 23% of Japan's total trade.[64]

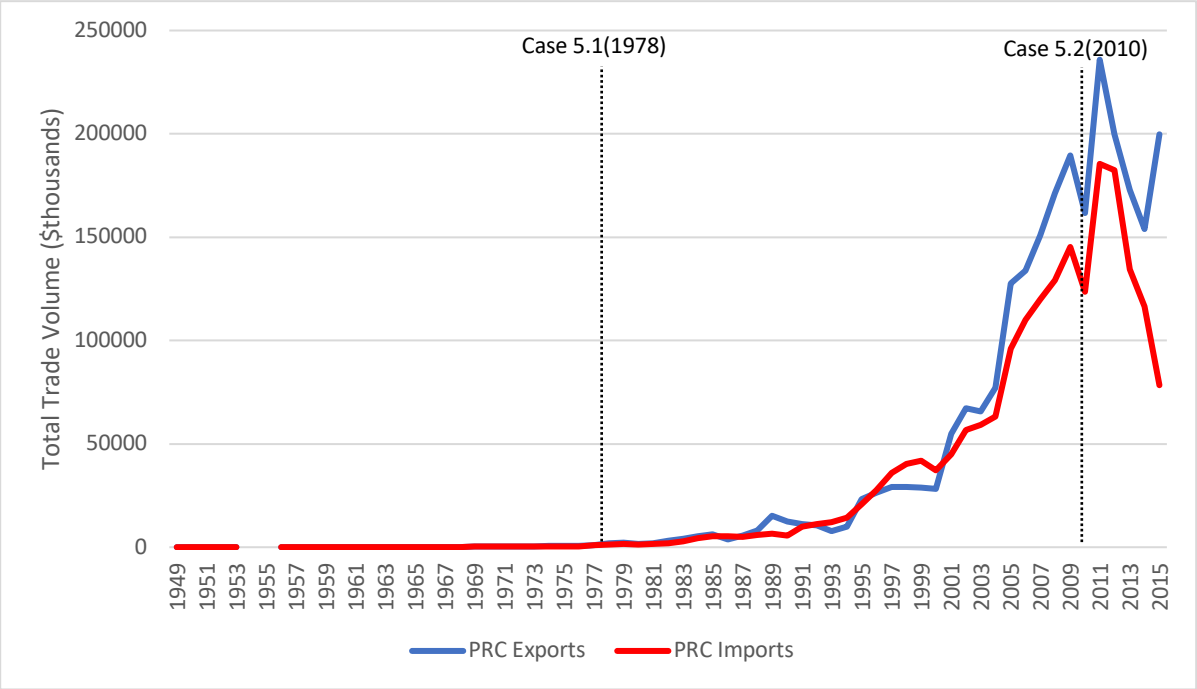

Figure 22 Japan's Trade with China (1949-2015)

Case #6.1: The April 1978 Dispute

As introduced in earlier sections, Chinese claims in the Senkaku/Diaoyu island dispute date back to 1970 and Beijing had experienced warming economic ties with Tokyo since 1972. The April 1978 Senkaku/Diaoyu dispute occurred against this backdrop of nascent (low by absolute terms), but rapidly growing Sino-Japanese economic interdependence. In particular Beijing was tremendously dependent on trade with Japan to meet Hua Guofeng's ambitious

[64] Data source: Ministry of Finance, Japan

economic development plans. The dispute occurred during diplomatic talks on the terms of the Treaty of Peace and Friendship and months after the Long-Term Trade Agreement (1978-1985) signed in February. [What is the reader supposed to be focused on? What role is the case playing?]

After Maoist rule came to an end in 1976, the Chinese leadership attempted to increase economic cooperation with Japan, driven by the increasing prioritization of economic development. During 1977 and 1978, they were involved in bilateral negotiations over the Long Term Trade Agreement and the Treaty of Peace and Friendship. Chinese leaders saw these agreements not only as serving China's economic interests but also its political interests by balancing with Japan against the influence of the USSR. The eagerness of the Chinese side in these negotiations contrasted with the hesitation and slow pace of Japanese side. Even though economic engagement with China was supported by many in the ruling LDP party, an influential wing (composed of pro-Soviet and pro-Taiwan elements) were weary of an unambiguous anti-hegemony clause that their Chinese counterparts wanted to include in the language of the Treaty of Peace and Friendship. These anti-treaty members of the Diet seized on the Senkaku/ Diaoyu Island issue as a way to mobilize opposition to the treaty (Tretiak 1978). The stalemate was broken when the anti-treaty faction of LDP proposed that the status of Senkaku/ Diaoyu Islands should be included in the treaty as an ultimate resolution of the dispute on April 7.

Chinese leaders were alarmed by this unfavorable shift in the status quo on the Senkaku/ Diaoyu Island dispute would dash their hopes for a rapid signing of the Treaty of Peace and Friendship with Japan. There is some disagreement about how the two-sides perceived the

status quo of the Senkaku/Diaoyu Island dispute. According to the uncovered *memorandum between Prime Minister Tanaka and Premier Zhou* provided by the Ministry of Foreign Affairs of Japan in 2001, during the visit to China in 1972 which started the normalization of China-Japan relationship, Kakuei Tanaka mentioned the Senkaku/ Diaoyu Islands at the end of his conversation with Zhou Enlai and the two leaders agreed to 'shelve' discussion of the dispute for future dialogue (倪志敏. 85-86).[65] To put things in terms of bargaining, Japan made an offer to take the entire pie in an ultimatum game where China had hoped for some sort of negotiated settlement short of zero.

The Japanese negotiating position in 1978 was strong: it exercised effective control over the disputed islands, it was militarily and economically more powerful than China, and it knew that Chinese leaders were more eager to sign the treaty than they were. By contrast, the strength of the PRC's claim in the Senkaku/Diaoyu Island dispute was particularly weak in 1978 in the face of this diplomatic fait accompli by the Japanese side to close down any room for bargaining over the sovereign status of the islands. The PRC did not exercise any administrative control over the disputed islands nor did it have the means to project naval power into the region; furthermore, claim over the Diaoyu Islands are based on the status of another territorial dispute – its claim that Formosa (Taiwan) is a part of the PRC. These are near textbook conditions for Chinese decisions to use military force. As Taylor Fravel (2008) noted in *Strong Borders Secure Nation*, Chinese decisions to use force in its territorial disputes reflect declining claim strengths and inferior claim postures where it occupied little or none of the lands contested. Faced with a

[65] The Ministry of Foreign Affairs of Japan disputes this account, claiming that Tanaka did not agree to Zhou's suggestion that discussion of the Senkaku/ Diaoyu Islands should be "shelved." The official position of the Japanese government is that there is no dispute over the sovereignty of the islands and thus consensus between the leaders on "shelving" (棚上げ) would constitute an official position that acknowledge the existence of a territorial dispute.

decline in its bargaining position, we would expect Beijing to signal its resolve through the use of military force to raise the estimated cost of conflict for Tokyo and thus preserve the bargaining range (maintain its status quo position that the sovereignty of the Senkaku/Diaoyu Islands is disputed).

Indeed, China reacted by provoking a militarized dispute (MID) with Japan by dispatching a large flotilla of vessels into the disputed waters near the Senkaku/Diaoyu Islands. The Japan Coast Guard has documented the whole incident with detailed description and data: "From April 12th to May 14th in 1978, a flotilla of Chinese fishing vessels appeared in the surrounding water of Senkaku Islands, 357 of which were invading the territorial water and 123 of which were making illegal operations." The Coast Guard immediately dispatched its strengthened force of patrols and aircrafts to warn the flotilla in the confrontation. The Japanese response elevates this incident to a level-3 MID (display of force) where the highest action by China is a border violation (12) and Japan's response is a show of force (7). Some IR scholars have dismissed the significance of these so-called "fishing boat" incidents as not "true" MIDs. Such an interpretation ignores the effectiveness of such actions as signals in state-to-state bargaining and their domestic political salience for leaders involved. On April 14th, Japanese parliamentary delegation led by Den Hideo met with Vice Premier Geng Biao[66]. During the meeting, Geng explained the incident as an unintentional accident for the fishing vessels were trying to chase the fish, while Den accepted the discourse even though the two sides know the incident was much beyond an accident. Prime Minister Takeo Fukuda's government chose to express their dissatisfaction but simultaneously tried to continue the dialogue. The crisis ended

[66] An interesting side note: The following year, after graduating from Tsinghua in 1979, Xi Jinping would work as a secretary Geng Biao, the then vice premier and secretary-general of the Central Military Commission, until 1982. Geng is for one of Xi's father's previous subordinates in northwestern China in the 1930s.

on April 18th, when all Chinese vessels withdrew from the disputed waters and took no further actions to challenge Japanese sovereignty over the islands. Later that year, Liao Chengzhi (the head of the Overseas Chinese Affairs Office, who was born and educated in Japan), as the representative of Deng Xiaoping, came to Japan with a statement claiming China's intention to prevent the conflict with Japan. The Fukuda government was similarly conciliatory by vetoing a plan to construct a typhoon-refuge on Senkaku/ Diaoyu Islands (which would be seen as escalatory by Beijing).

The negotiation over the Treaty of Peace and Friendship was re-initiated in July, after Fukuda took most of May and June to acquire inner-party consensus to sign the treaty. The proposed language that China recognizes Japan's sovereignty over the Senkaku/ Diaoyu Islands was dropped. The two sides finally reached a consensus on the anti-hegemony clause with the stipulation that it was not viewed as an anti-Soviet clause but in opposition to all efforts to seek hegemony in the Asia-Pacific region. Finally, the treaty was signed in August and Deng Xiaoping, who was then emerging as the paramount leader of China after a power struggle with Hua Guofeng, visited Japan in October in 1978. While in Japan, a Japanese reporter asked Deng a question on the Senkaku/ Diaoyu Islands, he replied: "...We think it would be bright to shelve this issue. It does not matter to put such issue aside, even for ten years. Our generation is not wise enough to reach a consensus. The next generation would be wiser to have a resolution that would be acceptable"[67]. Deng's reply has conclusively articulated the Chinese position toward the dispute of Senkaku/ Diaoyu Islands that it saw as the status quo since 1972. The fact that the Fukuda government did not issue a statement countering Deng's comments suggest that

[67] "Japan Has Published the Audio of Deng Xiaoping's Speech on Diaoyu Islands Issues." *The Paper*, 11 Feb. 2015, www.thepaper.cn/newsDetail_forward_1302902.

Beijing's provocation of a MID succeeded in achieving its desired bargain over the Senkaku/Diaoyu Island, or at least prevent a diplomatic fait accompli, given an unfavorable position.

Analysis

The deployment of the Chinese flotilla sent an effective military signal that China would not accept a unilateral settlement of the dispute as a condition for the Treaty of Peace and Friendship. There is little credence to Geng Biao's claim that this was an "accident." Such a large number of ocean-going fishing vessels, traveling from homeports as far north as Tianjin and as far south as Guangzhou, could not have escaped the notice of Chinese naval personnel. Additionally, the level of coordination and discipline between the crews suggested that the incursion was likely under PLA naval command and resulted from an order from the Politburo (Tretiak 1978). The pro-treaty Fukuda government did not respond by escalating the crisis further, by attempting to seize or evict the Chinese vessels from the disputed waters. No one was injured or killed in the resulting stand-off. The purpose of the mission was not to seize control of the islands but to send a credible signal from leaders in Tokyo of Beijing's displeasure with the anti-treaty group's attempts to revise the terms of the treaty. Inclusion of the disputed islands in the treaty would be a diplomatic defeat for Beijing as would the failure to conclude the treaty with Japan, particularly at such a politically important time for Deng. But the strategic application of para-military force was a credibly costly move for China because it risked both military escalation with Japan but it also had enough plausible deniability to keep enough to keep language about the Senkaku/Diaoyu dispute out of the treaty without eliciting a nationalist backlash in Japan that would endanger the passage of the treaty. This reflects a strategy of

sinking costs (putting Chinese personnel in danger) without tying the leaders hands (plausible deniability). In the parlance of today, this was a low intensity grayzone conflict. When the opportunity for negotiation on more favorable terms re-appeared, the Chinese vessels soon retreated, further enforcing the clear political motivation of the event.

