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How the Power of Business Affects the Commercial Peace: Commercial Interests,  
Economic Interdependence, and Militarized Conflict.

A dissertation submitted in partial satisfaction of the requirements for the degree  
Doctor of Philosophy in Political Science

by

Anita Renda Kellogg

2017

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## ABSTRACT OF THE DISSERTATION

How the Power of Business Affects the Commercial Peace: Commercial Interests,  
Economic Interdependence, and Militarized Conflict.

by

Anita Renda Kellogg

Doctor of Philosophy in Political Science

University of California, Los Angeles, 2016

Professor Ronald L Rogowski, Chair

There is a simple and compelling logic to the thesis that economic interdependence decreases the risk of military conflict between nations. As an unconditional proposition, however, this does not seem to be the case. Countries that are economically integrated do sometimes wage war against each other. Yet, most articulations of the commercial peace theory base the causal mechanism on the economic costs of conflict on the aggregate national welfare. This is particularly problematic if one believes, as most international relations scholars do, that foreign policies are an elite driven process rather than based on popular opinion.

My dissertation addresses the need for a clear and testable causal mechanism by which commercial exchanges have a pacific effect on bilateral relations. In order to do so, it focuses on those who gain the most from interstate economic exchanges. I argue that business must have an influential effect on the formulation of policy for economic interdependence to reduce interstate militarized disputes. Moreover, this condition must exist in both sides of a dyadic relationship in order to build the necessary trust that their shared economic prosperity will be prioritized when conflicts do occur. This argument is encapsulated in a two-level theory of the commercial peace that incorporates domestic politics into the interstate bargaining process.

I test this theory through a mixed method approach — (1) quantitatively examining the interaction of private sector size and bilateral trade on the likelihood of violent militarized disputes, and (2) two qualitative case studies tracing the process by which business exerts influence on security policy-making for the rival dyads of Colombia-Venezuela and China-Japan. The results establish the importance of economic elites in formulating foreign policy in conditioning the success of economic interdependence to reduce militarized conflicts.

The dissertation of Anita Renda Kellogg is approved.

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For Ryan P. Kellogg

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## CHAPTER ONE: INTRODUCTION

The argument that the benefits accrued through interstate commerce would increase the costs of war and hence reduce its occurrence can be found as far back as the writings of Kant and Montesquieu. The current body of literature, however, more directly emerges from Solomon W. Polachek's empirical formulation of the opportunity cost argument: "the implicit price of being hostile is the diminution of welfare associated with potential trade losses" (1980, 60). John R. Oneal and Bruce M. Russett extend this argument, explaining that "fearful of the domestic political consequences of losing the benefits of trade, policymakers avoid the use of force against states with which they engage in economically important trade" (1999, 5). For the past three decades, most research has operationalized these opportunity costs as trade interdependence and analyzed its potential effects on the probability of militarized conflict. During much of this period, realists and liberals have debated whether the commercial peace existed by means of statistical models measuring the correlation between levels of economic interdependence and the likelihood of conflict. While most found substantial effects for economic interdependence, a significant minority produced contradicting results; either trade increased conflict (Barbieri 2002; Barbieri 1996), had no substantive effect (Gartzke 2007; Gartzke and Li 2003), or the results were ambiguous (Morrow 1999). Within the last decade, however, a consensus has emerged that these variant findings were an artifact "of the discrepancy to variable construction alone" (Gartzke and Zhang 2015, 429). This has not resulted in a clear victory for the proponents of commercial

liberalism given that the literature has sought to expand beyond a simple correlation between economic interdependence and conflict.

The following reviews the latest research on the commercial peace, highlighting unresolved controversies and gaps that scholars have yet to address. Most pressing, the commercial peace thesis lacks a micro-foundational causal process explaining how economic ties reduce militarized disputes. This chapter lays out the basic theoretical framework of my argument to be further developed in Chapter Two.

## **Literature Review**

### *Trade Elasticities*

Some authors have argued that opportunity costs should be reformulated as “a function of economic activity within the context of available alternatives” (Crescenzi 2003).<sup>1</sup> This shifts the focus to the costs of exiting a trading relationship, which “are...what is lost in switching from this “best” option to the next best alternative” (Ibid.). This may be more what Polachek, himself, had in mind given that he asserts that tests of the commercial peace should go beyond trade flows, “but also on some measure of the welfare gain.... Precise measures of these require knowledge of each country's demand and supply curves for all commodities” (1980, 67). While this data was not available in 1980, limited measures on trade elasticities have since been developed. Polachek and McDonald (1992) use bilateral trade elasticities computed by Marquez (1990) at the

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<sup>1</sup> See also (Peterson 2014).

country level for OECD countries and conclude that trade inelasticities have a greater pacifying effect on conflict than the trade/GDP ratio. Crescenzi (2003; 2005) uses the same Marquez elasticities, which he multiplies by trade share (bilateral trade/total trade), and comes to the same conclusion. Zeev Maoz (2009) employs a newer and expanded elasticity dataset calculated at the commodity level by Kee et al. (2008) and aggregated at the county level. This figure is normalized and multiplied by Maoz's unique dependence ratio (imports from partner country/GDP). This measure is also positively correlated with a reduction in militarized conflict. While these authors make a strong case that incorporating demand elasticities produces a more accurate measure of potential costs of trade disruption, they entail a significant trade off in the coverage of dyads and years included. It is significant, however, that there is agreement across these studies that opportunity costs as operationalized by trade elasticities decrease the likelihood of military conflict.

### *Third Parties and Networks*

A further extension of opportunity costs is determining the effects of third party trade. While most conflicts are dyadic, trade is not. Thus, the focus on dyads risks oversimplifying the multilateral nature of the international system. In particular, the involvement of third parties has the potential to alter the costs of interstate conflict. Katja B. Kleinberg et al. argue that "When states have few alternatives to their existing trade, the risk of violent conflict declines. Moreover, this effect is largely independent of the size of the dyadic trade relationship with a potential opponent" (2012, 529). This argument is similar to the previous discussion of exit costs and the elasticity of trade.

Here though, it is not about the goods themselves, but that exit costs are incurred by the difficulty of the state in replacing its trade partners. On the other hand, Yonatan Lupu and Vincent A. Traag find that “indirect trade ties decrease the probability of conflict by increasing the costs of war both for the potential combatants and for their commercial partners” (2013, 23). Similarly, researchers have found that having multiple links to the international trade network significantly decreases the likelihood of conflict (Dorussen and Ward 2010; Kinne 2012).

### *FDI*

Trade is simply one form of economic exchange binding states in the international system. Foreign direct investment (FDI) may build stronger ties than trade. James R. Masterson points out that “Unlike trade, which can be diverted during a disruption of trade flows between states, FDI is largely permanent and may actually be used against the home country should conflict ensue” (2012, 8). Unfortunately, the data on FDI is far more limited than trade. Early studies used a monadic approach of total FDI inflows. Gartzke et al. (2001) and Hoon Lee (2005) found that states with larger FDI flows are less likely to use military force. Rosecrance and Thompson critique these studies, however, on the grounds that “all previous studies have looked at systematic factors, not particular FDI relationships and their effect on conflict between the countries doing and receiving the investing” (2003, 389). Addressing this issue, both Margit Bussmann (2010) and Polachek et al. (2012) find that bilateral FDI inflows and stocks substantially reduce militarized interstate disputes, even when controlling for endogeneity. Extending these analyses, Hoon Lee and Sara McLaughlin Mitchel find that “Higher levels of

bilateral and monadic FDI flows reduce the chances for severe militarized disputes over border issues” (2012, 698). In sum, there has been strong and consistent support for the pacific effects of economic interdependence measured as FDI.

### *Asymmetry*

Another controversy regarding the commercial peace thesis is the problem of asymmetry. Neorealists assert that trade imbalances may increase the likelihood of war "since the gains from trade do not accrue equally" (Masterson 2012, 5). As a result, states may "fear...that gains from trade accruing to other countries can lead to a military advantage for them. This is of particular significance in cases in which the trading states are enemies" (Massoud and Magee 2012, 5). If this contention were true, then states would be expected to avoid this security externality by preventing the establishment of substantial economic ties. James D. Morrow also points out that this logic requires the assumption that "marginal increases are of the magnitude of total military allocations relative to total national product" (1997, 27). He finds, however, that even for long-term rivals such as India and Pakistan "defense preparations are endogenous" (Ibid.). Therefore, "security externalities should not block trade between rivals during peacetime" (Ibid.). Similarly, Peter Liberman has shown that security constraints do not obstruct economic cooperation under the conditions of multipolarity (1996; 1999). Liberman's qualitative analyses of "British trade with Germany prior to the First World War and U.S. trade with Japan in the decade leading up to the Second" reveals that "neither Britain nor the United States significantly restricted trade until war was virtually upon them" (1996). Finally, Brandon J. Kinne demonstrates that network

trading ties constrain initiation of militarized conflict, even when trading ties are highly asymmetric (2012).

### *Distribution of Trade Benefits*

The uneven distribution of benefits from trade within nations is another issue receiving more attention from scholars. This argument hypothesizes that groups disadvantaged by international competition might lobby for the use of military force to protect their interests.<sup>2</sup> Not only is there a lack of empirical support for this argument, particularly for the post-World War Two era, but it is also logically flawed. The costs of militarized conflict extend beyond the loss of trading opportunities and are likely to offset any possible benefit from decreased economic competition. Moreover, “there are...many other mechanisms for limiting imports that are less costly, more likely to be effective, and face fewer political barriers to enact” (Brooks 2013, 873).<sup>3</sup> Actors, who perceive that they are being hurt by trade, may be neutral—not pushing for peace—but not advocating for war either.<sup>4</sup>

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<sup>2</sup> For example, see (P. J. McDonald 2009, 69-70; G. Schneider 2014, 177).

<sup>3</sup> Helen Milner also notes that even those firms who may lose from import competition will encourage economic openness if their operations are integrated into global production networks (1988, 365).

<sup>4</sup> This assertion is supported by Kirshner’s qualitative analyses of bankers and war (2007).

### *Natural Resources*

Similarly, some scholars contend that states may be motivated to use military force to further the commercial interests of influential sectors (P. J. McDonald 2009, 70).

According to this reasoning, states are incentivized to pursue militarized conflict to secure “key raw materials and inputs to the production process” (295). While there is some historical evidence to suggest the validity of this argument, there are no instances where this is the case after 1965 (Brooks 2013, 877; Brecher and Wilkenfeld 1997). Not only has trade become a more cost-effective substitute for these earlier conflicts of conquest, but the rise of FDI has provided a more secure means to obtain resources and supplies. This is borne out by the results of Lee and Mitchell’s study, which demonstrate that “increasing global FDI reduces states’ incentives to obtain resources by capturing neighboring territories” (2012, 690). Yet, the notion that states will pursue a strategy of military aggression to obtain strategic resources is most persistent when this resource is petroleum. In Chapter 4, I discuss the problem with this conventional narrative and how it has obscured the role that oil dependence has on business-state relations and the consequences for international security. Instead of seeing petroleum rich states as targets of aggression, I demonstrate how my theory of the commercial peace explains the tendency of these states to use military force even when economic ties should constrain them.

### *Domestic Institutions*

Despite the increased empirical sophistication of work on the commercial peace, one thing all of these analyses have in common is that the relationship between economic

interdependence and conflict is framed as unconditional, giving the impression that the proposition is universal, equally applicable to all actors at all times and places (Mansfield and Pollins 2001, 844). Two sets of studies that are exceptions that prove the rule, Gelpi and Grieco (2003; 2008) and Papayoanou (1999), focus on the constraints that political institutions place on national leaders. Both sets of authors argue that economic interdependence is pacific only for dyads in which both states are democracies because the survival of political leaders in authoritarian governments does not depend on the commercial class. More recent work in International Relations, however, has updated conventional thinking on the domestic accountability for the foreign policy decisions of authoritarian leaders (Weeks 2008; 2012; Colgan and Weeks 2015). These studies suggest that there may be distinctions between the type of autocratic government that affect their responsiveness to business interests. The problem of assuming autocracies are homogeneous is further supported by the fact that Gelpi and Grieco's findings have not been replicated in subsequent studies. The case studies in this dissertation feature two very different autocratic types of government and may shed some insight on what internal dimensions of autocracies may influence the degree of business power on policymaking.

### *Qualitative*

As evident from this survey of the commercial peace literature, it is striking that the findings from quantitative studies have been so robust. Moreover, while Keshk et al. (2004; 2010) challenged these results as being driven by the endogenous effects of



militarized disputes on trading relationships, newer research has reaffirmed the pacific influence of bilateral trade on interstate relations (Hegre, Oneal, and Russett 2010; Robst, Polachek, and Chang 2007; J.-W. Lee and Pyun 2016). Yet, there remains great skepticism of the validity of the commercial peace thesis. One reason is the weight of the counterexample of World War One. That the world's most devastating conflict up to that point broke out in the wake of the first wave of globalization calls for a stronger theoretical explanation for how economic ties generate pacific resolutions of international disputes and what conditions their success.<sup>5</sup> A key obstacle to expanding the commercial peace thesis beyond a simplistic correlation between measures of trade and FDI to militarized conflict is the dearth of qualitative analyses, particularly after World War One and between non-European powers. Mansfield and Pollins make this point, explaining that "resolving issues of historical boundedness, causal mechanisms, and contingency that are central to the relationship between interdependence and conflict—as well as issues surrounding the definition and measuring of both factors—will surely be aided by carefully constructed case studies" (Mansfield and Pollins 2003, 20). To this end, my dissertation includes two detailed case studies that demonstrate the validity of the causal process, as well as highlighting the conditions that limit its success.

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<sup>5</sup> For studies that dispute this conventional narrative of economic interdependence and World War One see Papayoanou (1999) who emphasizes that the lack of democratic institutions limited the influence of economic interests on German foreign policy; Solingen (2014) who argues that Germany under Wilhelm II's Kaiserreich (1888–1919) was dominated by a hyper-nationalist coalition promoting protectionism and militarization; and Gartzke and Lupu (2012) who argue that the war originated with Austria-Hungary and Serbia, which did not share meaningful economic ties, and who ultimately dragged in their allies Germany and Russia culminating in the broader European war.

## **Causal Mechanism**

The core problem with the commercial peace thesis is that it lacks a causal explanation that incorporates domestic level actors, such as the firms doing the trading, foreign policy making, and interstate relations (Mansfield and Pollins 2001; Simmons 2003; G. Schneider 2014). Given that states themselves do not trade, the commercial peace argument needs a “plausible mechanism linking private trade to public conflict behavior” (Simmons 2003: 31). My dissertation addresses this critical gap in the literature by developing a two-level theoretical framework linking the domestic politics of policy-making within the interstate bargaining process. I argue that economic interdependence will deter the use of military force to resolve international conflict when those businesses that would be harmed by the loss of the commercial relationship have sufficient power to influence policy outcomes in both states. Furthermore, locating the causal mechanism in the power of business at the domestic level addresses the need for international relations theories that go beyond treating the state as a black box to recognizing that the “state is not autonomous [and] leaders must listen to powerful interest groups” (Baird and Dixon 2010, 9).

## **Methods**

This theory is evaluated using a multi-method approach. Two statistical models test whether the size of the public sector mediates the pacific effects of economic interdependence on militarized disputes. While the quantitative approach establishes

the generalizability of the argument, process-tracing case studies are necessary to establish the causal process by which business seeks to influence international security policy when their interests are at stake. This dissertation examines two very different rivalries: Colombia - Venezuela from 1985 - 2010 and China - Japan over the Senkaku/Diaoyu Islands disputes. Both cases move beyond the euro-centric focus of qualitative studies that have characterized this topic. The Colombia - Venezuela case study is also unique as they are medium powers, countering the major power bias in existing research. Moreover, the variation within the cases of the efficacy of economic interdependence differs from past studies, which were chosen because the rivalry ended in war.<sup>6</sup>

Both cases selected are strategic rivalries—“relationships in which decision-makers have singled out other states as distinctive competitors and enemies posing some actual or potential military threat” (Colaresi, Rasler, and Thompson 2008, 3). Thus, they are least likely cases for the general proposition that economic interdependence reduces militarized conflict. Baird and Dixon point out that “In the classic realist framework, states engaged in security competition should not be affected by economic relationships, least of all economic relationships with the enemy” (Baird and Dixon 2010, 2). Additionally, China itself is a most difficult case for the commercial peace thesis. China’s status as an autarky until 1978 makes it a latecomer “to participation in the global economy and international institutions” (Masterson 2012, 8). As a result, internationally oriented economic interest groups have had less time to

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<sup>6</sup> (Copeland 2014).

establish pathways of power and influence on state policymaking. Moreover, China's strict capital controls and large domestic economy insulates it from "punishment" by international financial markets for its aggressive behavior (Kirshner 2007).

## **Scope**

These case studies are also notable because they occur in the post-Cold War era. That most case studies of economic interdependence consist of pre-World War Two conflicts is puzzling as the scope of the majority of quantitative studies begin with the 1950's. Defining the period of the theory's applicability is important as the state's responsibility and intervention in the economy has varied considerably. While the logic of the commercial peace certainly extends to earlier eras, governments became responsible for the performance of the national economy to a much higher degree through the institutions that emerged out of Bretton Woods. Moreover, prior to World War One "publics did not expect or require government to manage the economy, and recessions were considered (like earthquakes) to be acts of God. In the then prevailing climate of "laissez-faire," governments were not implicated in economic downturns and were not asked to work with other countries to avoid them" (Rosecrance and Thompson 2003, 380). For these reasons, the theoretical framework developed in this dissertation applies to the post-World War Two period.

## **Significance**

The commercial peace thesis has yet to substantially evolve beyond Kant's opportunity cost formulation. Therefore, this dissertation advances the theory that economic interdependence reduces militarized conflict with a two-level framework incorporating the domestic politics of foreign policy-making within the interstate bargaining process. Developing the micro-foundational causal process of the commercial peace enhances the theory's predictive power by establishing the conditions in which economic ties are more or less likely to alter the decision to use military force as a means of dispute resolution. This allows the argument to be applied to non-traditional issues of international security, such as the problem of petrostate aggression. The mixed methods research design evaluating my argument that business must have influence on policymaking in both countries in order for economic interdependence to reduce militarized interstate disputes moves the literature beyond statistical modeling debates that have characterized much of the research on this topic.

This dissertation is one of a very small number of international relations studies that directly considers how the interests of business affect foreign policy decisions on matters of national security. While the comparative politics literature has begun to explore the influence of business interests on internal military conflicts, similar examinations of business power in international security issues have not been forthcoming. Incorporating the comparative literature on business power has the potential to enhance the explanatory ability of many international relations theories. Moreover, the Colombia - Venezuela case study is one of the first to directly examine the

inclusion of business in national security decision-making with in-depth qualitative research including interviews with economic elites and government officials at all levels, including the heads of the ministries of Foreign Affairs, Defense, Trade, and Finance.

## **Structure**

The following chapter builds a two-level causal theory of the commercial peace that asserts that the efficacy of economic interdependence to reduce militarized interstate disputes depends on the extent to which business influences foreign policymaking. To do so, I assess the still nascent research on business power by detailing the levels of aggregation of these economic interests and the mechanisms available to them to influence policy outcomes. I also discuss the difficulty of measuring the degree of business influence, particularly for quantitative tests while explaining the operationalization choices used in Chapter Three. Chapter Three adapts statistical models of the commercial peace to test whether measures of private sector size mediate the effectiveness of trade interdependence to reduce the use of military force in resolving interstate disputes. These measures are the government's percentage of total consumption, the percentage of government revenue that comes from taxes, the amount of credit available to the private sector as a percentage of GDP, and the ratio between investment by the private sector and total investment normalized by GDP.

Chapter Four turns to the literature on the natural resource curse and the political economy of oil dependent nations. An understudied problem in international

relations is the aggressiveness of petrostates. Dyads containing at least one petrostate are 50% more likely to be involved in a militarized dispute with fatalities. I offer one explanation to this puzzle by asserting that petrostates are undeterred by economic interests in the decision to use military force in interstate disputes. This is because the “Dutch disease” and rentier politics of oil dependence reduces the influence of both public and private economic interests. I show that economic interdependence does not affect militarized conflict for petrostate dyads while exerting substantial pacific effects on their counterparts. Confirmation of these results also reinforces the theory’s key explanatory variable—business power.

Chapters Five and Six employ process tracing to illustrate the causal pathway by which business-state relations alter the effectiveness of economic interdependence to reduce militarized interstate disputes in the strategic rivalries of Colombia - Venezuela and China - Japan. Interviews in Colombia and Venezuela reveal large differences in business-state relations. While business is both formally and informally involved in national security institutions in Colombia, Venezuela’s rentier politics makes the inclusion of business interests somewhat arbitrary and limited at best. The fact that business was unable to protect its interests in any way under Hugo Chávez underscores the problem of deterring the military aggressiveness of petrostates.

Chapter Six explores the potential and limitations of economic interdependence to temper the challenges brought about by the relative change in the balance of power between China and Japan. The dispute over the Senkaku/Diaoyu Islands continues to raise fears, particularly from neighboring countries, that a militarized incident could

escalate into a much larger conflict. A key question for this case is determining the extent to which business influences policy when nationalist sentiments by the Chinese public, which are key to the Communist Party's political survival, urge for more aggressive actions. While dueling nationalisms keep the fire alive over the islands dispute, the economic harm inflicted to interests in both countries have led to the use of new bilateral commitments to economic cooperation as a means of dispute de-escalation. This study reveals that realist concerns cannot be completely sublimated by the liberal peace. On the other hand, economic ties do not become irrelevant when the impetus for geopolitical conflict is at its highest. Accepting these nuances may make the commercial peace a more powerful tool for reducing militarized interstate disputes by enhancing the knowledge of the conditions that affect the degree of business power and thereby the effectiveness of economic interdependence to reduce the likelihood of militarized conflict.



## CHAPTER TWO: THEORY

It is puzzling, to say the least, how a theory about economic interdependence could exclude a discussion of the businesses that form the basis for these commercial ties. Given the fact that international conflict substantially reduces commercial exchanges, one would expect that affected businesses would be highly motivated to participate in policy decisions regarding interstate dispute resolution.<sup>7</sup> The relationship between business and political power, however, remains an understudied topic.<sup>8</sup> The following conceptualizes business power by assessing the multiple mechanisms available to economic elites to achieve their preferred policy outcomes. In doing so, I establish the significant but often ignored links between business and international security policy. Connecting the distinct literatures on the commercial peace and business power, I advance a two-level theoretical framework of the commercial peace thesis in which business power at the domestic level determines the effectiveness of commercial ties to reduce the likelihood of interstate militarized conflict.

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<sup>7</sup> For studies that confirm the effects of conflict on trade, see (Anderton and Carter 2001; Glick and Taylor 2010; J.-W. Lee and Pyun 2016).

<sup>8</sup> As far back as 1959, Robert Dahl complained about the lack of political science studies on the issue of business and power (1959).

## **Business Power**

Conceptualizing business power goes beyond the identification of interest groups to the study “of the mechanisms by which business converts its interests into policy” (Culpepper 2011, 186). Firms or business associations may lobby decision makers to represent their interests. They may choose to invest in political campaigns and can play a significant role in the selection of candidates. Prominent business leaders may be appointed to key roles within the government. Economic elites may have privileged access to the media and direct engagement with policy makers. In many instances, business will directly participate in policymaking. For example, governments will “institutionalize business input into policy making or oversight councils” (B. R. Schneider 2010, 224).

Typically, these various mechanisms have been analyzed in terms of business’s instrumental and structural power. Instrumental power “entails concerted political actions to influence policy” (Fairfield 2010, 38). This form of influence is “an actor-centered, relational concept of power based on the idea of individual voluntary action and focus on the direct influence of an actor on another actor” (Fuchs and Lederer 2011, 4). In contrast, “structural power arises from a perceived threat that a reform will lead to reduced investment” (Fairfield 2010, 38-39). This latter approach considers “the structural dependence of state elites on private sector profitability and [emphasizes] the bargaining power of corporations promising jobs and income on the policy agendas of host governments” (Fuchs and Lederer 2011, 5). Doris Fuchs and Markus ML Lederer point out that while studies on the instrumental uses of power “suffer from poor data or

difficulties in attributing causal influence, business's structural power may not 'leave a trace' to begin with, as per definition the threat to move investments and jobs should governments make unfavorable policy choices need not even be voiced" (6).

For this reason, most studies have focused on assessing the instrumental power of lobbying and the factors determining the political participation of business. Newer research, however, has explored the structural power of how "material structures and organizational networks may also endow actors with direct rule-setting power" (7). Personal networks linking political and economic elites may also shape policy outcomes by producing a shared world view so that broad business interests become internalized objectives of government policy. Moreover, these networks may be the most important means of business influence. Haggard et al. note for all the studies in their edited volume, *Business and the State in Developing Countries*, "business influence over government came not through distant lobbying but through a shared world view, informal personal networks, and overlapping roles" (1997, 53). Understanding the strength of business's ability to influence policy requires the synthesis of instrumental and structural approaches to power "to do justice to the complexity of business-government interactions" (57).