What role did economic interdependence play in this crisis? At first glance, it seemed to play a major role as the motivating logic for both sets of leaders was to conclude a treaty that would deepen economic cooperation between China and Japan. But this is only half of the story because it ignores the equally compelling strategic logic that led China to provoke a MID with Japan. This is why it is important to separate the effects of economic interdependence on *strategy* from its effects on *interests,* or put another way to distinguish the constraint mechanism from the transform mechanism. Seen in the broader context of the Sino-Japanese relationship, the April 1978 case supports the predictions of the transformation mechanism (*H3c: As trade interdependence increases, China is more likely to settle territorial disputes peacefully.)* The dispute was resolved peacefully and the expectation of greater trade interdependence (represented by the Long Term Trade Agreement signed earlier in that year) was a major factor that neither Fukuda nor Deng wanted to see the dispute over the Senkaku/Diaoyu Islands to escalate further. In fact Deng's 1978 visit to Japan and his suggestion for the "shelving" of the dispute is often used as an example to show how economic engagement created a solid foundation for Japan's peaceful accommodation of China's rise. For three decades after the 1978 dispute, China and Japan's economies became even more deeply integrated and China did not militarily challenge Japan's control over the islands to the point where most analysts were taken by surprise by China's actions in the 2010 Senkaku/Diaoyu dispute and linked it to a narrative of China's "new" assertiveness (Johnston 2012).

But as this chapter has argued, this dispute dates back to at least 1970 and was shaped by the outcomes of conflicts going back to the 19th century. There is no doubt that economic engagement played a major role in how leaders in China and Japan defined the national interests of their countries in the decades after 1978. Trade did achieve the transformative effects that liberal scholars have noted, particularly in diminishing the relative value of conquering territory. This holds even after we control for China's growing capacity to explore and exploit underwater reserves of oil and gas, which makes the territory around the islands relatively more valuable (negating a common but misleading explanation for rising conflict in the region). China and Japan have signed agreements to jointly explore these resources in 2008 and 2011 rather than fighting over them. But equally critically, it did not solve the zero-sum nature of the territorial dispute between China and Japan over the sovereignty of the Senkaku/Diaoyu Islands. The hundred fold increase in trade between the two nations have not advanced the consensus on the issue of sovereignty one bit.

Therefore, it is equally important to consider the effect of economic interdependence on strategy in this case. The volume of trade between China and Japan in 1978 was still relatively small, less than $8 billion USD, but China's trade dependence on Japan in 1978 was relatively high (1.75% of GDP), which is still far lower than the levels it would achieve in the 2000s but is nonetheless above the median value for China's historic trade dependence. Japan's trade dependence was comparatively much lower. But it is unambiguous that the existing level of trade and the promise of further economic liberalization *did not* constrain Chinese leaders from provoking a MID when they felt that China's weak bargaining position on the Senkaku/Diaoyu islands was deteriorating. Nor was Deng willing to consider withholding economic cooperation with Japan, hypothetically by revising the terms of the Long Term Trade Agreement concluded

earlier that year, as the information mechanism and the logic of substitution would suggest. Beijing chose to use a para-military operation to send a costly signal to Tokyo instead of any economic sanctions. The state certainly has the means to use economic coercion, but these options are more costly than the military option of sending fishing boats because they would have endangered Deng's economic development goals. From a strategic perspective, economic sanctions would be effective as costly signals in a territorial dispute but they would create collateral damage (ex. souring Japanese investor sentiment and endangering medium and long run economic cooperation) that make them less attractive as coercive instruments. The economic relationship was also asymmetric and China was the more economically dependent and less technologically advanced of the two economies in 1978. If anything, Beijing's desire to conclude the treaty quickly and secure technology and development aid from Japan seem to have made the military option more attractive. Ironically, China's initiation of a MID in 1978 (and the failure of economic interdependence to constrain or inform) might have bought enough time for the transform mechanism to gain momentum over the subsequent decades. The effect of trade on the logic of military force can operate differently at the level of interests and the level of strategy and do so in this case.

Case #6.2: The September 2010 Dispute

We observe a similar dynamic in the 2010 Senkaku/Diaoyu Dispute, where the transform and inform mechanisms of economic interdependence also do not hold. Neither China's nor Japan's position on the status of the islands since Deng Xiaoping's 1978 suggestion to shelve the dispute for the next generation. However, the next generation of leaders did not prove wiser in coming up with an acceptable solution to this zero-sum game over sovereignty.

On the morning of September 7th, 2010, a Chinese fishing vessel sailing in the disputed waters near the Senkaku/Diaoyu Islands crashed into a Japan Coast Guard vessel. After rejecting the coast guard's request to inspect his ship and failing to escape from the guards on September 8th, the captain, Zhan Qixiong was captured and detained by the coast guard under the name of obstructing the public duties of coast guard personnel, along with his crew.[68] The detention quickly elicited China to initialize a series of meetings with the Japanese ambassador, requiring Japan to release Zhan. In reaction to Chinese strengthened pressure, Japan released all the fishermen on September 14th, yet still detained the captain. On September 19th, the local court of Ishigaki approved the decision to prolong the detention to 10 days.[69]

On September 21th, the Chinese premier Wen Jiabao demanded Japan to release Zhan in at an address to the United Nations General Assembly in New York, threatening that China would take "further action". At the same location and on the same day, Seiji Maehara, the Foreign Minister of Japan, said he was willing to have a meeting with Chinese officials to explain the Japanese response. Wen's speech was also a Chinese official expression of its opinion on the fishing vessel accident at the highest level. At the core of China's diplomatic concern is that the arrest of captain Zhan on the grounds that he was "obstructing the public duties of coast guard personnel" would only be valid if the crime was committed in sovereign Japanese territory, a status which Beijing disputes. As Fravel explains, "By moving to prosecute the Chinese captain for violating domestic laws, China viewed Japan as increasing the strength

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[68] The Issue for Japan Plus, "Issues on ownership of Senkaku Islands', 16 Sept. 2010, web.archive.org/web/20120202110526/http://www.bitway.ne.jp/bunshun/ronten/ocn/sample/keyword/100916.html.
"Trawler's collisions, JCG arrest of skipper near Senkakus protested," 9 Sept. 2010, https://www.japantimes.co.jp/news/2010/09/09/national/trawlers-collisions-jcg-arrest-of-skipper-near-senkakus-protested/#.WycrQRIzrOQ

[69] BBC News, "Japan Released the Detained Chinese Crews", 13 Sept. 2010, http://www.bbc.com/zhongwen/simp/china/2010/09/100913_brief_china_japan.shtml

of its claim by taking unprecedented actions that demonstrated its sovereignty over the islands and territorial waters."[70] However, reprehensible Zhan's actions -- unflattering footage was later leaked in which his belligerence contrasts sharply with the professionalism of the Japanese coast guard officers --, Beijing suspected Tokyo of using the incidence to establish a legal precedent that would strengthen Japan's already stronger position that the Senkaku islands are sovereign Japanese territory and no dispute exists over them.

Days following Wen's speech, the *New York Times* ran a headline article that China had carried out the "further action" threatened by Wen by placing an embargo on the rare earth metals that China exports to Japan.[71] This was a headline generated widespread concern that China was beginning to use economic sanction to gain political leverage over Japan in the negotiation. On the same day, the Chinese government arrested four Japanese citizens, accusing them as "entering into the military zone and recording the military targets illegally". On September 25th, the local court released Zhan, based on the "consideration for Sino-Japan relationship". As Zhan arrived at China, the Ministry of Foreign Affairs of China made a statement claiming its sovereignty over the Senkaku/ Diaoyu Islands and requiring Japan to apologize for the detention. rejected the Chinese request, re-stating Japan's sovereignty over the islands and "there is no need to reply" on September 26th. On September 27th, China initiated a MID by dispatching fishery administration vessels to the territorial waters of Senkaku/ Diaoyu Island, resulting in a confrontation with the Japanese patrols. The movement

[70] Fravel, Taylor, "Explaining China's Escalation over the Senkaku (Diaoyu) Islands" https://taylorfravel.com/documents/research/fravel.2016.GS.senkakus.escalation.pdf

71 "China Is Blocking Minerals, Executives Say," 24 Sept. 2010 https://www.nytimes.com/2010/09/24/business/energy-environment/24mineral.html

as a "patrol commitment" was later proven by the Spokesperson of the Ministry of Foreign Affairs in the press held on the next day.

In 2010, Chinese mines provided more than 90% of the global supply of rare earth metals[72] and China's decision to suspend rare earth metal exports to Japan (and later that year to the US and EU) sparked global concern.[73] The dominant narrative that emerged in the press and among policymakers is that the 'embargo' was a blatant attempt by Beijing to use economic coercion to force the Tokyo to release the arrested Chinese fishing captain. However, the evidence that calls into doubt whether the suspension of rare earths was in fact meant as a deliberate strategy of economic coercion. But what is clear is that the rare earths 'embargo' was not a good 'costly signal' and backfired strategically.

Analysis

Much ink has been spilled on the implications of the 2010 Senkaku/Diaoyu incident. It is centrally featured in the narrative about China's "new assertiveness" because the embargo of rare earth metals called into question the long-standing pattern of 'hot economics, cold politics' where economic engagement was isolated from political conflict in Sino-Japanese relations. It also reads like a text-book case for the information mechanisms by showing an example of economic interdependence giving China the means to use trade for coercive purposes. This economic sanction episode by China has launched a wave of interest in Chinese economic coercion. Bonnie Glaser writes in a CSIS report: "A more widely reported case of China using

[72] This is a generic term for metals in Group 3 of the periodic system. They are used in a range of advanced products such as hybrid vehicles, computer parts, smart phones, wind turbines, solar panels, energy-saving domestic electronics and guided missiles.

[73] See NYT reporting: http://www.nytimes.com/2010/09/23/business/global/23rare.html?pagewanted=all&_r=0

trade as a weapon to force a country to alter its policy occurred in September 2010 when Beijing blocked shipments of rare earth minerals to Japan… Beijing's action alarmed Tokyo and was a major factor in the decision of the Japanese government to release the captain. The embargo was viewed by many experts as evidence of Chinese willingness to use economic leverage to have its way in an international dispute."[74] The purpose of the case study is to determine whether the cost and benefits of using economic versus military instruments in the crises change with growing economic interdependence. I will present some evidence that casts this dominant narrative about economic coercion into doubt and discuss the similarities between the effects of interdependence in 1978 and 2010.