### *Business As Actor*

Business power is also exerted at multiple levels of aggregation: "as capital, as sector, as firm, as association, and as individuals and participants in policy networks" (B. R. Schneider 2010, 218). Most literature on business power has considered capital mobility

in terms of its indirect effect on “policies as policy makers try to anticipate policies that are likely to keep and attract capital” (Haggard, Maxfield, and Schneider 1997, 36).

Jonathan Kirshner, however, finds that domestic financial communities do seek to influence international security decisions when their economic interests are threatened by war (2007).

One of the most studied formulations of business is at the sector level, following “from the conventional Olsonian wisdom that businesses will be better able to overcome obstacles to collective action if they are small in number and homogeneous, as they usually are in capital intensive sectors” (B. R. Schneider 2010, 219). The sectoral approach can be useful “because many policies have very uneven distributions of costs and benefits across sectors. However, taken too far, sectoral analysis can obscure other bases of business politics such as corporate structure, business associations, and business networks that regularly swamp sectoral considerations” (Ibid.). With respect to the concerns of this dissertation, sectors that may be harmed by import competition will tend to seek protection through trade restrictions and regulatory hurdles. Given conflict with the importing country these sectors may take a neutral position—neither lobbying for or against the use of military force. On the other hand, they may act to constrain the state from militarizing the conflict as a possible escalation to war would create widespread costs to the whole domestic economy.

The business as firm approach analyzes “the political consequences of corporate organization” (Haggard, Maxfield, and Schneider 1997, 37). This approach recognizes the growing “dominance of the private sector by a handful of diversified business

groups” (45). Not only should the concentration or largeness of the firm size be noted, but perhaps even more important is their multisectoral diversification. For example, “the chaebol in Korea are involved in a range of related and unrelated manufacturing activities, service industries, land development, and (more recently) finance” (Ibid.). The impact of these large conglomerates “for relations between business and the state is the power that large firms are likely to wield from their sheer weight in aggregate economic activity” (46).

Business associations are another important means of obtaining policy preferences. Ben Ross Schneider uses structured comparisons of Latin American case studies to provide a relative measure of business power based on the relative strength and policy effectiveness of these organizations. He categorizes business associations according to whether they are “voluntary or state chartered (corporatist), whether they are encompassing or sectoral, whether they are based on production or employment relations, and whether they represent primarily large or small firms” (B. R. Schneider 2010, 220). While the lobbying or institutionalization of these organizations in the policymaking process may be easier to observe, Haggard et al. caution “that this approach can also overlook the importance of informal networks that provide alternative mechanisms for aggregating interests and interacting with state officials” (1997, 53).

The significance of networks linking economic and political elites is increasingly being recognized in research of business power. Studies have shown that an important source of policy influence comes from “how individual business people can participate

directly through appointment to government positions or close personal connections to top policy makers in personal or policy networks” (B. R. Schneider 2010, 220). These networks can “evolve out of long-standing social and kinship relations as well as common schooling and university training” (Ibid.).

Moreover, network ties do not have to be vertical, directly linking economic elites and politicians. Cesi Cruz and Benjamin A.T. Graham demonstrate that businesses may influence policy without these direct connections, because “their connections with other firms confer distinct advantages for the exercise of political influence, and this is especially true when considering political engagement at the national level” (2017, 1). Analyses of horizontal business ties are not unique; rather, these ties underscore the business as sector and business associations approaches. What Cruz and Graham bring to the literature is demonstrating that horizontal *social* relationships can be another means of political participation in the policymaking process.

Businesses pursue their political preferences by using multiple levels of aggregation and mechanisms of political influence. Schneider provides the helpful perspective of viewing this variation as a portfolio of political investments to analyze the strength of business power (2010, 221). The case studies in this dissertation examine both the instrumental and structural power of business actors, as defined above, on international security policy.

## *Business and Security*

A core issue of contention in the commercial peace literature is whether business has a substantial effect on national security decisions. Critics contend that when it comes to international security policy, business subsumes its economic interest to the flag. In many cases, however, it is problematic to differentiate the interests of business and that of the state. Military force is just one means of dispute resolution, and it seems reasonable to expect that when business has established pathways of influence, they will use their power to incentivize politicians to choose diplomatic options that preserve existing economic ties.

One of the difficulties in assessing business power in national security policy is that few studies directly examine the links between business and those charged with making decisions on matters of international security.<sup>9</sup> Notable exceptions are Jonathan Kirshner (2007), Patrick J. McDonald {\*McDonald:2009go} and Stephen G. Brooks (2013). All three of these studies find that business has a substantial role in the formulation of international security policy.

While capital is typically conceived as an agentless constraint, Kirshner examines the political participation of the banking and financial industry in the lead up towards war (2007). He finds that financial communities are always “cautious about war and policies that risk war because of the consequences of such actions for macroeconomic stability (203).” Their likelihood of realizing their policy preferences is “a function of the level of financial globalization (how large and interconnected global financial markets

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<sup>9</sup> See Brooks (2013) for a comprehensive discussion of this gap.

are) and the structure of the domestic economy” (209). During periods of high financial globalization, states with aggressive foreign policies “may be ‘punished’ by international financial markets, principally via capital flight, pressure on the exchange rate, and greater difficulty in borrowing abroad—in terms of both supply (finding willing lenders) and price (an interest rate premium)” (206). Even states who may have successfully insulated themselves from the financial markets “cannot escape the opportunity costs represented by the benefits foreclosed by their actions” (209).<sup>10</sup> This environment strengthens the power of domestic financial actors by referring to the rewards for peaceful behavior and the costs of an aggressive foreign policy.

Regarding domestic factors, Kirshner observes that “in ‘mature’ capitalist economies, with notable regularity, the financial sector tends to become larger and increasingly prominent” (214). Small developing states pursuing economic liberalization should be even more sensitive to the preferences of finance as they are in “great need of external finance, more open to financial flows, and highly vulnerable to the rapid, sudden movements of capital across borders” (220). In contrast, those states least likely to be constrained are large insular states—India, Russia, and China—and the holder of the world’s key currency—the United States. The financial community has little leverage in India, Russia and China because of their “less well developed financial services sectors, ambivalent attitudes toward financial liberalism, and large internal markets of which significant segments are detached from the global financial economy” (219). China’s fixed exchange rate and capital controls along with its one-party political system

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<sup>10</sup> See also: (Frieden and Rogowski 1996, 31-4).



leads Kirshner to warn that it “is virtually immune to domestic and international financial constraints on its national security strategy decisions” (220).

Brooks builds on Kirshner’s argument to assert that in the present era, economic actors in mature capitalist economies no longer need to actively lobby against war “because economic globalization—the accumulation of decisions by economic actors throughout the globe—now has sufficiently clear economic incentives for leaders” (2013, 867). He notes that while wars may have once been a useful means of gaining territory and resources, trade and, perhaps more potently, FDI is a cost-effective substitute for conflict. To support his claim, he points to states’ increased willingness to enact regulatory changes to make themselves more attractive to investment (876). To wit, most modern trade agreements, such as the TPP, are less about decreasing the barriers to imports but are designed to address the regulatory hurdles to trade and investment. Additionally, he points to the fact that in the current environment “governments who are host to FDI have generally shown a great willingness to act against threats to MNC [Multinational Corporations] assets that emerge from nonstate actors within their territory,” whereas in previous eras, “powerful states where MNCs were based that often were the ones who had to intervene to protect MNC assets from nonstate actors” (Ibid.). This thesis is buoyed by the multiplicity of studies that have found a link between FDI and reduced militarized conflict, for example (Bussmann 2010; Gartzke, Li, and Boehmer 2001; Kim 2013; H. Lee and Mitchell 2012; Masterson 2012; Rosecrance and Thompson 2003; Suzuki 1994). Furthermore, Brooks’s argument illustrates the need to

look beyond activities of direct lobbying as a means of influence to the power of agenda setting and personal networks.

Finally, Patrick J. McDonald focuses more narrowly on the domestic conditions that influence policy decisions on conflict and peace. He argues that governments possessing a large share of assets are less likely to be constrained by economic interests in their policy-making, and are, therefore, “more likely to engage in military conflict than governments overseeing more privatized economies” (P. J. McDonald 2009, 17). The financial autonomy gained by public assets “enables governments to redistribute publicly owned wealth within the economy toward political supporters (members of the winning coalition), tie significant portions of society to their survival in office and prevent the emergence of active opposition to its policies” (57). McDonald provides evidence of this argument with a quantitative model and a detailed case study of the World War One period. His empirical model shows that higher levels of the state’s non-tax revenue increase the likelihood of engaging in an interstate militarized dispute (77-95). In the next chapter, I also use this indicator as a proxy for business power. Unlike McDonald, however, I interact non-tax revenue with bilateral trade to determine if government dependence on tax revenue increases the pacific effects of economic interdependence.

McDonald also finds evidence of his theory in his case study of World War One. He demonstrates that Russia’s large public property holdings along with privileged access to French capital allowed the government to significantly increase military spending as it was free from the domestic constraints that might have deterred an arms

race with Germany. According to McDonald, Russia's dramatic military buildup along with its alliance with France prompted Germany to launch a preemptive war (185-232).

### *Measurement*

One factor that has hindered the study of business influence on policy is the difficulty of measuring business power. Not only does business have multiple mechanisms of influence, but because “business's political engagement often takes place out of the public eye...accessible, quantifiable indicators of business influence are rarely available” (Fairfield 2015, 4). The development of new methodological approaches such as network models and text analysis offer promising new means for analyzing data on business power. These quantitative studies, however, are limited in their ability to explain how social networks and other mechanisms of business power translate into policy outcomes. Therefore, qualitative work will continue to be essential to understanding the role of economic elites in policymaking, as well as discovering the determinants of relative business power. Case studies provide the ability to gain an understanding of the motivations of members of the business community and the politicians responsible for policy making “by drawing on extensive fieldwork...interviews, and documents unavailable outside the studied countries” (Ibid.).

With so many mechanisms available to business, case studies need to be methodologically rigorous to avoid ignoring other potential mechanisms unrelated to the commercial peace thesis that may be responsible for the outcome of interest. Therefore, the case studies in this dissertation use process-tracing to evaluate the extent

to which business influences international security policy. This method for within-case analysis applies a Bayesian logic framework to evaluate the strength of the collected evidence. In practice, this means that the collected data are evaluated by the probability that the evidence would exist if the theory were true or false “relative to the prior expected probability of finding this evidence” (Beach and Pedersen 2013, 83). Therefore, as Bennett explains, “the more unlikely a piece of evidence is in light of” alternative hypotheses, “the more that evidence increases our confidence that” the theory “is true if the evidence proves consistent” with the theoretical expectations (2009, 1:709).

The difficulty of operationalizing business power results in the necessity of a mixed method approach evaluating its significance as a generalizable theory, as well as illustrating the mechanisms that determine how business obtains its preferred policy outcomes.

## **Defining Conflict**

One reason for the discrepant results of studies on the commercial peace is that they often differ on the definition of conflict. International conflict can occur on a variety of levels: from low-intensity incidents, including; trade disputes, diplomatic disagreements, and unintentional border violations to high-intensity incidents such as; the mobilization of troops, displays of possible force, or the use of the military to resolve a dispute. This distinction is an important theoretical issue as several studies have shown that greater interaction through commercial exchanges may increase the probability of low-level conflicts

(Crescenzi 2005; Gartzke and Westerwinter 2016; Massoud and Magee 2012; Pevehouse 2004). Failing to take this variation into account hampers understanding the effect of economic interdependence on the likelihood of militarized disputes.

While scholars of the liberal peace began with the quest to understand the determinants of war and peace, the rarity of full-scale wars led them to shift their focus to militarized disputes. The use of military force is a critical threshold in international relations as it is at this point that “diplomacy becomes more actively coercive...there is a perception of a heightened risk of war, and the emotional climate of decision-making becomes increasingly clouded by hostility and fear” (Hensel 1994, 281). Thus, there is a general concern that conflicts involving the threat or use of force are the most likely to escalate into war, inflict the most damage on the countries involved, and undermine the stability of the international system.

My theory applies only to conflicts in which states threaten, mobilize, or employ military force as a response to an interstate dispute. There is considerable evidence that these measures inflict widespread costs to business interests. I do not expect economic elites to effectively deter lower levels of conflict due to the possibility of increased friction from more frequent interactions and the fact that many nonviolent incidents recorded in the

Correlates of War (COW) Militarized Interstate Disputes (MIDs) dataset are often non-deliberative (Palmer et al. 2015).<sup>11</sup>

## **Theoretical Implications**

Despite decades of academic work on the commercial peace, scholars have failed to consider how business power would mediate the effect of economic interdependence on the decision to use military force to resolve an interstate dispute. Assuming the state is a “black box” responsible for the level of economic ties and security decision-making, the commercial peace theory has lacked a causal mechanism explaining how economic interdependence affects foreign policy on international conflict. Thus, the theory has been unable to predict the conditions altering the effectiveness of economic interdependence to reduce the likelihood of militarized interstate disputes. My dissertation addresses this gap with a two-level theoretical framework incorporating domestic politics within interstate bargaining. Specifically, I assert that economic ties will only deter the use of military force when business has an influential role in policymaking. The following illustrates the implications of this causal mechanism.

Given the occurrence of a bilateral conflict:

1. When there is **no** economic interdependence: economic elites lack the motivation to mobilize and actively participate in the policy to initiate or

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<sup>11</sup> For example, the MIDs dataset records a dispute between the U.S. and Indonesia based on an incident in 2003 when U.S. “warships and planes briefly violated Indonesian waters near the island of Java (Palmer et al. 2015).

respond to a militarized incident. Therefore, state policymakers are not constrained by commercial interests when making decisions on the use of military force as a means of interstate dispute resolution.

2. When there is economic interdependence, affected businesses will use a portfolio of mechanisms to obtain a peaceful resolution of the international conflict. The degree of business's power to implement their preferred policy outcomes will mediate the pacific effects of economic integration. Thus,
  - a. If business has sufficient leverage on policy in both countries, there is a higher probability that the conflict will be resolved peacefully.
  - b. If business is excluded from the policymaking process, economic interdependence will not alter the likelihood of a militarized interstate dispute.

These implications can be visualized using a two-by-two table as displayed in Figure 1.

Figure 1: Business Power and Military Conflict

		<b>Country A</b>	
		High Business Power	Low Business Power
<b>Country B</b>	High Business Power	<b>1</b> Reduced Military Conflict	<b>2</b> No Effect on Conflict
	Low Business Power	<b>3</b> No Effect on Conflict	<b>4</b> No Effect on Conflict



## CHAPTER THREE: THE PRIVATE SECTOR

The literature on business power has yet to develop a large-*n* measure of policy influence. This section attempts to capture business strength on policy through three indicators: tax revenue, the amount of domestic credit available to the private sector, and the private sector's investment in the national economy.<sup>12</sup> These latter two variables are derived from a rare study measuring the relative size of the private sector (Stampini et al. 2013).<sup>13</sup> The lack of established quantitative measures of the size and impact of the private sector in both political science and economics is another fact that emphasizes the crucial underdevelopment of research into the relationship between business and politics.

I do not claim that a quantitative measure can capture the multiple mechanisms that economic interests use to achieve their desired political outcomes. Moreover, due to the complexity in the relationship between business and policymaking a general measure of private sector strength ignores the underlying institutional and historical environments that certainly contribute to the degree of business power. Qualitative studies are necessary to understand the influence of economic interests in any particular case, but they cannot on their own establish a general theory that places the business-state relationship as the key causal driver of the theory that economic interdependence reduces militarized conflict.

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<sup>12</sup> All measures come from the World Development Indicators.

<sup>13</sup> The author is not aware of other research on private sector size.

The three indicators used in this chapter suffer from the significant data limitations that characterize research in this area of economics. They are, at best, very imperfect, gauges of private sector strength. One question for this chapter is whether these indicators even provide valuable insight to the causal role of business power. It is my hope, however, that this work initiates a larger conversation between political science, economics, and business management on the methods and measures that can reveal general assessments of the business-state relationship. Newer methods, such as survey experiments and text analysis, and data generating approaches to analyzing international conflict offer hope for better tests in the future. Despite the current limitations, this chapter makes a significant contribution development and empirical strategy for studying a two-level model of the commercial peace, incorporating the relative strength of business as a potential mediator of economic interdependence's effect on reducing the likelihood of militarized interstate disputes.

## **Business Proxies**

Tax revenue (as a percentage of GDP) captures the state's dependence on the public and businesses to fund its goals at home and abroad. While there is considerable variation in how tax burdens are appropriated, the greater the total tax revenue, the more accountable the government is to those providing these funds. For example, when Colombian President Álvaro Uribe sought a new security tax to expand the war on

FARC, business elites insisted on the creation of a council to allow them to oversee military procurement (Flores-Macías 2013).

The amount of domestic credit available to the private sector (as a percentage of GDP) is one factor that determines the size of private commerce. Stampini et al. explain that “Credit is a key determinant of private sector production; when governments absorb most available credit, the private sector is likely to be constrained by lack of finance” (2013, 142). As chapter four explains in greater detail, the capital-intensive nature of oil extraction limits the credit needed for private sector growth. When credit is directed to the private sector rather than the state, the importance of the private sector to the national economy increases its influence on policymaking. Finally, I test whether the degree of private sector investment (as a percentage of GDP) has a mediating effect on economic interdependence.

## **Model Specification**

Although modeling disputes on the commercial peace characterized much of the debate on the true effects of economic interdependence for decades, a general consensus has emerged on the key determinants of conflict.<sup>14</sup> While the MID dataset has provided a common measure for conflict across studies, as mentioned previously, the inclusion of both low and high-intensity conflicts can be a conundrum when the dependent variable is actually violent military

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<sup>14</sup> For some examples, see (Lupu and Greenhill 2017; Hendrix 2015; Colgan 2013).

conflict. The conventional solution to this issue is a binary indicator for those conflicts that result in at least one fatality. This solution, however, restricts the understanding of many serious militarized disputes that did not result in official death counts. Moreover, it takes a fairly rare event—military conflict—to a much rarer occurrence—fatal disputes. Statistic models of rare events require greater data and the effects often appear quite small.

A less common approach is to use a continuous variable of dispute severity. This also provides a test as to whether the interaction of business power and economic interdependence reduces the escalation of conflict. The MID data includes a five-point level of hostility (LOH) scale for each state's highest military action in the dispute. This scale defines the hostility level as "1 is no militarized action, 2 is the threat to use force, 3 is the display of force, 4 is the use of force, and 5 is war" (Sweeney 2003, 737).

The next question is how to measure dispute hostility given that each state often responded with a different level of military action. Diehl and Goertz address this problem by developing the baseline rivalry level (BRL) scale which multiplies each state's LOH and transforms the ordinal numbers into an interval scale based on the relative frequency in a cumulative distribution function (Diehl and Goertz 2001, 292). This results in a scale that ranges from 2 to 100. A similar measure is constructed for fatalities. Since most MID data with fatalities do not list the exact number, the dataset provides six categories: 1) 1-25, 2) 26-100, 3) 101-250, 4) 251-500, 5) 501-999 6) > 999 deaths. The midpoint of the range

is used as the fatality estimate. The fatalities of both sides are estimated, transformed into natural logs, and then placed into a cumulative distribution scale. Both the LOH and fatality scale are spliced together to create the BRL, which ranges from 2 to 200. The full explanation of this procedure can be found in their book *War and Peace in International Rivalry* (Diehl and Goertz 2001, 281-292).

The appeal of the BRL scale is the ability to analyze the data with a linear model, however, the problem of selection bias must be addressed. Given that these analyses are restricted to conflicting states, they “do not employ a random or representative sample” (Braithwaite and Lemke 2011, 114). Therefore, previous studies have used a Heckman selection model to examine dispute severity. This requires a selection equation to predict the likelihood of conflict followed by a linear regression of the severity of military force used. The problem is that this model requires an exclusion restriction — the determination of variable(s) that should affect the onset of conflict, but not their severity. When these variable(s) are not theoretically justified, “the ‘cure’ may be worse than the ‘disease’...[since] the appropriateness of a selection model and the quality of the results are highly sensitive to the identification of the selection process itself” (Brandt and Schneider 2007, 5). The lack of theoretically specified variable(s) to identify the conflict onset equation is evident in the diversity of variables used. For example, Reed uses dyadic peace years to identify conflict onset, but not escalation (2000). Yet as Brandt and Schneider

point out, there is no reason to believe that the number of peace years does not also affect conflict escalation. Moreover, this variable does not provide enough information to adequately distinguish the equations (Brandt and Schneider 2007, 19). The same problems apply to Braithwaite and Lemke's use of contiguity, rivalry, and minor-minor status (2011) and Sweeney's selection of allies to distinguish conflict onset from escalation and severity (2003).

Perhaps the most important problem with using a Heckman selection model is that it "treats censored observations as missing, which gives rise to the sample selection problem that the model is designed to correct. Results are typically interpreted in terms of *potential outcomes*" (Vance and Ritter 2014, 529). This is a significant issue for conflict models for which a value of zero represents the lack of a dispute not missing data. Instead, Colin James Vance and Nolan Ritter advocate for the 2 PM model, commonly used in economics and other fields. This model also "involves the estimation of a probit and OLS regression, but is distinguished by the omission of the inverse Mills ratio from the latter regression. Results from the 2 PM are interpreted in terms of *actual outcomes*" (Ibid). Thus, this model does not require an exclusion restriction and is more appropriate for studies interested in the effects of the observed values of the independent variable.

In the following, I estimate two separate models—(1) a logit model for the likelihood of a militarized dispute with fatalities and (2) a two-part model examining the probability of dispute severity—to whether private sector

indicators mediate the effectiveness of economic interdependence to reduce the likelihood of militarized interstate disputes. I examine all dyads in the MID dataset for the years 1960 - 2007.

## **Variables**

### *Dependent Variables*

**FATAL DISPUTES:** this variable is coded as a one if a military dispute with at least one fatality occurred between a dyad in a given year. The value is zero for all other dyad years.

**SEVERITY OF DISPUTES:** In the 2 PM, the first part of the model is a selection equation using a logit regression on the binary as to whether a MID event occurred or not for each dyad year. The second part is a regression of the BRL (level of hostility scale) for those dyad years with the occurrence of a MID.

### *Independent Variables*

**BILATERAL TRADE:** is the natural log of the total trade flow between a dyad.<sup>15</sup> Given that the model also includes the natural log of both states' GDP, this variable is essentially equivalent to the measurement of trade dependence (total trade divided by

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<sup>15</sup> All monetary values are in current US\$. Data is from (Barbieri and Keshk 2012).

the higher GDP of the two nations). Additionally, it avoids confounding the effects of trade and economic size on the probability of conflict.<sup>16</sup>

### *Private Sector Variables<sup>17</sup>*

TAX REVENUE (% of GDP).

DOMESTIC CREDIT AVAILABLE TO PRIVATE SECTOR (% of GDP).

INVESTMENT—GROSS FIXED CAPITAL FORMATION, PRIVATE SECTOR (% of GDP).

### *Control Variables*

The included control variables are derived from the model in Hegre et al. (2010) and Oneal and Russett (2005), which is the most fully specified model, and therefore, the basis for most of the literature on the determinants of MIDs. Additionally, these variables have been shown theoretically and empirically to be significant predictors of militarized disputes. Detailed explanations for the control variables can be found in the above references.

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<sup>16</sup> For a more detailed explanation see: (Hegre, Oneal, and Russett 2010, 768; Keshk, Pollins, and Reuveny 2004, 1164-5.).

<sup>17</sup> All three variables are from the WDI database which can be accessed at the [www.worldbank.org](http://www.worldbank.org).



*GDP*: As mentioned above, the natural log of each states GDP are included in the model. They are represented according to the lower and higher value. These variables also control for country size as discussed in Hegre (2009).<sup>18</sup>

*Lower and Higher Democracy*: are based on the Polity scores for each state.<sup>19</sup> These variables control for the democratic peace and the research suggesting that “democracies and autocracies are particularly likely to fight one another” (Oneal and Russett 2005, 298).

The following variables are included to control for the balance of power theory of conflict.

*Probability of Winning and National Capacity*: are both based on Composite Index of National Capacity (CINC) score (version 4.0).<sup>20</sup> This index attempts to capture a nation’s capacity for military conflict through measurements of a state’s iron and steel production, military expenditures, military personnel, primary energy consumption, total population, and urban population. The probability of winning is the larger CINC value divided by the sum of both states’ scores. This provides an indicator of the balance of power between the states as “conflict should be less likely when capabilities are closer

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<sup>18</sup> Data are from (Feenstra, Inklaar, and Timmer 2013; Maddison 2010).