There is disagreement among scholars on whether China's suspension of rare earth exports was intended as economic coercion, that is to say the decision was made to gain political leverage on the dispute with Japan over the arrested fishing captain[75] (Hagstrom 2012, Morrison and Tang 2012, and Johnston 2013). The disagreement is not over whether or not exports were suspended in 2010 but whether the timing had anything to do with the dispute in the East China Sea. As Linus Hagström notes (**bold** added by this author for emphasis):

> Although the timing of the export halt might seem to imply a connection, there are certain data that favour Beijing's side of the story. *Asahi Shimbun* reported in **mid-August 2010** that Beijing had decided on a 40% cut in the export of rare earth metals in the second half of that year, quoting environmental reasons. This decision allegedly 'came as … a shock' to Japanese Industry Minister Naoshima Masayuki and 'caused panic in Japan'—the world's biggest importer of rare earth metals. **On August 18**, the parliamentary secretary of the Ministry of Economy, Trade and Industry, Kondō Yōsuke, travelled to Beijing in an unsuccessful attempt to maintain exports at the 2009 level. Ten days later, at a Japan–China High-Level Economic Dialogue meeting, Naoshima reportedly asked Chinese Minister

[74] *China's Coercive Economic Diplomacy: A New and Worrying Trend* https://www.csis.org/analysis/chinas-coercive-economic-diplomacy-new-and-worrying-trend

[75] Also see: King, Amy, and Shiro Armstrong. "Did China really ban rare earth metals exports to Japan." East Asia Forum. Vol. 8. 2013.

> of Industry and Information Li Yizhong and Commerce Minister Chen Deming to reverse the decision, but the effort was again unavailing. The Chinese side restated the environmental argument and also emphasized fears of over-exploitation of resources.

The arrest of the Chinese fishing captain occurred on September 9, almost a month after the Chinese announcement to reduce rare earths exports and two weeks after failed attempts by METI to reverse the decision. The timing of the announcement means that the decision was unlikely to be motivated by the unfolding Senkaku/Diaoyu dispute. This is further reinforced by the fact that China also halted some rare earth shipments to the United States and Europe as well and they are not party to the dispute in the East China Sea. What seems more likely is that METI's announcement that China has suspended rare earth shipments to Japan on September 23 (just days before the Japanese government released the fishing captain on September 29) was an attempt to put pressure on Beijing to reverse its rare earth metals industrial policy. The backlash against Beijing's perceived use of rare earth exports as a weapon was felt around the world. Mines long shuttered in the United States and Australia announced plans to restart operations to counter China's strategic dominance in this commodity. If Beijing did indeed withhold rare earth exports to Japan for political leverage then it quickly capitulated. Beijing stated that it would resume the exports on October 28, and effectively did so to Japan on November 19, 2010. This two month suspension of exports did not have much of an impact on Japan economically, as it was insufficient for Japanese firms to exhaust the stockpiles of rare earth metals they have accumulated. The episode also jeopardized China's reputation as a secure and stable supplier of rare earth metals (and other commodities) and dampened foreign demand for the commodity. China had gained a near monopoly in industry because of cheap labor, lax environmental standards, and state support in terms of cheap land and financing for

the industry. A subsequent WTO investigation in 2012 would find that China's rare earth export quotas were motivated by industrial policy to incentivize intermediate rare earth metals processing firms to relocate to China (or for its own firms to upgrade industrially to fill these niches). If anything, this goal was made more difficult by the press coverage given to its rare earth 'embargo' in 2010 and the resolution of the case shows the strength of international economic institutions in constraining economic coercion.

Instead, the more plausible explanation of Chinese strategy should focus on the its arrest of Japanese citizens on the dubious grounds of "entering into the military zone and recording the military targets illegally" (a tit-for-tat move for the arrest of Zhan that is much more in character with Beijing's conduct of foreign policy). This move likely put enough pressure on the Noda government to release Zhan in exchange for the exchange of the release of the four Japanese citizens. Beijing's next move was calibrated to return the status of the Senkaku/Diaoyu Island dispute to what China views as the status quo. This is why the Ministry of Foreign Affairs of China made a statement claiming its sovereignty over the Senkaku/ Diaoyu Islands and requiring Japan to apologize for the detention. But, in light of the intense publicity and nationalist mobilization in both countries around the event, this demand by Beijing was incredibly tone deaf and insensitive to the pressure of public opinion in Japan. The arrest of captain Zhan was almost certainly not a deliberate effort at territorial revisionism by Japan. The threat to try him under Japanese law (whereas standard operating procedure in the past was to quietly return the arrested seaman back to Chinese authorities), can probably be attributed to the inexperience of the new DPJ government under Prime Minister Noda (which, ironically, was seen as one of the most pro-China administrations in years). The incident and media coverage sparked public outrage in Japan after footage was released of the Chinese fishing

trawler ramming two Japanese Coast Guard patrol ships while attempting to flee. The media narratives around rare earths embargo and the arbitrary arrest of Japanese nationals in China created an environment where it was impossible for any Japanese government to meet Beijing's demands. The Noda government rejected the Chinese request for an apology, re-stating Japan's sovereignty over the islands and "there is no need to reply" on September 26th.

On September 27th, China initiated a MID by dispatching fishery administration vessels to the contiguous territorial waters of Senkaku/ Diaoyu Island, resulting in a confrontation with Japanese Coast Guard patrols. China's action in 2010 was very similar to the 1978 case with a notable difference. In contrast to Geng Biao's denial of government involvement, a Ministry of Foreign Affairs spokesperson acknowledged that the incidence was part of a "patrol commitment," confirming the deliberate governmental approval for this escalatory move. The deployment of the fishery administration vessels in 2010 was so important because it marks the beginning of a series of militarized actions that indicate a change in Chinese strategy towards the Senkaku/Diaoyu Island dispute. No longer were leaders in Beijing satisfied with the "shelving" of the dispute in 1972, in 2010 they seem to move towards a position of strengthening China's claims by establishing facts on the water. Figure 23 shows data from the Japanese Ministry of Defense counting the number of Chinese vessels approaching or entering into the territorial water of Senkaku/ Diaoyu Islands. Starting from September 2010, the number of identified vessels within the contiguous water went through a sharp increase from zero, to a peak of 24. On December 25th, 2010, China proposed that the two countries agree to "shelving" the dispute but was rebuffed by Japan. Over the next two years there were regular incursions and, beginning in 2012 after Japan nationalized the Senkaku/Diaoyu Islands, they have increased dramatically in frequency to hundreds of incursions per month.

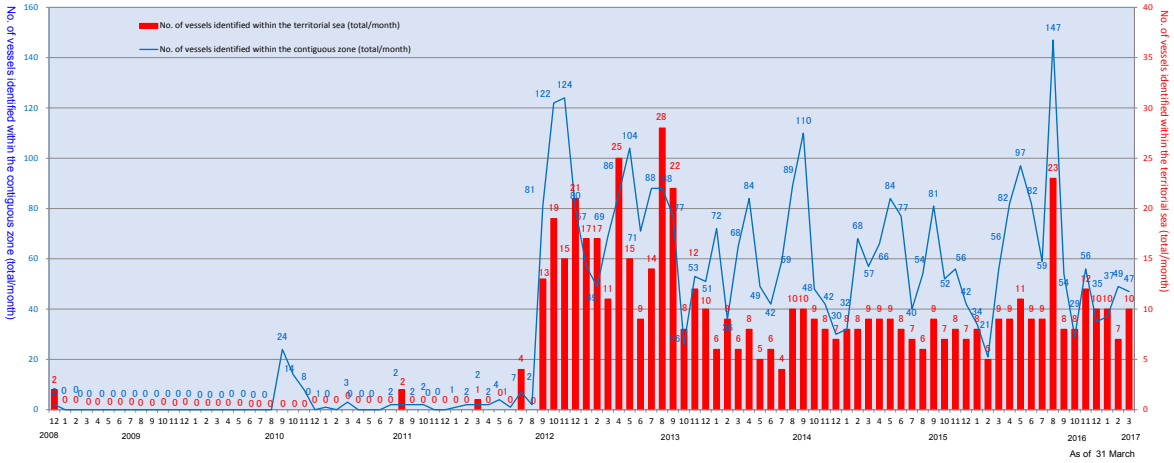

Figure 23 Number of Chinese Vessels in Japanese Territorial Waters and Contiguous Zone (2008-2016)

In the following months, Sino-Japanese relations continued to deteriorate. On October 9th, all four detained Japanese citizens had been released. But, starting from October 16th, large scale anti-Japan protests broke out in cities across China, and were particularly large in Chengdu, Xi'an, and Zhengzhou. Thousands of people participated in the protests in the three cities, and many shops selling Japanese products and Japanese cars parked on the street were destroyed by the protesters. The government waited until October 19th to condemn the protests in an official statement at a Ministry of Foreign Affairs press conference. According to research by Jessica Weiss (2014), this type of decision to allow popular protests to take place represents a hand-tying strategy by the authoritarian state to strengthen its international negotiating position. Subsequent work by Weiss, Kristin Vekaski, and Kacie Miura, has shown that local leaders in cities that depend more on Japanese investment served as a bulwark against these nationalist campaigns by more actively protecting Japanese businesses from protesters.

After all is said and done, what role did economic interdependence play in this crisis? The volume of trade between China and Japan in 2010 was massive, totaling some $290 billion

dollars, and much more diversified (see Appendix A for a detailed comparison of the structure of trade between China and Japan at the product-level in 1978 and 2010). China's trade dependence on Japan in 2010 was quite high (6.14% of GDP), which is far above the median value for China's historic trade dependence. Unlike in 1978, Japan's economic dependence on China in 2010 was equally high; since 2008, China became Japan's largest trade partner. However, did this mutually high level of economic interdependence alter Beijing's conduct of foreign policy in significant ways?

As I noted earlier, the 2010 Senaku/Diaoyu crises at first appear to be an example of the information mechanism (*H2c: As trade interdependence increases, China will be more likely to initiate economic sanctions and less likely to initiate MIDs*). But the weight of evidence on the rare earths embargo is against the notion that is was a deliberate attempt to use economic sanctions as a substitute for military force in costly signaling. Instead, the fact that China continued to escalate the crisis by dispatching government vessels after the return of the arrested captain suggest that high levels of economic interdependence did not constrain China's willingness to use military force to strengthen its bargaining position. In fact, bilateral trade volume and the level of economic interdependence between China and Japan would continue to increase after 2010, but China's willingness to use military force in its dispute with Japan has increased dramatically. In October 2012, seven PLA warships return from exercises in the western Pacific, and became the first-ever PLA warships to transit through Japan's contiguous zone when they passed south-southeast of Yonaguni Island. This was a clear show of military force meant to signal unambiguously China's resolve over the Senkaku/Diaoyu islands and would be coded as a level-3 MID. Such MIDs occurred with regular frequency in the years that followed 2012 with large scale Chinese naval exercises in the East China Sea in January 2013

and incidents such as a Chinese frigate putting a 'radar-lock' on a Japanese destroyer later that year. The suspension of military-to-military contact means that these incidents create serious risks of accidental escalation, as such they are classic examples of Schelling's 'rocking the boat' strategy of brinksmanship. At the same time, the research by Vekasi and Miura show that China's ability to wield economic coercion (through consumer boycotts and anti-Japanese protests) are constrained by economic interests at the local level. Similarly, China would eventually scrap its rare earths export quotas in 2014 after the WTO ruled against its export restrictions in a 2012 case brought by Japan, United States, and other governments. These examples show that, as economic interdependence increases, so do the externalities that economic sanctions would produce on one's own economy and on third party economies. This is why we observe no additional episodes of economic sanctions targeting Japan since 2010 even though tensions continued to escalate until 2018. On balance, interdependence makes economic coercion more difficult but it does not constrain military coercion short of war (H1c: *As trade interdependence increases, China will NOT be less likely to initiate a MID*).