<sup>19</sup> (Marshall et al. 2002)

<sup>20</sup> (Singer 1988)

to equal” (D. S. Bennett and Stam 2000, 699). The model also includes the natural log of the higher CINC score, because “the larger state is the weak link in the chain of peaceful dyadic relations [as] it is less constrained in projecting military power” (Hegre, Oneal, and Russett 2010, 768).

*Contiguity*: is a dichotomous indicator of whether the states in a dyad share a common border.<sup>21</sup> Shared borders greatly increase the propensity towards conflict.

*Distance*: is the natural log of the distance between the capitals of both countries. This value accounts for the transportation costs of projecting military power further from home as well as the degree of political relevance between pairs of states.<sup>22</sup>

*Alliances*: denotes whether the states have at least one formal alliance.<sup>23</sup>

Additionally, temporal dependence is adjusted for with a cubic spline for peace years as described in Beck et al. (1998). These coefficients are not reported in the results below.

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<sup>21</sup> (Stinnett et al. 2002)

<sup>22</sup> (Hegre, Oneal, and Russett 2010, 766)

<sup>23</sup> (Gibler and Sarkees 2004)

## Logit Results

Table 1: Private Sector Strength on Fatal Militarized Disputes

	(1)	(2)	(3)	(4)
	Trade	Tax	Credit	Investment
Bilateral Trade <sub>ln</sub>	-0.102*	0.083	-0.119*	-0.045
	(0.043)	(0.107)	(0.056)	(0.156)
Tax Revenue (% GDP)		0.072***		
		(0.017)		
Trade * Tax Revenue		-0.012**		
		(0.004)		
Domestic Credit			0.003	
			(0.012)	
Trade * Domestic Credit			-0.002	
			(0.001)	
Investment (% GDP)				-5.860
				(4.583)
Trade * Investment				0.219
				(1.130)
Smaller GDP <sub>ln</sub>	0.223*	-0.118	0.138	0.019
	(0.089)	(0.153)	(0.118)	(0.150)
Higher GDP <sub>ln</sub>	0.341**	-0.077	0.367**	0.506
	(0.125)	(0.207)	(0.119)	(0.289)
Lower Democracy	-0.126***	-0.075*	-0.071***	-0.039
	(0.023)	(0.031)	(0.018)	(0.028)
Higher Democracy	0.010	0.048	0.015	0.045
	(0.013)	(0.052)	(0.017)	(0.031)
Higher Capability <sub>ln</sub>	0.315**	1.051***	0.217	0.132
	(0.109)	(0.218)	(0.130)	(0.358)
Probability of Winning	-2.317*	-1.084	-1.244	-1.947
	(0.940)	(1.469)	(1.054)	(1.682)
Contiguity	2.169***	3.014***	3.243***	3.231***
	(0.283)	(0.557)	(0.383)	(0.683)
Distance <sub>ln</sub>	-0.449***	-0.151	-0.538***	-0.459*
	(0.102)	(0.250)	(0.120)	(0.202)
Alliances	0.415	0.712	0.403	0.295
	(0.231)	(0.574)	(0.283)	(0.518)
<i>N</i>	269250	75450	210063	43652
Dyads	11027	6621	9945	3886
Log-likelihood	-1702.731	-246.198	-841.019	-220.001

Clustered standard errors in parentheses

Omitted: peace years and splines

All Dyads 1960-2007

\*  $p < 0.05$ , \*\*  $p < 0.01$ , \*\*\*  $p < 0.001$

Table 1 displays the results from the logit model, which tests the mediating effect of the private sector indicators on economic interdependence's significance on reducing the probability of fatal militarized disputes. Equation 1 establishes that in a model without interactions, bilateral trade significantly decreases the likelihood of fatal conflicts. The signs of the control variables are in the expected direction in all four equations. Beyond these observations, the coefficients are not particularly meaningful. One way in which interactive logit models are often misinterpreted is taking the value of the lower order coefficients of an interaction term. Braumoeller explains that "because interactive relationships imply that the impact of  $X_1$  on  $Y$  varies depending on the level of  $X_2$ , the idea of 'the impact of  $X_1$  on  $Y$  in general' is in fact a meaningless one" (2004, 809). Additionally, the significance of the interaction coefficient provides insufficient information to determine if there is a substantively meaningful interaction among the independent variables (Berry, DeMeritt, and Esarey 2010, 257). One method to determine the significance and substantiveness of the interaction is to plot "how the marginal effect of one variable on  $\Pr(Y)$  varies with the value of another variable" (261).

Figure 2: Tax Revenue on Fatal MIDs

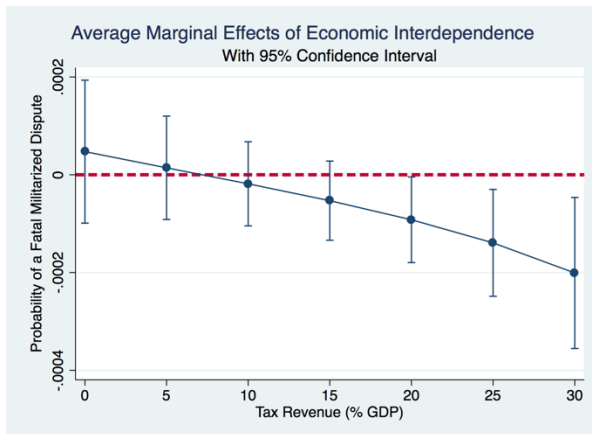


Figure 3: Credit to Private Sector on Fatal MIDs

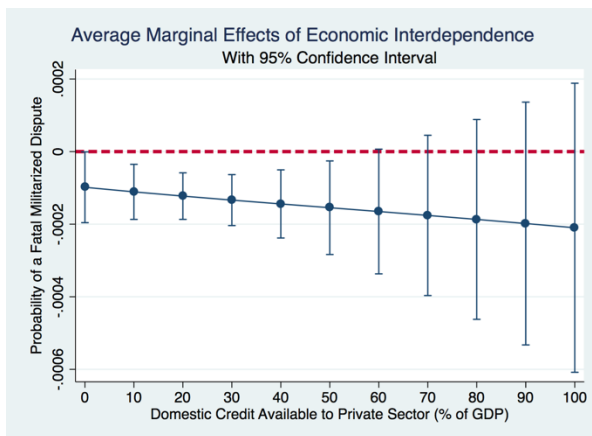
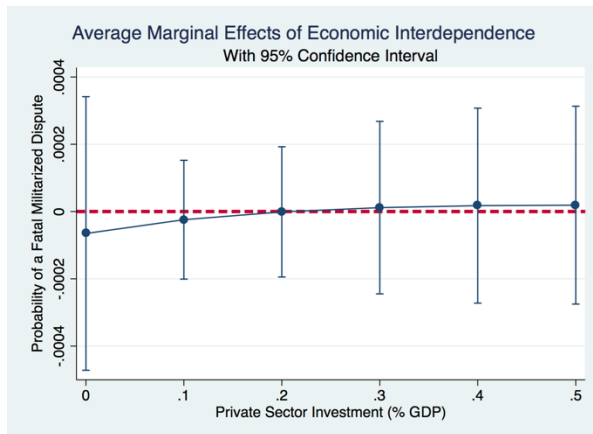


Figure 4: Private Sector Investment on Fatal MIDs



Figures 2, 3, and 4 show the marginal effects of the private sector indicators on bilateral trade's impact on fatal conflicts. Greater amounts of tax revenues and credit to the private sector increase the pacific effects of economic interdependence. Private sector investment in the economy, however, appears to have no relationship with bilateral trade or fatal disputes.

## 2PM Results

Table 2: Private Sector Strength on the Severity Level of Militarized Disputes

	Trade		Tax		Credit		Investment	
	Logit	Regress	Logit	Regress	Logit	Regress	Logit	Regress
Bilateral Trade <sub>ln</sub>	-0.018 (0.025)	-3.153*** (0.951)	0.031 (0.065)	-0.442 (3.342)	0.011 (0.034)	-3.834** (1.244)	-0.055 (0.078)	-1.333 (2.678)
Tax Revenue (% GDP)			0.007 (0.021)	0.283 (0.850)				
Trade * Tax Revenue			-0.007* (0.003)	-0.239 (0.185)				
Domestic Credit			-0.001 (0.007)	-0.070 (0.184)				
Trade * Domestic Credit			-0.001 (0.001)	-0.008 (0.018)				
Investment (% GDP)							-6.131*** (1.545)	64.309 (100.558)
Trade * Investment							0.829 (0.523)	-44.739 (28.933)
Smaller GDP <sub>ln</sub>	0.133** (0.050)	-0.834 (1.531)	0.169 (0.101)	-2.860 (2.786)	0.089 (0.066)	2.452 (1.770)	0.014 (0.111)	6.783 (4.368)
Higher GDP <sub>ln</sub>	0.252*** (0.061)	-0.253 (1.955)	-0.143 (0.100)	-1.879 (3.263)	0.223*** (0.061)	-1.822 (2.098)	0.089 (0.133)	-0.308 (5.888)
Lower Democracy	-0.083*** (0.010)	-0.834* (0.381)	-0.075*** (0.014)	0.015 (0.599)	-0.059*** (0.009)	-0.163 (0.291)	-0.054** (0.018)	0.603 (0.889)
Higher Democracy	-0.001 (0.009)	0.425 (0.291)	0.011 (0.020)	1.888*** (0.486)	-0.013 (0.010)	0.379 (0.314)	0.005 (0.018)	0.695 (0.884)
Higher Capability <sub>ln</sub>	0.199*** (0.060)	4.419 (3.022)	0.697*** (0.126)	11.393 (6.326)	0.173** (0.067)	5.002 (4.212)	0.384* (0.165)	7.319 (7.778)
Probability of Winning	-1.535** (0.484)	-51.216** (16.963)	-0.551 (0.820)	-52.467 (32.437)	-1.336* (0.579)	-9.378 (17.262)	-1.566 (0.927)	0.691 (40.479)
Contiguity	1.955*** (0.168)	-0.781 (4.686)	1.769*** (0.230)	15.546* (7.264)	2.039*** (0.205)	9.217* (4.479)	2.057*** (0.386)	13.219 (12.690)
Distance <sub>ln</sub>	-0.365*** (0.057)	0.919 (2.405)	-0.187* (0.094)	-2.491 (4.216)	-0.373*** (0.072)	-0.500 (2.728)	-0.287* (0.129)	-4.363 (4.872)
Alliances	0.406** (0.131)	6.726 (4.094)	0.520* (0.255)	17.884* (7.352)	0.315* (0.150)	10.370* (4.731)	0.184 (0.197)	4.831 (8.158)
N	269250		75450		210063		43652	
Log-likelihood	-1.21e+04		-2548.854		-7874.529		-2206.854	

Clustered standard errors in parentheses  
\*  $p < 0.05$ , \*\*  $p < 0.01$ , \*\*\*  $p < 0.001$

The significance of the results from the logit model on fatal conflicts are replicated in the 2PM model, shown in Table 2, on the severity of militarized conflict. Once again, Equation 1 is the standard commercial peace argument. Interestingly, bilateral trade appears to have no effect on the onset of conflict, but significantly reduces the severity of the military force used to resolve the dispute. This result echoes other findings suggesting that trade may increase low level disputes but reduce violent militarized conflict.<sup>24</sup> Figures 5, 6 and 7 largely mirror the marginal effects in the logit model, although, the effects of available credit to the private sector loses its statistical significance. Private sector investment shows more potential to also enhance the pacific effects of bilateral trade, but the paucity of data and large margins of error inhibits a more definite interpretation. The combined results from both models support the plausibility that the state's reliance on business to fund its goals and grow the economy conditions the success of the commercial peace.

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<sup>24</sup> See for example, (Crescenzi 2005; Gartzke and Westerwinter 2016; Massoud and Magee 2012; Pevehouse 2004).



Figure 5: Tax Revenue on the Severity Level of Militarized Disputes

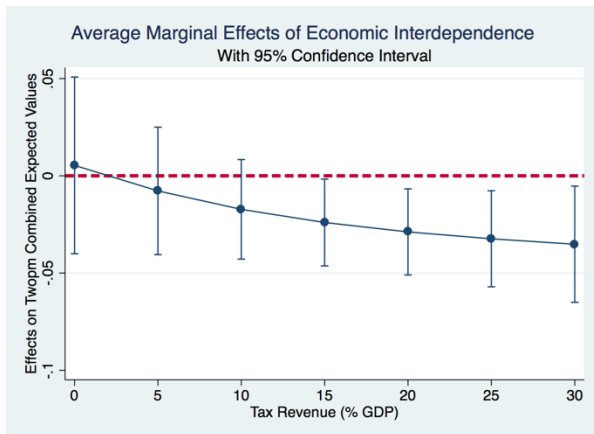


Figure 6: Credit to Private Sector on the Severity Level of Militarized Disputes

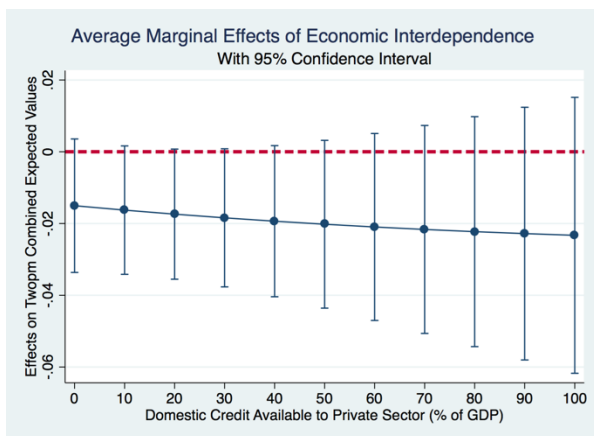
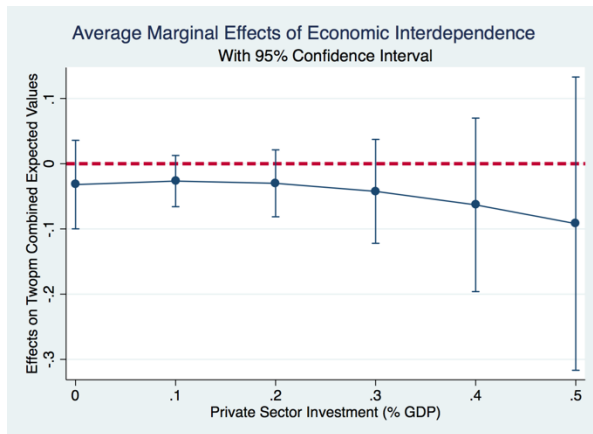


Figure 7: *Private Sector Investment on the Severity Level of Militarized Disputes*



Another way of thinking about the role of business in policymaking and its impact on the economic incentives of employing military force is to examine the problem of the increased propensity of petrostates to be involved in militarized interstate disputes. The political economy literature has firmly established that the size and influence of the private sector in oil dependent states are considerably smaller than their counterparts due to the “Dutch disease” and rentier politics. The next chapter investigates whether my two-level theory of the commercial peace can explain the violent aggressiveness of petrostates.

## CHAPTER 4: PETROSTATES AND INTERSTATE CONFLICT

We have become accustomed to equating the oil rich countries of the Middle East with international conflict. Russia's military aggression against Georgia in 2008 and the Ukraine in 2014, as well as Venezuela's mobilization for war against Colombia in 2008, however, are evidence that petrostates<sup>25</sup> constitute a wider threat to international security and peace. Given that dyads that include at least one petrostate are 44% more likely to be involved in interstate conflicts with fatalities than their counterparts, shown in Table 3, it is apparent that petro-aggression is a significant problem for global stability. Therefore, it is surprising that research investigating why these dyads are more likely to engage militarily is nascent. This dissertation contributes to the literature on the relationship between oil dependence and international conflict by applying my two-level framework of the commercial peace. By acknowledging the importance of business actors to whether economic interdependence will exert a peaceful influence on interstate relations, I assert that petrostates are more likely to be involved in violent conflicts because they are not constrained by economic interests in using military force as a means of interstate dispute resolution.

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<sup>25</sup> Defined as nations that are 20% or more economically dependent on oil and gas revenues. Additionally, references to oil revenues include both oil and gas.

*Table 3: Odds of a Fatal Militarized Dispute*

Table 3: Odds of a Fatal Militarized Dispute			
	Odds Ratio	95% Confidence Interval	
Petrostate Dyads	1.437138	1.212497	1.703399
<i>N</i>	547773		
All Dyads 1970-2007			

Given the consequences of interstate conflicts that include petrostates, it is perplexing that before 2010, scholars largely ignored the relationship between oil dependence and interstate conflict.<sup>26</sup> Despite a lack of empirical testing, the conventional argument presumes that natural resource abundance increases a petrostate’s vulnerability to attacks by its neighbors. Recent studies, however, have challenged this assumption by showing petrostates to be the primary initiators of conflict and that these disputes are not over oil resources (Colgan 2010; Colgan 2013; Ross and Voeten 2015; Schultz 2015; Meierding 2016).

An overlooked fact of petrostate conflicts is that they often occur between economically interdependent countries. Recently, John Muller argued that Russia's seizure of Ukrainian territory in 2014 challenged the notion of the commercial peace as Putin’s “foray in an area of deep economic

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<sup>26</sup> Koubi et al. (2014) echo these sentiments in their review of the natural resource curse literature.

interdependence doesn't seem to have been waylaid by potential economic cost considerations" (2014). Like many proponents and critics of economic interdependence, Mueller makes the mistake of assuming that economic interdependence should have a uniform effect on interstate conflict. Yet the causal mechanism of the commercial peace — that state leaders are constrained in resolving disputes by military force by businesses with financial interests in interstate trade — predicts that the pacific effects of economic interdependence should vary according to the degree of business influence on policymaking.

The following challenges the conventional narrative that petrostates have a greater risk of being targets of conflict by their neighbors seeking control over resource rich territory. I then show that the propensity of petrostates to be involved in military conflicts remains largely unexplained. By incorporating the comparative politics literature on the resource curse, I describe how oil dependence limits the size of the private sector and the inclusion of business in policymaking. The resulting consequences alter how petrostate leaders respond to the economic costs of international conflict. I test the validity of my argument that a two-level account of the commercial peace broadens the understanding as to why petrostates are more militarily aggressive by using the statistical models developed in the previous chapter. I expect that economic interdependence will not alter the likelihood of fatal and severe military interstate disputes between petrostate dyads, while exerting a pacific influence on their counterparts.

## **Existing Literature**

### *Targets or Aggressors?*

Rather than viewing petrostates as targets in the international system, Jeff Colgan explored the possibility that *resource-backed aggression* explained why petrostates are involved in a disproportionate number of militarized disputes (2010, 676). Both Colgan (2010) and Cullen Hendrix (2015) employ analyses of directed dyads, finding that petrostates are much more likely to initiate militarized disputes than to be the target of aggression. Complementing these studies, Emily Meierding’s in-depth qualitative research reveals the flaws in the logic that states can benefit from oil wars. She identifies four overlooked “impediments to exploiting foreign oil: invasion costs, occupation costs, international costs, and investment costs” (Meierding 2016, 262). Moreover, her research shows that the most common historical examples used to back the “petrostate as target” claim were not directly about oil. For example, her case studies of “Japan’s invasion of the Dutch East Indies (1941– 42), [and] Iraq’s invasion of Kuwait (1990)” find that these were wars for survival. She also demonstrates that “the Iran–Iraq War (1980–88) and the Chaco War between

Bolivia and Paraguay (1932–35),” were not even connected to oil interests (Ibid).

The strongest rebuttal to the arguments put forth by Colgan and Meierding is from Francesco Caselli et al. who find a high risk of conflict “where only one country of the pair has oil and this oil is close to the border” (2015, 304). Kenneth Schultz, however, shows that the result in Caselli et al. is “driven by a number of false positives: dyads in which the disputed territory does not encompass the oil near the border” (2015, 3). For example, he finds that within Caselli et al.’s own data “many of the most conflict-prone dyads with oil near the border were not, in fact, fighting about oil: for example, India–Pakistan, Israel–Egypt, Israel–Syria, Russia–Japan, and Armenia–Azerbaijan. Indeed, in some of these cases, the disputed territory does not overlap with the oil deposits” (17). Instead, Schultz finds “disaggregating territory into fifty-kilometer square grid cells reveals that cells that provide access to oil are, if anything, less likely to be part of dispute than cells without oil” (3). Evidence from several multinomial models support Schultz’s conclusion “that that the grid cells located on top of onshore deposits are associated with a lower probability of a dispute, while grid cells that give access to offshore oil or that sit on a path to oil are neither more nor less likely to be implicated in a claim than those that do not” (19).

Apart from the study by Caselli et al., the above works call into question the logic that it would be in a sovereign nation’s interest to attack its territorial rivals to gain control over oil resources. Colgan finds that the petrostates initiate

interstate conflicts at “a rate 94 percent higher than that of nonpetrostates” (2010, 664). Meierding provides in depth qualitative evidence that the four wars most commonly thought to be over petroleum resources were instead about security needs and national survival. Finally, Schultz points out that conflict over disputed territories usually only encompass a small portion of that area of land. He finds that territories that contain oil are less likely to be the target of an interstate dispute. Through a combination of quantitative and qualitative analyses, these studies convincingly argue that petrostates are rarely, if at all, targets of military aggression for control over their oil resources in the modern era. In doing so, they have reinitiated the question — why are petrostates involved in a significantly higher number of militarized conflicts?

### *Existing Theories of Petro-State Conflict*

To date, there have been two theories proffered to explain petrostate aggression: (1) oil wealth in revolutionary regimes increases the tendency of these leaders to initiate military conflict (Colgan 2010; Colgan 2013), and (2) high oil prices lead to increased willingness of petrostates to initiate military conflict (Hendrix 2015). The following briefly summarizes these arguments while demonstrating their insufficiency to fully address the problem of petrostates and international conflict.

Colgan explains the aggressiveness of petrostates by looking at the effect of oil revenue on states with revolutionary governments. He focuses on these



regimes because they tend to be substantially more aggressive than their counterparts due to the type of leadership that emerges from these governments. These leaders are “likely to have greater risk acceptance for achieving their desired political outcomes” (Colgan 2010, 666). Revolutionary governments also result in “the removal of domestic political and institutional constraints” (676). Oil income increases the revolutionary leader’s autonomy and reduces the possibility of being removed from office for foreign policy decisions (670).

While an important contribution to the literature, Colgan’s theory does not fully address why petrostates are involved in a greater number of dyadic militarized disputes. He cannot assert that the effect of oil on conflict is limited to revolutionary governments. Indeed, he admits that his classification of revolutionary governments does not entirely encapsulate the aggressive leadership he theorizes about. In particular, Russia is a significant outlier. Colgan notes “Russia’s democratizing revolution under President Boris Yeltsin in 1990-91 did not generate an overly aggressive government” (683). Moreover, he also notes that willingness to initiate conflict by Putin’s Russia demonstrates that revolutionary governments are “not a necessary condition for having aggressive preferences” {Colgan:2014tn}.

Hendrix offers an alternative explanation by asserting that oil exporters are more conflict-prone when oil prices are high (Hendrix 2015). The record high prices and conflictual events of 2008, particularly Russia’s invasion of Georgia

and Chávez's military aggression towards Colombia, have led many to intuitively support this hypothesis. Yet, many have also noted that Russia's invasion of the Ukraine may be due to a counter phenomenon; the economic challenges of low prices possibly incentivized Putin to pursue a "rally-around-the-flag" strategy. Although Hendrix concludes that the data supports his explanation, his empirical results produce mixed support for the argument. While MID initiations by petrostates do seem price contingent in the directed dyads regression, the reverse is true at the monadic level. When it comes to relative bellicosity of petrostates, however, his results show the exact opposite. He does not offer an explanation for the contrasting results of these analyses.

Both Colgan and Hendrix use directed dyadic tests to assess whether their independent variables explain the initiation—whether State A was the first to take a codeable action—of a militarized dispute by a petrostate. The authors of this dataset, however, have repeatedly stated that this variable "should not be interpreted to be the states that "started" the conflict, or that are responsible for the conflict" (Ghosn, Palmer, and Bremer 2004, 139). Thus, while Colgan and Hendrix find support for petrostate initiation, they do so within the context of these limitations.

## **Oil and the Private Sector**

The well-known phenomena of the “Dutch disease” and the rentier politics that result from natural resource abundance explain why oil dependent economies have smaller and less influential private sectors. The “Dutch disease” shifts resources and industry away from private enterprises and expands the state's role in the economy. Abundance in natural resource production causes a decline in the manufacturing and agricultural sectors. One reason is due to the ‘resource movement effect’: “as the resource sector booms, it draws labor and capital away from the agricultural and manufacturing sectors and raises their production costs” (Ross 2012 Kindle Locations 1148-1149). The decline of these sectors is also the result of the ‘spending effect’: “as money from the booming resource sector enters the economy, it raises the real exchange rate. A higher real exchange rate makes it cheaper to import agricultural and manufactured goods than to produce them domestically” (Kindle Locations 1149-1151).