The strategy of Chinese uses of military force over the 1978 and 2010 Senkaku/Diaoyu island disputes differ in significant ways and did the outcomes. Beijing used military force in 1978 to deter -- to block language about the Senkaku/Diaoyu dispute out of the Treaty of Peace and Friendship -- and did so with an operation that provided plausible deniability of government involvement. Beijing's use of force in 2010 was to compel Japan to issue an apology, walking back the precedent that it set by attempting to try captain Zhan under Japanese law. However, we know that it is much harder to compel than to deter in international affairs (Schelling; Art 1980). It is perhaps no surprise, therefore, that Beijing succeeded in 1978 and failed spectacularly in 2010 (its heavy-handed actions created a public backlash in Japan that prepared

the ground for the 2012 crisis that led to the nationalization of the disputed islands). But the logic behind its use of military force in both cases was one that was driven by the strategic need to reverse a decline in its bargaining position over a zero-sum dispute over sovereign territory. Until 2012, China has limited these incursions into disputed territories using non-military vessels and aircraft, reinforcing the fact that the policy is intended to signal rather than to fight for control.

Even though many of these skirmishes around the Senkaku/Diaoyu islands involve non-military vessels from both sides (ex. coast guards), they represent bargaining that is taking place in the shadow of power. One factor that must be examined is the fact that economic interdependence has given Beijing the resources to modernize its military in the decades since 1978. China's defense budget increased more than seven-fold from $10.7 billion in 1978 to $76.4 billion in 2010. The PLA Navy and Air Force would have struggled to project power to the Senkaku/Diaoyu Islands in 1978 experienced rapid modernization in the 1990s. According to IISS, the capital ships of the Japanese Maritime Self Defense Force (JMSDF) consisted of 4 helicopter carriers, 26 destroyers, 10 frigates, 6 corvettes, and 19 attack submarines in 2010. The PLAN's East China Sea Fleet alone had 16 attack submarines, 4 destroyers, 13 corvettes, and 14 frigates in 2010. With the exception of destroyers and helicopter carriers, one of the three PLAN fleets could closely match the naval capabilities of the entire JMSDF and does not lag far behind in terms of modern weapons technology. With its defense budget fixed at 1% of a stagnant GDP, the JMSDF is still a formidable navy (2nd largest in Asia) but lags increasingly behind the PLAN in total tonnage. The similarly narrowing gap in the balance of forces exists when comparing the PLA Air Force with the Japanese Air Self Defense Force (JASDF) and a much bigger gap still exists between the coast guards of the two countries. The massive

disparity between relative PLA capabilities in 1978 and 2010 is not reflected in dramatically different approaches used by Beijing in the two crises. This suggests that strategy in these disputes is not dictated by relative military capabilities alone, which makes sense because war just has to be costly enough relative to a negotiated solution to create room for bargaining. In 1978, China already possessed a nuclear deterrent and Japan was backed by the United States, a nuclear-armed ally; the differences in military capabilities on the cost of war are therefore marginal. China might be able to engage in more MIDs because it had previously lacked the capabilities to do so, but the political logic of diplomatic bargaining remains the most powerful driver of MIDs.

The transformative effect of economic interdependence may play a perverse role in incentivizing low-intensity MIDs. In 1978, economic interdependence was still relatively low and both China and Japan were willing to compromise politically to achieve a higher level of economic cooperation because the alternative of continued isolation was very real if either side backed out of the negotiations. The massive increase in economic interdependence in the subsequent decades and the proportional increase in the opportunity cost of severing this relationship makes it a less credible alternative. This mutual dependence on trade creates a stability-instability paradox not unlike that created by the advent of thermonuclear weapons. Massive retaliation is not a credible threat when it risks mutually assured destruction, but permits conflict at lower levels of intensity. Trade also makes wars between interdependent economies prohibitively costly for both sides, but should not constrain military behavior where revoking trade would not be a credible response. Commercial interests are not immediately impacted by military conflict at lower levels (such as military exercises and other shows of force), but are very sensitive to economic coercion (such as import or export restrictions). Even

though policymakers view incidents such as border skirmishes with grave concern, markets tend to ignore these minor disputes because they generate no immediate economic costs. Trade can thus bring stability at high levels of conflict – transforming *interests* and making war unthinkable-- but creates instability at lower levels of conflict -- incentivizing *strategies* of risky military behavior short of that threshold. There is also little evidence that economic interdependence transforms interests to such a degree that compromise is possible on territorial disputes like the Senkaku/Diaoyu Islands (*H3c: As trade interdependence increases, China is more likely to settle territorial disputes peacefully.)* Even though trade expanded by nearly three hundred-fold, the diplomatic positions about the status of claims over the islands were the same in 2010 as they were in 1978.

Today, under yet another generation of leaders – Shinzo Abe in Japan and Xi Jinping in China -- the two sides appear further than ever from a mutually agreeable resolution. As Sheila Smith suggests, the 2010 crisis has brought the divergence between China and Japan over Senkaku/ Diaoyu Islands from the quiet bilateral discussions into public scrutiny and debate. It also marked the first time Japan perceived that China poses a serious challenge to its effective control over the islands. This recognition was quickly reflected in the joint exercise conducted by Japan Self Defense Force and U.S. military in December of the same year and the subsequent deepening of Japanese security cooperation with the U.S. under Abe. For his part, Xi Jinping has sought economic cooperation with Japan while adopting a more assertive strategy, by declaring an Air Defense Identification Zone (ADIZ) in the East China Sea in November 2014 and more actively disputing actual Japanese control of the waters around the Senkaku/Diaoyu islands with increased patrols of ships and aircraft. The economic relationship has once again warmed in 2018 with the reopening of high-level economic talks in April and war between the

two Asian giants remain highly unlikely. But the status of the Senkaku/Diaoyu Island dispute remains unresolved and is likely to remain a source of continued militarized disputes future.

6.2 Vietnam Cases: South China Sea Dispute

China and Vietnam's competing claims in the South China Sea have a complicated history due to the partition of Vietnam during the Cold War and its subsequent reunification under Hanoi. China supported the North Vietnam government in Hanoi in its war against the rival South Vietnam government in Saigon, but in the final year of the war, after American forces had started to withdraw from Vietnam after the 1973 Paris Peace Accords, China seized the lightly garrisoned Crescent Group islands in the Paracels from South Vietnam in January 1974. Following the demise of South Vietnam in April 1975, the Hanoi government reclaimed some islands in Paracels and Sprartlys that were previously controlled by Saigon. These competing claims between Hanoi and Beijing resulted in many rounds of minor conflicts and naval skirmishes in the South China Sea both before and after the 1991 Normalization. The most serious of these clashes took place in February to March of 1988 in the Johnson South Reef Skirmish in the Spratlys. In response to Vietnam's occupation of the Fiery Cross Reefs, China increased its naval presence in the disputed waters and redoubled its own efforts to occupy land features in the Spratlys. Then, on March 13, a hot conflict broke out in Johnson (Chigua) Reef, east of Fiery Cross Reefs. According to Chinese sources, PLAN destroyers encountered Vietnamese ships approaching in March 13 (Fravel 2008). Both sides deployed sailors on the reef the next morning, each with the order to evict the other side off the reef. Later that day, a shoving match broke out, during which multiple shots were fired from both sides; and ships from both sides opened fire upon each other subsequently. As a result, the PLAN,

with one sailor injured, sank all Vietnamese ships within half an hour, killing 74 Vietnamese sailors, as both sides confirmed after the conflict. The PLAN then ordered by Beijing to cease further attacks on Vietnamese forces and facilities, deescalating the crisis.

From a legal standpoint, these maritime territorial disputes have been heightened by the differences between China's Nine-Dash Line discourse and the Exclusive Economic Zones discourse of the United Nations Convention of the Law of the Sea (UNCLOS). According to the definition of EEZ under UNCLOS, which China participated in its negotiation process 1973 to 1982 and subsequently ratified in 1996, "the coastal state possesses sovereign rights for the purpose of exploring and exploiting, conserving and managing the natural resources of the water superjacent to the seabed and of the seabed and its subsoil." As to the breadth of EEZ, UNCLOS dictates that "the exclusive economic zone shall not extend beyond 200 nautical miles from the baselines from which the breadth of the territorial sea is measured."[76]

[76] United Nations Convention on the Law of the Sea - Main Page." p.43

Figure 24 Map of the South China Sea Islands Dispute

Despite being a signatory of UNCLOS, China has long favored the Nine-Dash Line claims that was inherited from the U-Shape Line drawn by the Republic of China in 1947 (Ba 2011). As shown in Figure 24, the discrepancy between China's claim line and the 200-nautical mile EEZ line is considerable. Vietnam disputes the southern part of the Paracels and the entirety of Spratlys based on its EEZ claims under UNCLOS. However, as mentioned earlier,

China possesses the majority of Paracel Islands and is in the process of expanding its military presence and influence in Spratly Islands by building artificial islands with military capacities.

Economic Context: Sino-Vietnamese Economic Engagement

The discovery of natural resources in Paracel and Spratly Islands has also fueled up competition between Beijing and Vietnam. The earliest oil exploration record in South China Sea record could be traced back to early 1980s, during which China drilled some 120 wells in South China Sea. Although only about ⅓ of the drilled wells turned out to be resourceful, western oil companies saw the potential of South China Sea, and swarmed in to cooperate with China and Vietnam. I will focus on two such oil rig incidents to analyze whether China's conduct of foreign policy, particularly its propensity to use military force and economic sanctions, changed as its economic interdependence with Vietnam increased. As Figure 25 shows, China trade with Vietnam was more than 100 times greater in 2014 compared to 1994.

Figure 25 Log Scale of Vietnam's Trade with China

Case #6.3: The 1994 Wanan Bei Oil Rig Incident

Following the 1979 war, China and Vietnam did not normalize diplomatic relations until November 1991. In 1994, trade between the two countries was beginning to recover, would reach about $220 million USD by the end of the year. It was in this context of low but growing economic interdependence that the Wanan Bei Oil Rig Incident took place. Starting in April 1994, the American-owned Crestone Energy Corporation started a joint oil exploration project with the Chinese government in Wanan Bei-21 block, a oil-rich territory southwest of the Spratly Islands about 280 miles off the Vietnamese coast (Ang 2001). Vietnam controlled oil exploration blocks 133, 134, and 135 (partially overlapping with what Chinese named as Wanan Bei-21 block), and had a few oil rigs under construction in the area as a result of Hanoi's cooperation with Mobil Consortium in early 1990s. While the existence of Vietnam-controlled oil rigs posed no substantial threat to China's exploration or future development within the vicinity, Beijing regarded Vietnam's presence in Wanan Bei as an overt violation of its sovereignty and its energy interest within South China Sea. Vietnam, likewise, demanded both China and Crestone to stop their joint exploration, claiming that the deed of Beijing and Crestone was a sheer violation of Vietnam's sovereignty (Jian 1997).