Since the 1970s, “virtually all oil-exporting countries in the developing world” have nationalized oil industries (Kindle Locations 441). As a result, oil dependence increases the size of the government as a fraction of the national economy. Ross explains, “since agricultural and manufacturing sectors are typically in private hands, their declining profitability will reduce the size of the private sector” (Kindle Locations 1171). What remains of the private sector are services which provide “the economy with things that cannot be easily imported—like construction services, health care, and retail stores” (Kindle

Locations 1174). Given that the “Dutch disease” concentrates national wealth to the state treasury, the state is the largest client for services. As a result, financial success depends on access to government to obtain lucrative contracts rather than being determined by market competition.<sup>27</sup>

Oil dependent countries are also known for their rentier politics. Terry Lynn Karl explains that the resource curse effect on the merchant class is more extreme in oil dependent countries “because domestic capitalist economic groups, notoriously concentrated in monopolies or oligopolies, are dependent on oil rents and the political power arrangements that distribute them through patronage” (Karl 2007, 11). Moreover, as “this wealth is the result of a windfall and privileged links to the state and ... largely independent of merit-based efforts made by citizens, this pattern of wealthy-creation encourages rent-seeking as well as a tendency to live beyond one’s means” (12).

Another consequence of oil wealth is that governments are less dependent on taxes to generate revenue. This increases the states’ autonomy from the economic interests that might oppose engagement in military conflicts. In Chapter 2, I articulated McDonald’s argument on the consequences of the state’s ownership of large public assets. He also points out that reducing the size of the private sector is critical as “domestic economic sectors capable of surviving open

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<sup>27</sup> Author interview with Gabriela Febres-Cordero, former Venezuelan Minister of Trade from 1989–1992.

competition from foreign producers generally support restrained national interests and cooperative foreign policies” (2009, 48).

Petrostates use the rents from oil revenue to eliminate any existing opposition group and prevent the formation of new movements that could challenge the regime. This explains the well documented correlation between oil wealth and regime stability (Karl 2007; Ross 2015; Wright, Frantz, and Geddes 2013). While this applies to all civil society groups, private enterprises are particularly singled out. For example, Karl notes that in Kuwait and Qatar, “the political distribution of oil rents eliminated the influence of the merchant class in decision making, leaving the rulers with no real political opponents that could base themselves in a social class” (Karl 2007, 21). Consequently, the regime’s political survival is not vulnerable to economic downturns in the short to medium term, such as those caused by lower oil prices.

Although the business community is small and lacks influence in petrostates, it is commonly argued that the direct beneficiaries from the nation’s oil wealth should also be less likely to support militarized conflict that might adversely affect their own pockets.<sup>28</sup> Solomon W. Polachek directly challenged this argument through findings that Saudi Arabia is more likely to initiate conflict with the countries it trades with (\*Polachek:1980hr p.80}. Moreover, there are two logical issues with the argument that the direct beneficiaries of oil revenue constrain decisions to use military force.

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<sup>28</sup> (See for example, Colgan 2013)

First, state leaders conscientiously prevent oil entrepreneurs from transforming their wealth or economic position into political power. Often this requires strategic demonstrations that these individuals owe their status to the state, and consequentially, their wealth and personal freedom can be taken away at any time. In Russia, for example, when the nation's wealthiest businessman and head of the oil group Yukos, Mikhail Khodorkovsky, challenged Russian President Vladimir Putin politically, Khodorkovsky was imprisoned. Yukos's assets were seized by the Russian government and later auctioned off to bogus companies that were then acquired by the state-owned gas company, Gazprom (S. Dixon 2008). Another illustration comes from Venezuela. When the workers and managers of the state-owned oil company, *Petróleos de Venezuela, S.A.* (PDVSA) went on strike to protest changes to the constitution, President Hugo Chávez, fired more than half of PDVSA's 40,000-person workforce, making loyalty the key characteristic for employment.

Second, there is no empirical evidence linking a decrease in oil profits to a decline in the personal income of the state leader(s) due to massive corruption and the fact that revenue losses are easily shifted to other parts of the economy (Hults 2007, 11). For example, after Chávez broke the PDVSA strike, he "radically shifted its orientation towards meeting government objectives" (14). PDVSA's primary goal became providing "large and easily adjustable revenues to the Venezuelan government. For 2005 and 2006, PDVSA paid the government 71.1% and 74.6%, respectively, of the revenues it obtained from

Venezuelan operations” (21). The higher percentage in 2006 reflects \$11 billion in lost profits “because of state-mandated actions” (Ibid). The Venezuelan government also gained discretion over extrabudgetary revenue, such as widely expanded social programs known as *misiones*. Not only did the state establish the funding rates of these *misiones*, but there was also no oversight to ensure that the revenue was spent as allocated. In another example:

The 2008 [Venezuelan] budget projected revenue based on \$ 35 per barrel of oil, but for three weeks in 2008, the Venezuelan oil basket sold for at least \$ 116 a barrel, which was 233 percent higher than the budgeted amount. Finance Minister Rodrigo Cabezas reportedly justified this underestimate by stating that it was a way to “minimize the risk” of an external shock; he promised to channel any surpluses for the benefit “of the people and only for the people.” Such systematic underestimation generated an average revenue surplus of 20 percent each year— basically an amount that Chávez was free to use unaccountably (Corrales 2011 Kindle Locations).

In sum, petrostates can risk the economic losses of international conflict because there are no opposition groups to hold the government accountable and any decline in oil revenue can be shifted onto other parts of the economy rather than affecting the personal income of state leaders.

Table 4: Private Sector Size in Oil Dependent Countries

	Table 4: Private Sector Size of Oil Dependent Countries		
	(1)	(2)	(3)
	Tax Revenue	Domestic Credit Available to Private Sector	Private Sector Investment
Petrostates	-3.416*** (0.083)	-13.990*** (0.164)	0.056*** (0.001)
Observations	226057	424371	202815

Standard errors in parentheses

\*  $p < 0.05$ , \*\*  $p < 0.01$ , \*\*\*  $p < 0.001$

Table 4 demonstrates that petrostates collect significantly less tax revenue and domestic credit available to the private sector than their counterparts.

Puzzlingly, they also seem to have more private sector investment. It is possible this is the result of oil dependent states increased attractiveness to FDI (Ross and Voeten 2015). These results verify the theoretical expectation that the private sector is smaller and less influential in petrostates than in other nations.

## **Empirical Results**

I test whether petrostates lack the constraints of business when economic interdependence would otherwise incentivize non-militarized means of interstate dispute resolution using the same models described in Chapter 3. A petrostate is defined as a country for which oil and gas revenues make up at least 20% of the total economy. Oil and gas revenue are from (Ross 2013). GDP data are from (Feenstra, Inklaar, and Timmer 2013). Table 5 provides a complete list of petrostates included in the regression analysis covering the years 1970 to 2007.



Table 5: List of Petrostates

<b>PETROSTATES 1970-2007</b>	
Algeria	Mauritania
Angola	Mexico
Azerbaijan	Nigeria
Bahrain	Norway
Bolivia	Oman
Brunei Darussalam	Papua New Guinea
Cameroon	Qatar
Chad	Russia
Congo	Saudi Arabia
Ecuador	Senegal
Egypt	Sudan
Equatorial Guinea	Syrian Arab Republic
Gabon	Timor-Leste
Indonesia	Trinidad and Tobago
Iran	Turkmenistan
Iraq	United Arab Emirates
Kazakhstan	Uzbekistan
Kuwait	Venezuela
Libya	Yemen
Malaysia	

Table 6 displays the logit coefficients for the probability of a militarized dispute with fatalities. The results of the control variables are as theoretically expected. Equation 1 shows the results for the standard commercial peace model. The results here differ somewhat from Table 1 because the models in this chapter begin in 1970, rather than 1960, because this latter period is when oil industries became nationalized. Equation 2 adds the effect of petrostate dyads to this model. Although, neither bilateral trade or petrostate dyads coefficients are statistically significant, they are in the theoretically

expected direction. Equation 3 models the interactive effects of economic interdependence and petrostate dyads.

Table 6: Oil Dependence and Fatal MIDs

Table 6: Fatal Militarized Disputes			
	(1)	(2)	(3)
Bilateral Trade <sub>ln</sub>	-0.062 (0.042)	-0.066 (0.041)	-0.129** (0.042)
Oil Dependent Dyads		0.181 (0.217)	-0.412 (0.258)
Bilateral Trade <sub>ln</sub> * Oil Dependent Dyads			0.169** (0.056)
Smaller GDP <sub>ln</sub>	0.037 (0.070)	0.030 (0.070)	0.052 (0.070)
Higher GDP <sub>ln</sub>	0.081 (0.121)	0.078 (0.121)	0.077 (0.117)
Lower Democracy	-0.117*** (0.023)	-0.113*** (0.022)	-0.109*** (0.021)
Higher Democracy	0.031* (0.013)	0.035* (0.014)	0.031* (0.014)
Higher Capability <sub>ln</sub>	0.659*** (0.117)	0.682*** (0.117)	0.688*** (0.113)
Probability of Winning	-3.901*** (0.865)	-4.020*** (0.880)	-4.018*** (0.870)
Contiguity	1.904*** (0.307)	1.928*** (0.298)	1.867*** (0.295)
Distance <sub>ln</sub>	-0.529*** (0.107)	-0.534*** (0.109)	-0.583*** (0.111)
Alliances	0.476 (0.262)	0.454 (0.263)	0.451 (0.264)
<i>N</i>	241603	241603	241603
Dyads	11016	11016	11016
Log-likelihood	-1388.958	-1388.243	-1380.519

Clustered standard errors in parentheses

Omitted: peace years and splines

All Dyads 1970-2007

\*  $p < 0.05$ , \*\*  $p < 0.01$ , \*\*\*  $p < 0.001$

Figure 8 shows that the marginal effect of bilateral trade on the probability of a militarized dispute with fatalities is substantial for dyads without a petrostate, while having no effect on interstate relations that include at least one oil dependent country. These separate effects can also be seen in Figure 9 which

displays the different predictive margins for non-petrostate and petrostate dyads at distinct levels of bilateral trade.

Figure 8: Petrostate Dyads and Fatal MIDs

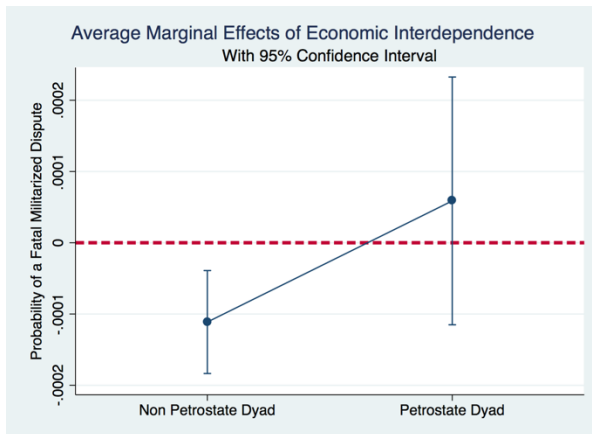
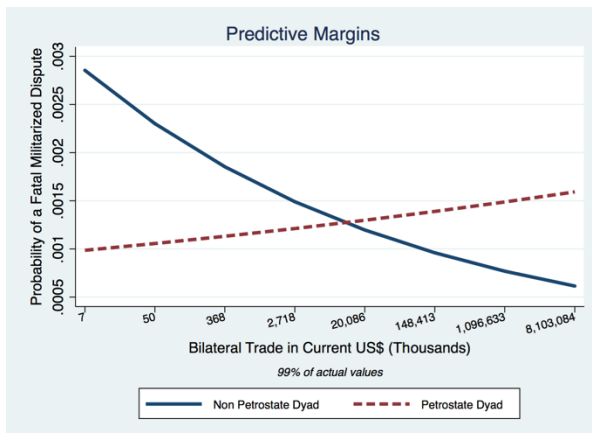


Figure 9: Predictive Margins on Fatal MIDs



The results of the 2 PM are reported in Table 7. As expected, Figures 10 and 11 show that economic interdependence reduces the likelihood of increasingly severe military conflicts, while having no effect for petrostate dyads.