In an attempt to cut off the supply of one Vietnamese oil rig conducting drilling activities, China deployed two PLAN frigates to block Vietnamese ships trying to reach the Wanan Bei block in late July. By July 21, the Chinese frigates turned back at least one Vietnamese vessel carrying supplies to the oil rig. Shortly after the blockade occurred, Chinese Foreign Ministry issued a statement claiming that "Vietnamese drilling activities in [Wanan Bei] have gravely encroached upon China's sovereignty and maritime interests," (Ang 2001) a common diplomatic discourse used by Beijing to express discontent toward incident at

contested territories. However, the following statement: "...the Vietnamese side shall be held responsible for the ensuing consequences" spurred speculations that this blockade could deteriorate into far severer conflict. Vietnamese Embassy in Beijing, later that day, responded that they "were 'very concerned' about reports of the blockade," and used the continental shelf concept in UNCLOS to back up its claim that Wanan Bei belongs to Vietnam both historically and legally. Vietnam also occupied 7 reefs in the eastern part of the Spratlys throughout 1994 as part of the escalation of this dispute (Fravel 2008).

To resolve this issue, the two sides met on August 1994 at the Sino-Vietnamese Vice-Ministerial meeting, during which "joint development of [Spratly]" which includes the issue of Wanan Bei oil rig, was discussed (Ang 2001). Although the first round of talk failed to achieve a consensus, it laid down a solid framework for future negotiations. Later when President Jiang Zemin visited Hanoi in November 1994, both sides agreed to form a working group to solve the issue of Spratly, which resulted to the forming of Joint Working Group (on Spratlys) in July 1995. Ultimately, after rounds of talks, both Beijing and Hanoi signed the Land Boundary Treaty in December 1999 that agrees to divide the disputed land territory that no one has de facto control upon roughly evenly but did not explicitly address the Wanan Bei block or maritime disputes.

Analysis

What role did economic interdependence play in the course of this dispute? After the collapse of the USSR, Vietnam saw the need to improve economic ties with China. By 1994, China was exporting primarily light manufactured goods such as machine components (30%) and cigarettes (14%) to Vietnam and importing crude petroleum (40%) and raw grains (20%)

from Vietnam. The economic relationship was tilted heavily in China's favor, China's trade with Vietnam accounted for 0.04% of China's total trade while Vietnam's trade with China accounted for over 5.38% of Vietnam's total trade (excluding Hong Kong). Against the backdrop of this asymmetric economic relationship, the two countries were engaged in zero-sum bargaining over control over a disputed tract of maritime territory.

The inform mechanism would predict that China might opt to use economic signals rather than military signals while the constrain mechanism would predict that military force can be used in this case without generating economic externalities. China had the economic leverage to use sanctions or embargo Vietnam's oil exports but did not adopt this policy option. Instead it chose to use military force to dispute Vietnam's maritime claims by dispatching PLAN frigates and limiting access only to the disputed oil bloc that was being explored. The choice to use military force was probably helped by the fact that the PLAN had conventional superiority in the military balance. The Vietnamese navy in 1994 had around 60 coastal combatants and 7 frigates, mostly Soviet-made, at its disposal (IISS). By contrast, just the PLAN's South Sea Fleet, the navy command with jurisdiction over the South China Sea, alone, has over 300 patrol vessels, 18 destroyers, 37 frigates, and 2 submarines. It therefore enjoyed a massive military superiority and can be confident of military victory if the dispute was escalated militarily.

Beijing's use of military force served a limited political objective -- to exclude Vietnam from exploring for oil in the Wanan Bei block. Vietnam for its part chose not to escalate by confronting China militarily but instead seized other reefs to strengthen its claims in the Spratlys and other opportunities for oil exploration. The crisis deescalated when both sides opted to seek a diplomatic solution to the dispute. However, these negotiations stopped short of solving the tricky issue of maritime boundaries in the Spratlys and Paracels but did succeed in opening up

avenues for further economic integration. Trade and investment were not derailed by the 1994 dispute and bilateral trade would increase by more than 100 fold over the next two decades.

Case #6.4: The 2014 Haiyang Shiyou 981 Standoff

The summer of 2014 marked the nadir of Sino-Vietnamese relationship since the normalization in 1991. As a result of a series of naval collisions in the vicinity of the Chinese-controlled oil rig Haiyang Shiyou 981 in Paracel Island, a wave of anti-China sentiments erupted within Vietnam, resulting in up to hundreds of casualties in Vietnam within the month that the collision occurred.[77]

The controversy arose from China's decision to move China National Offshore Oil Corporation's (CNOOC) Haiyang Shiyou 981 oil rig to Vietnam's Exclusive Economic Zone on May 2014 (Poh 2017). As a direct response to China's incursion of its EEZ, in May 3 and May 7, 2014, respectively, Vietnam deployed several vessels within the vicinity of the oil rig. Over the course of next week, Vietnamese vessels and Chinese vessels involved in three different collision near the HD-981 rig. According to the officials in Hanoi, the Vietnamese naval ships, in attempts to stop Chinese ships from entering the rig to set it up, blocked the Chinese ship, and were later "intentionally rammed [at]" by the nearby Chinese ships. Although no live ammunition was used by either side and no casualties reported, Vietnamese officials claimed that Chinese ships did use water cannons upon Vietnamese ships.[78] Later in May 26, a Vietnamese fishing boat, parked about 17 nautical miles southwest of the very oil rig, was

[77] Hodal, Kate, and Jonathan Kaiman. "At Least 21 Dead in Vietnam Anti-China Protests over Oil Rig." The Guardian. May 15, 2014. Accessed June 09, 2018.

[78] Pham, Nga. "Vietnam and China Ships 'collide in South China Sea'." BBC News. May 07, 2014. Accessed June 09, 2018.

reportedly rammed by a Chinese vessel. The Vietnamese fishing boat was later sunk, with all 10 crew members rescued.[79]

Beijing and Hanoi exchanged strongly worded diplomatic protests in response to this series of naval collision took place. After the May 7 collision, Chinese Foreign Ministry issued a standard territorial sovereignty statement claiming that "the disruptive activities by the Vietnamese side are in violation of China's sovereign rights." Hanoi later said, in a matter to reply Beijing's discourse, that "[Vietnam] would do everything possible to protect its rights and does not rule out taking legal action against China at an international tribunal."[80]

Analysis

The transform mechanism would anticipate that the dramatic increase in economic linkages between China and Vietnam since 1994 would help solve the underlying sources of conflict, namely the maritime territorial disputes in the South China Sea. But both sides maintained a consistent stance on the sovereignty of their competing territorial claims in 2014. This is despite the fact that China's export to Vietnam in 2014 reached $59.6 billion USD, of which 20% were machinery components and another 21% are pre-assembled high-end electronics. Vietnam's exports to China, valued at $19.6 billion were much more diversified in 2014 compared to 1994. Some 42% of Vietnam's 2014 exports were comprised of low-end electronic products and microcircuits and only 6.3% was of crude petroleum, signaling Vietnam's move up the value chain and integration with regional production networks. Commodities such as crude petroleum are much less relationship-specific than electronics

[79] Perlez, Jane. "China and Vietnam Point Fingers After Clash in South China Sea." The New York Times. December 20, 2017.
[80] Pham 2014

manufacturing, meaning that alternative suppliers can be more easily found. Vietnam's more diversified economy was therefore more capable of resisting Chinese economic pressure in 2014 than 1994 and economic sanctions against Vietnam would carry greater opportunity costs than before. Nevertheless, Poh (2017) reports interviews with Vietnamese government officials who revealed that Hanoi was very concerned about potential vulnerability to Chinese sanctions and government-linked research institutions were tasked with coming up with contingency plans. She writes, "an official pointed out that the issue of Vietnam's economic dependence on China was always a major source of concern, especially during the oil rig incident… many expected that China would initiate sanctions soon after the oil rig incident blew up" (Poh 2017).

Instead, local officials in bordering Chinese provinces of Guangxi and Yunnan were specifically instructed to ensure that economic interactions along the China-Vietnam border were not affected by the dispute and to proactively approach Vietnamese counterparts to maintain economic ties (Poh 2017). Poh recounts another official interview subject who said, "we were very prepared for Chinese sanctions, but it did not happen," this official attributed the lack of sanctions to the fact that "Vietnam would escape from China's orbit in the long run" even though the short term consequences would be huge and Vietnam would have to go into recession to restructure its economy. She extends this logic to argue that Beijing was wary of the potential long term consequences of economic sanctions even though they have short term utility. The anxiety that sanctioning Vietnam would produce might scare off the participants of projects such as the Belt and Road Initiative (BRI) and the Asian Infrastructure Investment Bank (AIIB), undermine its charm offensive in East Asia, and work against its image that is different from the Western countries that once used economic coercion to take advantage of China and other Southeast Asian countries.

I think these possible explanations that Poh offers only capture half of the strategic picture. She is right to highlight the fact that Chinese leaders were concerned about the tradeoff between short-term potency of economic sanctions and the long term consequences for the transform mechanism (all three explanation she offers are forms of future cooperation). However, as I've discussed in earlier chapters, economic interdependence can also make low intensity conflict involving military force, attractive in the short term. If the purpose is signaling of resolve in territorial dispute over where the Chinese oil rig could operate, then the limited deployment of PLAN and coast guard vessels to the succeeded in protecting China's maritime interest of this controversial oil rig. After all, China still enjoyed massive military superiority to Vietnam in the South China Sea and was not afraid to escalate the conflict further. Contrary to the logic of the inform mechanism, Beijing was cautious of the opportunity costs of economic signaling and opted instead for a carefully calibrated amount of military force – enough to stop what Chinese leaders saw as the harassment of its national oil rig by Vietnamese vessels.

Unlike with the Wanan Bai incident in 1994, the oil rig collisions in 2014 resulted in a diplomatic stalemate between Beijing and Hanoi. But no further escalation of the conflict occurred after China effectively signaled its resolve to adopt military threat as a strong commitment to protect its sovereign claims in the Paracels; the signal was clearly received by Hanoi as it was deterred from any further military action toward the oil rig site before its voluntary withdraw in July[81].

[81] Ruwitch, John. "Chinese Oil Rig Moved Away from Disputed Waters off Vietnam." Reuters. July 16, 2014. Accessed June 09, 2018.

Chapter 7 Conclusion

The belief that heightened economic interdependence inhibits conflict rests upon a widely-cited empirical literature that rests upon untested causal mechanisms. At a time of elevated tensions between China and its neighbors over territorial disputes despite record levels of economic interdependence, it is more important than ever to get this relationship right. This project challenges the notion that we can leave peace to market forces, that economic engagement will somehow solve political problems. I show that economic engagement is not a panacea but a double edged sword.

My dissertation aims to answer a number of questions that interest scholars and policymakers: What does increasing economic interdependence mean for politics in the Asia Pacific? Will economic engagement constrain China's use of military coercion? Will China use more economic coercion? Is the US not using enough economic coercion? My results show that economic interdependence does not consistently restrain militarized conflict but does constrain the use of economic sanctions. Economic interdependence therefore may not deter low level military conflict between trade partners such as those between China and Japan and Vietnam. The mechanism of constraint is not there because commercial interests are not threatened. But war remains an off equilibrium path outcome and because war is highly disruptive to trade, greater economic interdependence reduces its likelihood. The process of escalation from minor militarized dispute to all out war is not fully understood and likely to be idiosyncratic. But my research suggests that, contrary to commercial peace theory, economic interdependence may create dynamics similar to stability-instability paradox of nuclear weapons. My results also cast doubt on the substitution of economic signals for military signals

that is central to the inform mechanism to explain the commercial peace, economic interdependence does not enable states to engage in more economic coercion. Of course, the findings in the setting of China and its neighbors may not be generalizable to other regions and time periods and will require additional out-of-sample data and analysis to validate.

7.1 What can China Teach the Commercial Peace Literature?

The larger ambition of this dissertation is to contribute to our general understanding of economic interdependence in international relations by using China to reconcile and test conflicting mechanisms of commercial peace literature. An IR scholar may question the dissertation's focus on Chinese foreign policy to study a general theory of IR?

The short answer is that China's resurgence as a global power makes it the most critical case for economic interdependence. There have been over 5660 articles written about China in *Foreign Affairs*. Nearly half of these (2060) were written after the combination of the Beijing Olympics and Global Financial Crisis in 2008 as the total number of articles from 1949 to 2007 (2700). Yet IR scholarship lags behind this reality in its focus. Figure 1.1 shows each world region's share in IR journal articles from 1980-2014 contrasted with that region's share of world GDP in 2015. The biggest gap in our understanding relative to its economic significance is East Asia. Only about 10% of published work in IR focus on East Asia (including China), half of those that focus on Europe (22.18%) and one third of those that study the United States (28.05%) or have cross-national designs, Russia/USSR (16.99%). Because theories of international relations are not so good at making point estimates of outcomes for specific countries, particularly those that rely on cross-national regressions, to understand what economic interdependence means for China, one must study China.

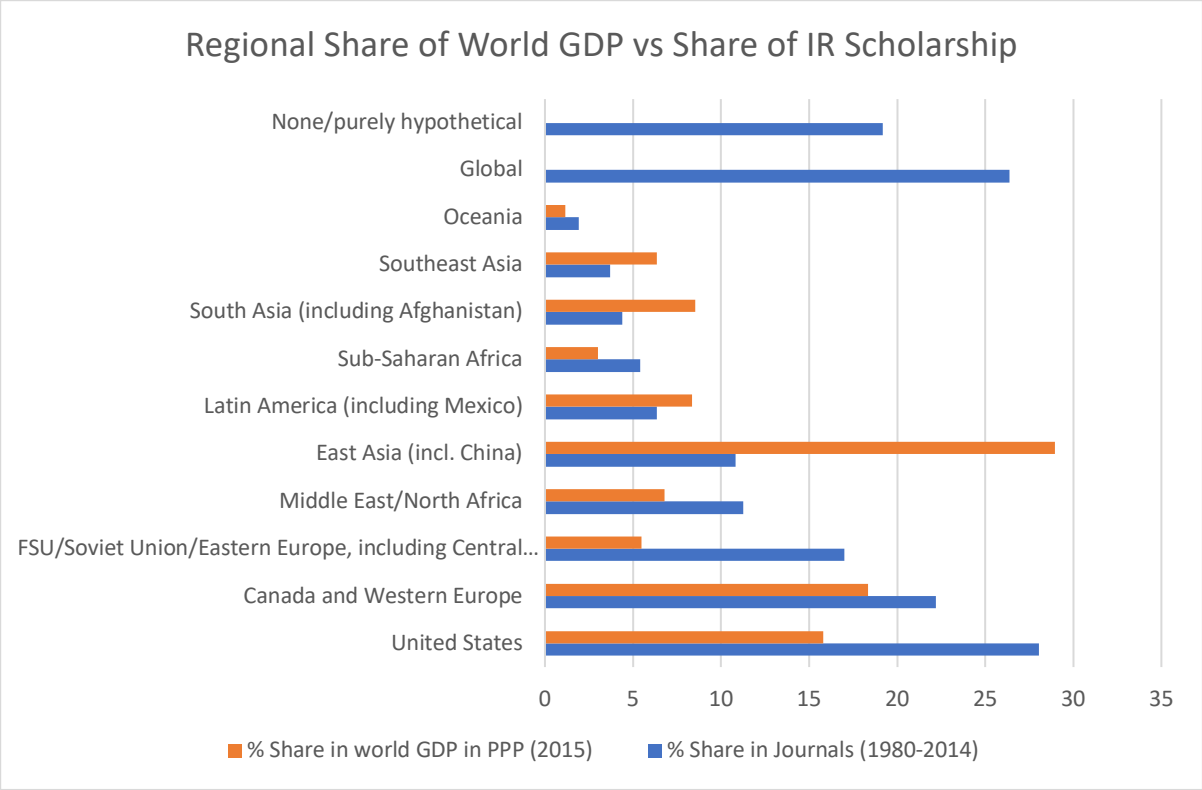

Figure 26 Survey of 2015 TRIP Results

The longer answer is that the generalizability of IR theories need to be tested and reevaluating the findings of the field cannot be done without using area knowledge. IR theories that claim to be universal are, in fact, biased by where they draw their data and evidence. Scholars like Johnston (2012), Acharya (2009), and Kang (2003) have examined why "general" IR theories are often not good for explaining political outcomes in East Asia and have elaborated on the benefits of "bringing East Asia in" to mainstream IR discourse. As Johnson (2012) points out, "ignoring East Asian cases in IR might mean that many of the claims in transatlantic IR theory today have external-validity problems, and including these cases/observations might mean our theories of IR require serious revision." Nor is this problem addressed by many of the large-N datasets in IR which include the (near) universe of states. Johnson points out that large-N studies can suffer from two region-related problems: "First, the

included cases may not support the general findings… second, some large-N work is that the coding of East Asian cases is sometimes inconsistent with the preponderance of available evidence." Both problems exist in the scholarship on economic interdependence.

According to the same TRIP survey in Figure 26, the economic interdependence literature represents about 10% of published work in international relations over the last 40 years, one of the largest topics of interest to scholars. The trouble is that the data used to test 'universal' models of interdependence are motivated by the European experience. Deductively valid theories that are generated from a biased set of observations or contain assumptions that are not generalizable to other contexts will perform poorly when explaining outcomes out of sample. Since the end of World War II, East Asia has experienced one of the highest levels of trade integration in the world and also one of the highest incidences of militarized disputes. A structural explanation based on the pattern of border disputes in East Asia is something an average treatment effect measure of trade interdependence would miss. I think a lot of this is a red herring, frankly; in Europe, borders were resolved so likelihood of conflict dropped.

Historically, the idea that economic integration can promote peace (reduce conflict) emerges from the experience of Western European economic integration. Intense military rivalries which touched off WWI and WWII seemed to dissipate with the formation of the European community. The political project behind European economic integration was to use trade to make conflict unthinkable. However, it is very difficult to disentangle preferences over outcomes and strategy and isolate the effects of trade in this case. When we observe a reduction in military conflict in Europe after World War II, we do not know if the Marshall Plan transformed the preferences of European leaders away from conquest or because economic integration created conditions where it made strategic sense to compete economically instead

of militarily.[82] The fact that World War II settled many of European territorial disputes (Danzig, Alsace-Lorraine, Rhineland, Sudetenland etc.) that were long-standing sources of conflict in the past further complicates matters since most empirical studies of the commercial peace rely on post-1950 data.

In contrast, Asia has also experienced high levels of economic integration but, unlike Europe, fundamental disagreements about sovereignty continue to persist in Asia. The political settlement of WWII clearly defined borders in Europe, but failed to do so in Asia. WWII shattered colonial empires in Asia, but did not include the subjects at the negotiating table. The collapse of the Japanese empire and surrender of Japanese troops created border problems on the Korean Peninsula, Manchuria (borders with Russia and Mongolia), and the South China Sea (claims by China, Taiwan, Vietnam, Philippines, and Malaysia). The dissolution of British rule left problems between Burma, Thailand, China, Nepal, Tibet, and India. The partition of India, Pakistan, and Bangladesh is at the root of most of the conflict in South Asia. The dissolution of French rule in Indo-China created disputed borders between Vietnam, Laos, Cambodia, and China. Almost all the militarized conflicts in Asia over the past half-century can be attributed to one of these border disputes. China, with 33 land and maritime disputes along its vast borders, accounts for roughly 40% of total disputes in Asia (Fravel 2014).

The pattern of China's regional integration offers a unique opportunity to isolate these causal mechanisms and determine the extent to which trade changes the strategic calculus of using military force. This is because the Chinese Communist Party (CCP) has staked its legitimacy on the preservation China's territorial integrity (Weiss 2014; Shirk 2007). Fravel

[82] This point was exhaustively debated between neoliberals and neorealists after the formation of the European Union (Grieco 1998, 1996, 1995; Moravcsik 1998; Rosecrance 1997).

(2007; 2008) demonstrates that China is more likely to use military force in territorial disputes when the state's bargaining power declines relative to that of its adversary but notes that its use of force is relatively rare. These findings are consistent with a large literature on territorial disputes which establishes well documented link between territorial disputes and militarized conflict (Schultz 2015; Huth 2009; Vasquez 2009; Hensel and Mitchell 2008; Hensel 1996; Vasquez 1995). The normalization of economic with China was not predicated on resolution of long standing territorial disputes and there is no ambiguity that Beijing's preferred outcome over the reunification of Taiwan or the status of islands in the South China Sea remain unchanged despite decades of economic integration. Thus, any effects of trade on conflict would be through changes to China's preferences over strategy.

7.2 Is China an Exception to the Commercial Peace?

This dissertation offers an explanation for why China appears to be an anomaly to commercial peace theory by examining the relationship between borders, trade, and conflict. Since 1945, Asia has been more prone to conflict over borders than other regions in the world and China accounts for nearly half these territorial disputes (Fravel 2014). However, while disputed borders have been found to depress international trade flows in other regions, they have not impeded China's trade with its disputant neighbors. Additionally, I find that trade does not constrain China in the use of military force, even when it is more trade dependent on the target. In other words, China continues to use military force against its trade partners because China's economic integration occurred despite the failure to resolve many of its long standing territorial disputes.

In contrast to established commercial peace theories, I argue that mutual dependence on trade creates a stability-instability paradox not unlike that created by the advent of thermonuclear weapons. Massive retaliation is not a credible threat when it risks mutually assured destruction, but permits conflict at lower levels of intensity. Trade also makes wars between interdependent economies prohibitively costly for both sides, but should not constrain military behavior where revoking trade would not be a credible response. On the one hand, commercial interests are not immediately impacted by military conflict at lower levels (such as military exercises and other shows of force, the kinds of military operations we increasingly observe in the East China Sea and South China Sea). Even though policymakers view the use of military force in these incidents with grave concern, they do not trigger economic costs as markets tend to ignore these minor disputes. On the other hand, territorial disputes are the underlying grievance behind the vast majority of Chinese uses of military force. Therefore, as long as China's territorial disputes remain unresolved, economic interdependence can increase the frequency with which China uses military force in these disputes while putting a ceiling on the intensity. Trade can thus lead to stability at high levels of conflict --making wars unthinkable-- but creates instability at lower levels of conflict -- incentivizing risky military behavior short of that threshold.

APPENDICES

Appendix A

Table of Summary Statistics of Key Variables

VARIABLES	(1) N	(2) mean	(3) sd	(4) min	(5) max
Year (year_id)	1,890	1,985	19.22	1,949	2,016
China COW Code (ccodea_id)	1,890	710	0	710	710
Target COW Code (ccodeb_id)	1,890	747.6	178.1	2	999
Total Trade AB (totaltrade_n)	1,551	1.943e+10	6.518e+10	0	6.591e+11
China's GDP (gdp_china)	1,651	2.550e+12	2.787e+12	8.786e+10	9.510e+12
Target's GDP (gdp_target)	1,367	7.148e+11	2.155e+12	1.652e+08	1.690e+13
IV: China's Trade Dependence (dep_china)	1,405	0.00544	0.0137	0	0.0973
IV: Target's Trade Dependence (dep_target)	1,249	0.0605	0.133	0	1.204
china_initiator_mid	168	0.607	0.490	0	1
china_initiator_sanction	88	0.307	0.464	0	1
DV: Onset of China initiated MID (mid_onset)	1,890	0.0540	0.226	0	1
DV: Onset of China initiated Sanction (sanction_onset)	1,890	0.0143	0.119	0	1
Joint Regime Type (regime)	1,890	8.211	6.696	0	19
Target Democracy (demdumy1)	1,890	0.334	0.472	0	1
Territorial Dispute (dispute)	1,890	0.387	0.487	0	1
Contiguity (contig)	1,865	0.522	0.500	0	1
Distance (logdist)	1,626	8.125	0.659	6.697	9.285
Capabilities Ratio (logcaprt_i)	1,890	1.592	0.820	-0.515	3.673
cinc_china_i	1,890	0.139	0.0394	0.0913	0.246
cinc_target_i	1,890	0.0182	0.0423	4.33e-05	0.319
Affinity (s2un_i)	1,460	0.688	0.571	-1	1
S-score Affinity (s3un)	1,161	0.718	0.290	-0.708	1
Target GDPPC (lngdppc_WDI_PW)	1,274	7.722	1.612	4.984	10.91
Development (gdpcc_contig)	1,274	1,018	2,922	0	25,023

Appendix B

Table 1 Robustness Check with Rare Events Logit (China_initiator)

VARIABLES	(1) Model 1	(2) Model 2	(3) Model 3	(4) Model 4	(5) Model 5	(6) Model 6
dep_target		2.116	-3.011		1.085	-9.062
		(1.829)	(3.152)		(3.374)	(8.553)
dep_china	34.88***	33.12***	-4.824	37.14***	36.95***	-14.86
	(8.852)	(8.964)	(11.94)	(9.861)	(11.06)	(18.70)
regime	-0.0426	-0.0372	-0.0921**	-0.0755	-0.0796	-0.172***
	(0.0340)	(0.0342)	(0.0390)	(0.0530)	(0.0521)	(0.0518)
s2un_i	-0.952***	-0.966***	-2.372***	-0.761**	-0.772**	-2.754***
	(0.331)	(0.331)	(0.636)	(0.353)	(0.351)	(0.743)
logcaprt_i	-0.452	-0.470	-1.051***	-0.927	-0.910	-1.947***
	(0.337)	(0.357)	(0.383)	(0.729)	(0.590)	(0.715)
gdpcc_contig	3.98e-05	3.27e-05	2.17e-05	6.71e-05	5.86e-05	8.59e-05
	(4.12e-05)	(4.19e-05)	(4.24e-05)	(6.98e-05)	(6.29e-05)	(7.35e-05)
dispute	2.270***	2.314***	2.455***	1.811*	1.813*	2.154**
	(0.492)	(0.541)	(0.552)	(0.951)	(0.926)	(0.841)
contig	0.307	0.272	-0.444	-0.622	-0.576	-1.826**
	(0.402)	(0.414)	(0.428)	(0.589)	(0.639)	(0.778)
logdist	-0.238	-0.175	-1.051*	-0.448	-0.448	-1.735**
	(0.434)	(0.469)	(0.573)	(0.861)	(0.850)	(0.876)
trend			0.0890***			0.128***
			(0.0292)			(0.0384)
Constant	-1.108	-1.715	4.429	1.070	1.115	10.33
	(3.953)	(4.322)	(4.682)	(8.207)	(8.007)	(7.775)
Observations	893	893	893	893	893	893

Robust standard errors in parentheses
*** p<0.01, ** p<0.05, * p<0.1

Table 2 Robustness Check with Rare Events Logit (China_target)

VARIABLES	(1) Model 1	(2) Model 2	(3) Model 3	(4) Model 4	(5) Model 5	(6) Model 6
dep_target	5.013***	4.966***	3.812*	-33.21	-48.48	192.4
	(1.894)	(1.904)	(2.263)	(51.15)	(47.17)	(555.1)
dep_china		5.282	-21.00		50.52	212.6**
		(17.66)	(24.89)		(38.02)	(100.1)
regime	-0.0446	-0.0462	-0.0771	-0.0837	-0.114	-2.389***
	(0.0442)	(0.0457)	(0.0501)	(0.118)	(0.112)	(0.502)
s2un_i	-0.641	-0.655	-1.434**	7.791	7.057	-13.05
	(0.447)	(0.458)	(0.673)	(6.418)	(6.663)	(10.52)
logcaprt_i	-0.861***	-0.830***	-1.189***	-0.774	-0.788	31.80***
	(0.324)	(0.302)	(0.309)	(1.872)	(1.779)	(6.064)
gdppc_contig	-8.60e-05	-9.00e-05	-0.000226	0.00112**	0.00118***	0.00609***
	(0.000158)	(0.000157)	(0.000167)	(0.000466)	(0.000420)	(0.00135)
dispute	2.018***	2.022***	2.187***	3.379***	1.935**	30.75***
	(0.681)	(0.676)	(0.722)	(0.672)	(0.793)	(4.133)
contig	0.660	0.705	0.541	-5.617**	-4.404**	-7.129
	(0.521)	(0.550)	(0.657)	(2.431)	(2.072)	(6.824)
logdist	-0.666	-0.614	-1.167*	2.916**	2.557**	16.15***
	(0.509)	(0.521)	(0.648)	(1.192)	(1.151)	(1.300)
trend			0.0562*			-0.663
			(0.0306)			(0.441)
Constant	2.463	1.990	5.639	-31.25**	-26.95*	-96.36***
	(3.878)	(3.905)	(4.596)	(13.31)	(13.80)	(32.28)
Observations	766	766	766	766	766	766

Robust standard errors in parentheses
*** p<0.01, ** p<0.05, * p<0.1

Appendix C

Robustness Check of Table 1 with Different Scope Conditions

VARIABLES	(1) Without Hong Kong	(2) Regional Dummies	(3) Great Power Dummies	(4) East Asia Dummy	(5) Asia Only	(6) East Asia Only
dep_china	34.47***	32.78***	27.87***	37.47***	40.77***	50.06***
	(9.064)	(9.626)	(9.515)	(10.34)	(14.16)	(14.10)
dep_target	2.004	1.512	1.905	1.152	1.515	-0.0717
	(1.850)	(1.758)	(1.672)	(2.037)	(1.955)	(1.976)
regime	-0.0399	0.0138	-0.0150	0.0212	-0.0181	0.0628
	(0.0345)	(0.0316)	(0.0316)	(0.0398)	(0.0349)	(0.0457)
s2un_i	-0.974***	-1.065***	-0.811*	-0.946***	-1.092**	3.382
	(0.335)	(0.368)	(0.428)	(0.339)	(0.470)	(2.115)
logcaprt_i	-0.531	-0.462	-0.382	-0.522	-0.285	-0.273
	(0.361)	(0.466)	(0.320)	(0.472)	(0.320)	(0.483)
gdpcc_contig	2.41e-05	-3.54e-05	-3.88e-05	3.79e-05	-3.58e-05	1.90e-07
	(4.23e-05)	(5.33e-05)	(5.79e-05)	(4.26e-05)	(5.98e-05)	(6.28e-05)
dispute	2.406***	2.491***	2.581***	2.421***	4.179***	4.780***
	(0.547)	(0.575)	(0.662)	(0.566)	(0.610)	(0.816)
contig	0.277	1.380**	0.596	0.831*	1.291	1.738**
	(0.418)	(0.568)	(0.496)	(0.434)	(0.792)	(0.679)
logdist	-0.179	-0.176	-1.305	0.297	-2.411**	-2.187
	(0.474)	(0.468)	(0.897)	(0.891)	(1.013)	(1.349)
oceania		0.674				
		(1.319)				
south_asia		-1.557**				
		(0.639)				
o.central_asia		-				
usa			2.610			
			(1.867)			
rus			1.443			
			(1.129)			
ne_asia				0.638		
				(1.028)		
se_asia				1.497*		
				(0.842)		
Constant	-1.766	-2.633	6.338	-7.332	13.02	6.128
	(4.370)	(4.339)	(7.123)	(7.813)	(8.128)	(11.30)
Observations	893	893	893	893	708	438

Robust standard errors in parentheses
*** p<0.01, ** p<0.05, * p<0.1

Appendix D

Robustness Check of Table 1 with Country Fixed Effects, Year Fixed Effects (DV in Models 1-3 is MID onset and TIES onset in Models 4-6)

VARIABLES	(1) Country FE	(2) Country FE and Year FE	(3) Country FE	(4) Country FE	(5) Country FE and Year FE	(6) Country FE
dep_china	24.36*	9.383	3.301	12.83**	-9.240	-14.92
	(14.79)	(14.72)	(9.325)	(5.878)	(31.79)	(18.44)
dep_target	-1.562	-3.961	-3.169	-11.87	-7.813	-15.44
	(1.975)	(3.067)	(2.386)	(9.746)	(4.782)	(9.692)
regime	0.241	-0.139***	0.255	0.0365	-0.128**	-0.0292
	(0.173)	(0.0453)	(0.293)	(0.0937)	(0.0530)	(0.0943)
s2un_i	-0.668	-1.529*	-1.603	0.737	-4.220***	-0.0610
	(0.478)	(0.829)	(1.120)	(1.499)	(1.569)	(1.377)
logcaprt_i	3.043	-1.292***	0.315	6.823***	-1.519***	2.446
	(2.969)	(0.499)	(2.956)	(1.421)	(0.443)	(3.387)
gdpcc_contig	-0.000323*	4.04e-05	-0.000319*	-0.000159	2.28e-05	-0.000125
	(0.000180)	(4.94e-05)	(0.000190)	(0.000223)	(0.000104)	(0.000231)
dispute	0.118	2.577***	-0.212	15.35***	2.881**	14.92***
	(1.043)	(0.486)	(1.001)	(0.969)	(1.193)	(1.048)
o.contig	-		-	-		-
o.logdist	-		-	-		-
contig		-0.814			-0.874	
		(0.552)			(0.904)	
logdist		-0.773			-2.219*	
		(0.768)			(1.151)	
trend			0.0634*			0.0972*
			(0.0357)			(0.0553)
Observations	361	482	361	242	370	242

Robust standard errors in parentheses
*** p<0.01, ** p<0.05, * p<

Appendix E

**** Hausman tests of IIA assumption (N=893)

Ho: Odds(Outcome-J vs Outcome-K) are independent of other alternatives.

Omitted	chi2	df	P>chi2	evidence
1	2.420	17	1.000	for Ho
2	0.229	16	1.000	for Ho
3	0.080	16	1.000	for Ho

**** suest-based Hausman tests of IIA assumption (N=893)

Ho: Odds(Outcome-J vs Outcome-K) are independent of other alternatives.

Omitted	chi2	df	P>chi2	evidence
1	14.008	20	0.830	for Ho
2	8.037	20	0.992	for Ho
3	3.539	20	1.000	for Ho

**** Small-Hsiao tests of IIA assumption (N=893)

Ho: Odds(Outcome-J vs Outcome-K) are independent of other alternatives.

Omitted	lnL(full)	lnL(omit)	chi2	df	P>chi2	evidence
1	-30.928	-16.913	28.028	20	0.109	for Ho
2	-76.964	-69.305	15.317	20	0.758	for Ho
3	-83.756	-79.302	8.908	20	0.984	for Ho

Appendix F

Main Findings	Author(s)	Methodology and Unit of Analysis
Trade	Lupu and Traag (2012)	Regression, network
Decreases	Dorussen and Ward (2010)	Regression, network
Warfare	Hegre, Oneal, and Russett (2010)	Regression, dyads
	Oneal and Russett (2003)	Regression, PRD
	Oneal and Russett (1999)	Regression, PRD
	Polachek, Robst, and Chang (1999)	Regression, dyads
	Oneal and Russett (1997)	Regression, PRD
	Oneal and Ray (1997)	Formal model, regression, dyads
	Polachek (1997)	Regression, PRD
	Oneal, Oneal, Maoz, and Russett (1996)	Regression, PRD
	Copeland (1996)	Case study, system
	Mansfield (1994)	Regression, dyads
	Gasiorowski and Polachek (1982)	Granger causality, system
	Polachek (1980)	Regression, dyads
Trade	Barbieri (2002)	Regression, dyads
Increases	Barbieri and Levy (1999)	Regression, dyads
Warfare	Barbieri (1996)	Regression, dyads
	Domke (1988)	Case study, system
Indeterminate	Li and Reuveny (2011)	Regression, dyads
or no Effect	Ward and Hoff (2007)	Prediction, network
	Ward, Siverson, and Cao (2007)	Bayesian model, dyads
	Keshk, Pollins, and Reuveny (2004)	Regression, dyads
	Gartzke and Li (2003)	Replication, dyads
	Gartzke (2003)	Regression, dyads
	Gartzke, Li, and Boehmer (2001)	Regression, dyads
	Dorussen (1999)	Formal model, >2 actors
	Morrow (1999)	Formal model, 2 actors
	Dorussen (1997)	Formal model, >2 actors
	Reuveny & Kang (1996)	Granger causality, dyads
	Gowa (1994)	Formal model, 2 actors
	Gasiorowski (1986)	Regression, dyads

PRD = Politically relevant dyads

Appendix G

James Fearon (1995) places Blainey's basic insight that the causes of war reside not in disparities of power but in incompatible beliefs about power in a rationalist and internally consistent framework. The theory models foreign policy between two states as a competitive negotiation or zero-sum bargain. Reasoning leaders generally are trying to avoid war because it is a costly outcome. Warfare is only one way in which states can pursue their interests. Leaders that negotiate and obtain the settlements that result from fighting before fighting begins are made better off than those that must pay the high costs of war (Wagner 2007). The theory assumes that leaders of states engage in rational calculation when they are considering the use of force against an adversary. The adversary have incentives to feign strength and to conceal weakness. Because information about an adversary's resolve or capabilities is generally incomplete, rational leaders must nevertheless make decisions in an environment of uncertainty. The centrality of uncertainty to the bargaining theory of war means that the advent of war is itself stochastic (Gartzke 1999). But they can still find themselves at war for three reasons: i) uncertainty generated by asymmetric information, ii) credible commitment problems, and iii) indivisibility.

i. Asymmetric Information

First, war can occur as competitors mistake relative resolve or capabilities, and because competition generates incentives for actors to conceal true information about these variables. In an uncertain world, egoistic leaders can benefit by bluffing. This "asymmetric information" argument encourages researchers to seek for ways that states or other actors may be able to communicate more or less credibly (Schultz 2001a), though this is difficult (Schultz 2001b). This is because revealing information about one's true resolve and capabilities is a double edged

sword, it may help avoid the costs of war by encouraging a negotiated settlement ex ante but it could also result in getting a more unfavorable settlement than otherwise possible. Fearon (1997) outline two archetypal ways that states can signal credibly: tying hands and sinking costs. Sunk costs occur when a state takes an action that is costly up front such as mobilizing forces during a crisis. They are informative because they to the degree that they differentiate resolved or capable actors from those that are less willing to pay the cost of fighting. Tying hands occur when an actor imposes on themselves a cost that they only incur in the event that they fail to act in a manner consistent with their ex ante claims. A classic example is audience costs, where a leader makes a threat publicly and claiming that the domestic public will punish her if she fails to carry out the threat.

Common to both sinking costs and tying hands is the idea that imposing costs on oneself in the short run might allow one to achieve a better bargain in the longer run. Slantchev (2005) extends this logic to show that military threats exhibits characteristic of both, they are inherently costly (due to audience costs) and change the local distribution of power (the costs for mobilization is a sunk cost). Gartke, Li, and Boehmer (2001) pointed out that economic interdependence, particularly capital market openness, can create another channel through which states can engage in costly signaling to overcome problems of asymmetric uncertainty. They note that as the probability of militarized conflict increases, states with open capital markets can incur a variety of economic costs as a result of escalation towards conflict. If those states persist towards conflict in the face of these economic costs, an example could be capital flight, it will reveal that their resolve over the disputed issue. The greater the degree of economic interdependence, the more a resolved country could demonstrate its willingness to fight ex ante

and thus we should observe fewer incidents of militarized disputes involving these countries as a result. I will say more about this in the discussion of the constraint mechanism below.

ii. Credible Commitment

Second, actors can fight because they face a "commitment problem" created by time inconsistency. If power relations are shifting over time, so that one actor is declining in power relative to another, then agreements between them are unstable, as the rising power will often have an incentive to insist on better terms in the future, when it becomes more capable. The declining power in turn has incentives to blunt the ascent of the rising state. Since fighting a winning war today may be better than losing one tomorrow, commitment problems can cause conflict. Powell (2006) shows that large, rapid shifts in the distribution of power can lead to war in three classes of commitment problems: preventive war, preemptive attacks due to offensive advantage, and conflicts produced by bargaining over issues that affect future bargaining power.

This literature connects to a much older literature on power transitions but leaves many questions unanswered: what are the sources of dissatisfaction for the rising state? How to operationalize dissatisfaction to make it empirically testable? And is the rising state or the declining state more likely to launch the war? (Debs and Monteiro 2014). They note power shifts must be large enough and rapid enough to create a serious danger of war, thus slow moving trends that is the subject of power transition theory -- such as growing economic interdependence or different rates of economic growth – are unlikely to trigger a credible commitment problem because they are neither large nor rapid. Instead, they present a model

where large and rapid shifts in power are a product of endogenous military investments and show that whether or not these investments are made public or private determines whether or not preventative war is likely.

But one way that trade might operate to create an exogenous shift in power is in cases of economic embargoes among economically interdependent states. As Debs and Monteiro (2014) correctly point out, these cases are rare because the target state need to be strong enough to wage war and dependent enough on that trade to care to fight. But history contains a handful of these cases: 1) Britain's decision to use force against China in the Opium Wars after the Qing government threatened to end the opium trade in 1839, the government sponsored consumer boycott against Japanese goods in the 1930s was a major cause of the Second Sino-Japanese War, and the US decision to cut off metals and oil exports to Japan in 1941 triggered Pearl Harbor. In each of these cases, the decision to cut off trade with a major trade partner threatened to permanently alter the balance of power and was the impetus for preemptive war. This explanation for how the suspension of trade could lead to war through commitment problems has not yet been studied by scholars and might prove a fruitful direction of future inquiry. But the logic is roughly analogous to the trade expectations theory developed by Copeland (2014).

iii. Indivisibility

Finally, actors can fight over issues because the issues at stake are not readily divisible. This so-called "indivisibility problem" appears to be an infrequent cause of war as it is typically possible to fashion bargains through side payments that resolve this motive for war. Further, the fact that indivisibility problems can be resolved does not mean that actors invariably have

an interest in resolving them; competitors may choose to retain or even develop indivisibility problems for strategic advantage. This in turn could lead to fighting in a chicken-type scenario if actors are unable to unravel previous indivisibilities.

Trade is not directly relevant to this path way to war unless one thinks that economic interdependence might fundamentally alter the a state's interest such that they are willing to negotiate over previously indivisible issues. This might be the case in some territorial disputes as where growing economic interests might spur a negotiated settlement. A growing literature also suggest that East Asian governments can manipulate nationalism to increase the salience of the indivisibility problem in certain territorial disputes (Fang and Li 2018; Henripin 2014; Fravel 2005). But if indivisibility can be manipulated then it is difficult to distinguish from high resolve and becomes a subset of costly signaling strategy in the asymmetric information problem. Something that is indivisible at the individual-level such as national identity can lead to "all of nothing" preferences among citizens but because the state is a social construct, leaders do in fact make concessions about territory even in the age of the nation-state (Fravel 2009).

Appendix H

Event	Event Window	Window Size	Country	CAR	tstat (above 1.96)	Result
Taiwan Strait Crisis 1	7/19/1995-7/26/1995	7	PRC	-0.0573577	-1.242736	N/A
Taiwan Strait Crisis 1	7/19/1995-7/26/1995	7	ROC	-0.1133048	-2.597118	-11.33%
Taiwan Strait Crisis 1	7/20/1995-7/26/1995	5	PRC	0.0346026	1.684938	N/A
Taiwan Strait Crisis 1	7/20/1995-7/26/1995	5	ROC	-0.0362654	-1.959665	-3.62%
Taiwan Strait Crisis 1	8/15/1995-8/25/1995	10	PRC	-0.0621598	-2.029928	-6.21%
Taiwan Strait Crisis 1	8/15/1995-8/25/1995	10	ROC	0.0552933	3.346376	5.52%
Beijing suspends high level contacts	5/19/2016-5/25/2016	5	PRC	-0.0055318	-0.7714825	N/A
Beijing suspends high level contacts	5/19/2016-5/25/2016	5	ROC	0.0200684	1.234903	N/A
Beijing suspends high level contacts	5/19/2016-6/15/2016	20	PRC	0.0187263	1.517876	N/A
Beijing suspends high level contacts	5/19/2016-6/15/2016	20	ROC	0.0399457	3.639708	3.99%
Mischief Reef	2/7/1995-2/13/1995	5	PRC	0.0505654	1.058161	N/A
Mischief Reef	2/7/1995-2/13/1995	5	PHL	0.0377431	1.306699	N/A
Scarborough Schoal	4/6/2012-4/12/2012	5	PRC	0.0249561	1.294428	N/A
Scarborough Schoal	4/6/2012-4/12/2012	5	PHL	-0.004166	-0.896372	N/A
Banana ban	5/3/2012-5/9/2012	5	PRC	-0.0095622	-0.4873731	N/A
Banana ban	5/3/2012-5/9/2012	5	PHL	-0.0113668	-0.4529421	N/A
Rare earths embargo	9/21/2010-9/27/2010	5	PRC	0.0153667	0.8826241	N/A
Rare earths embargo	9/21/2010-9/27/2010	5	JPN	0.0157315	0.7715376	N/A
Fukushima	3/10/2011-3/15/2011	4	PRC	-0.0072366	-0.4216843	N/A
Fukushima	3/10/2011-3/15/2011	4	JPN	-0.1827077	-2.084478	-18.27%
Senkaku nationalization	9/10/2012-9/14/2012	5	PRC	0.0106066	0.560009	N/A
Senkaku nationalization	9/10/2012-9/14/2012	5	JPN	0.0264443	1.564885	N/A
Trump trade war	6/15/2018-6/20/2018	4	PRC	-0.0528207	-2.294989	-5.28%

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