Table 7: Petrostates and the Severity Level of MIDs

	(1)		(2)		3	
	Logit	Regress	Logit	Regress	Logit	Regress
Bilateral Trade <sub>ln</sub>	0.003 (0.024)	-2.974** (1.011)	0.004 (0.024)	-3.079** (0.976)	-0.035 (0.027)	-3.190** (0.974)
Oil Dependent Dyads			-0.091 (0.117)	9.198* (4.484)	-0.564** (0.175)	7.709 (6.899)
Bilateral Trade <sub>ln</sub> * Oil Dependent Dyads					0.117*** (0.032)	0.329 (1.274)
Smaller GDP <sub>ln</sub>	0.047 (0.046)	-2.340 (1.687)	0.051 (0.047)	-2.751 (1.720)	0.068 (0.047)	-2.681 (1.684)
Higher GDP <sub>ln</sub>	0.013 (0.066)	-0.934 (2.534)	0.016 (0.066)	-1.327 (2.452)	0.021 (0.065)	-1.329 (2.450)
Lower Democracy	-0.073*** (0.010)	-0.757 (0.390)	-0.074*** (0.010)	-0.684 (0.373)	-0.074*** (0.010)	-0.688 (0.375)
Higher Democracy	0.014 (0.009)	0.374 (0.331)	0.013 (0.009)	0.539 (0.337)	0.010 (0.009)	0.528 (0.340)
Higher Capability <sub>ln</sub>	0.476*** (0.063)	6.991 (4.361)	0.467*** (0.064)	7.583 (4.319)	0.466*** (0.064)	7.580 (4.318)
Probability of Winning	-2.390*** (0.458)	-59.783** (19.617)	-2.341*** (0.461)	-64.277*** (19.457)	-2.293*** (0.456)	-63.760** (19.644)
Contiguity	1.754*** (0.180)	-5.028 (5.155)	1.748*** (0.179)	-4.675 (5.112)	1.712*** (0.181)	-4.625 (5.121)
Distance <sub>ln</sub>	-0.351*** (0.067)	-0.923 (2.615)	-0.349*** (0.066)	-0.868 (2.685)	-0.376*** (0.066)	-0.894 (2.676)
Alliances	0.448** (0.138)	7.430 (4.630)	0.458*** (0.137)	6.911 (4.802)	0.463*** (0.139)	6.937 (4.789)
<i>N</i>	241603		241603		241603	
Log-likelihood	-1.03e+04		-1.03e+04		-1.03e+04	

Clustered standard errors in parentheses  
 Omitted: peace years and splines  
 All Dyads 1970-2007

\*  $p < 0.05$ , \*\*  $p < 0.01$ , \*\*\*  $p < 0.001$

Figure 10: Petrostate Dyads and the Severity Level of MIDs

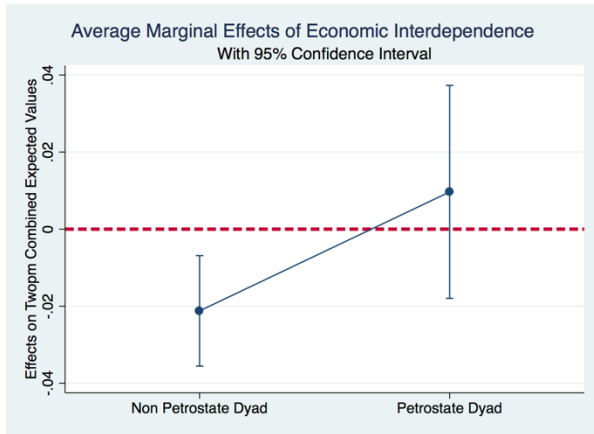
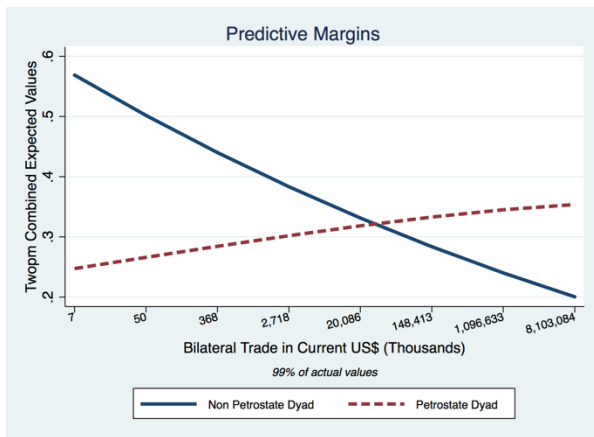


Figure 11: Predictive Margins on the Severity Level of MIDs



Both models demonstrate that economic interdependence reduces the scale of military force used to resolve interstate disputes for dyads without a petrostate, while having no effect on petrostate dyads. This is consistent with the hypothesis that petrostates are more willing to use military force because they are unconstrained by the business community with financial interests in the

peaceful resolution of conflict. The variation between petrostate and non-petrostate dyads also strengthens support of a multilevel framework for the commercial peace which incorporates the degree of business influence on domestic policymaking within the interstate bargaining process.

These quantitative analyses give credence to the theory that the military bellicosity of petrostates is a result of the natural resource curse, which reduces the size and influence of the private sector. Without these economic constraints, petrostates are more likely than their counterparts to make policy decisions that harm the financial interests of their domestic businesses. This causal process is further evaluated in Chapter 5's case study of Colombia - Venezuela relations. Although growing economic interdependence between these rivals led Colombian business elites to successfully seek peaceful resolution of their longstanding territorial disputes, the weaker power of their counterparts due to Venezuela's petro-politics ultimately undermined trade's contribution to improving the interstate relationship. These combined analyses support the hypothesis that petrostates are aggressive international actors because they are undeterred by the economic consequences from militarizing disputes.



## CHAPTER FIVE: COLOMBIA – VENEZUELA RELATIONS

The Colombia - Venezuela dyad has long been one of Latin America's most active militarized rivalries. That this rivalry carries with it a significant risk of war is evident in both the 1987 naval standoff in the Gulf of Venezuela<sup>29</sup> and the militarized incidents between 2008 - 2010 when repeated confrontations led both countries to fully mobilize their militaries for a potential engagement. In both instances, the OAS was able to intervene and prevent further escalation of the conflict. Several scholars had thought, however, that the growing economic cooperation between Colombia and Venezuela, which began in the early 1990s, would prevent future conflicts from becoming militarized (Weisbrot and Johnston 2010; Trinkunas, Jaskoski, and Sotomayor 2012). One might interpret this sequence of events as an apparent failure of the commercial peace. Instead, this chapter will demonstrate the centrality of business power to the success of economic interdependence to reduce militarized interstate disputes by examining the pathways through which business achieves its preferred policy preferences. The contrast between the strength of Colombia's business community and the weakness of economic elites in Venezuela sheds light on some of the factors that determine the success of business in policymaking. In particular, I show how the rentier politics of oil dependency weakens not only the influence of the private sector but also other economic stakeholders in the government, allowing petrostate leaders to enact policies that harm the national economy without losing power. The lack of commercial

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<sup>29</sup> Referred to as Coquibacoa in Colombia.

constraints on the use of military force helps explain why petrostates are more likely to be involved in fatal militarized disputes.

## **Overview of the Colombia - Venezuela Rivalry**

While Latin America is typically studied by political scientists for the problem of internal violence that many of these countries face, the region is not immune from fatal interstate disputes. Of the region's rivalries, the Colombia - Venezuela relationship is the most likely to become militarized (Mares 2012, 90). As it is with most strategic rivalries, the primary issue of dispute is territory (Hensel 1994; Rasler and Thompson 2006).

Colombia and Venezuela share a land border that spans 1,378 miles. While the demarcation is settled on paper, many areas of this territory are very rural and receive few services from either state's government. In these places, it is often not clear to locals or each nation's military where the actual border between Colombia and Venezuela lay. The journalist Laura Gils described this area as a type of "third country" in which the families who live there cannot find the demarcation line or determine if they are Colombian or Venezuelan.<sup>30 31</sup>

Tensions along the land border are often due to the ease with which drug traffickers and guerrillas cross the border freely to avoid capture and arrest. Interstate

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<sup>30</sup> Interview with author, 2015.

<sup>31</sup> This confusion has led to rumors that the current Venezuelan President Nicolás Maduro, who unusual for a Venezuelan lacks a birth certificate, may have been born in the Colombian border town of Cúcuta (Lansberg-Rodríguez 2015).

conflicts regarding the land-based territory have primarily been based on the right of “hot pursuit,” meaning that the military and national police may cross the border when chasing criminals, particularly organized crime like drug trafficking. Both nations have violated each other’s territorial sovereignty in this manner. The lack of an official agreement to demarcate the Colombia - Venezuela maritime border has also been a source of conflict. This issue became salient in the 1960s with the discovery of potential offshore oil fields and changes to maritime law (George 1988, 143).<sup>32</sup>

The crisis that nearly led to war between the two countries began on August 9, 1987 when the Colombian navy ship Caldas sailed below the 12th parallel with orders to “expel Venezuelan fishing boats and naval craft from the disputed waters” (George 1988, 151). Venezuela responded by deploying naval “frigates to the scene to reassert Venezuela's claim of territorial jurisdiction over the waters” (139). This, in turn, prompted Colombia to send additional naval vessels to the area, resulting in a protracted naval encounter, during which “Venezuelan warships crossed the prow of the Caldas and dispatched Mirage fighter aircraft to overfly it” (Ibid.). On August 21st, the Organization of American States (OAS) became involved at Colombia’s behest and helped negotiate an end to the military standoff (Ibid.).

At the time of the Caldas incident, Colombia - Venezuela had virtually no cross-border trade. In the first part of the 1990s, both countries responded to the economic decline of the 1980s by rapidly pushing through neoliberal economic reforms that

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<sup>32</sup> The 1982 United Nations Convention on the Law of the Seas, an accord that Venezuela has never agreed to nor signed, establishes 200-mile maritime economic zones (Domínguez, Mares, United States Institute of Peace 2003).

strongly affected domestic markets and their national openness to trade. The two countries signed a bilateral free trade agreement in 1991, leading very rapidly to interdependence. The extraordinary nature of this shift in bilateral commercial relations is captured by Echavarría and Gamboa, who note that “during the 1990-95 period, imports within the Andean Group grew by a remarkable 27% per year and exports by 35% per year, perhaps the fastest effect of integration recorded to date” (Echavarría and Gamboa 2000, 6).<sup>33</sup>

While economic interdependence did not reduce the frequency of border disputes, it did incentivize non-militarized resolutions of these conflicts. The MID dataset records several low intensity disputes during this period, most involving Venezuelan military intrusions into Colombian territory when pursuing drug traffickers and Colombian guerrillas who had attacked their border posts. Concerned about the negative ramifications on their commercial relations, the two countries established the *Comisión binacional de Fronteras* (Combifron) or "Binational Commission of Frontiers" which facilitated regular meetings between the defense ministers to exchange military information. As such, political relations became sublimated to this important economic relationship.

The new dynamics of Colombia - Venezuela relations continued until the second half of Hugo Chávez's tenure as the President of Venezuela, when Chávez began using their mutual trade dependence as a tool of political coercion. The relationship between economic interdependence, militarized conflict, and business power over this period is

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<sup>33</sup> The Andean Group also included Bolivia and Ecuador at this time.

illustrated in Table 8. The following section compares business influence in both countries. The centrality of business power to the pacific effects of economic interdependence is then demonstrated by examining two similar interstate conflicts in 2001 and 2005. I then account for the events that led to the severing of economic ties and brought the countries back to the brink of war.

*Table 8: Colombia - Venezuela Trade and Conflict*

	<b>Conflict</b>	<b>Interdependence</b>	<b>Business Power</b>
1985-1989	Militarized	Low	Not Relevant
1990-2003	Non-Militarized	High	Colombia: High Venezuela: Low/Moderate
2004-2010	Militarized	Coercive and then ENDED	Colombia: High Venezuela: None

## **Business and the State**

### *Colombia*

The Colombian political economy is known for its strong ties between business elites and the state. This relationship is built on personal networks, the revolving door

between high-level government positions and employment in the private sector, and strong business associations. Additionally, the institutionalized structure of policymaking in Colombia requires “extensive consultation among party factions and with the private sector interest groups that are closely tied in with them” (Bushnell 1993, 275-6). This point is echoed in Schneider, writing that “by the 1970s, economic policy makers usually announced new policy initiatives in assemblies of major business associations rather than in Congress” (2004, 148). This integration extends beyond economics into security interests as well. For example, President Uribe was only able to garner support from business elites for a new security tax through the creation of a joint commission with business representatives that would have “strict oversight of expenditures” to ensure that the new revenue stream was spent effectively on security measures (Flores-Macías 2013, 489-90). Interviews with former and current Defense Department officials confirmed the importance of formal and informal meetings with the business community.<sup>34</sup> Overall, there appears to be a consensus of a generally harmonious and institutionalized relationship between economic interests and state policy in Colombia.

### *Venezuela*

The oil industry in Venezuela has profoundly shaped the nation’s economics, politics, and civil society. Venezuela’s economic dependence on oil revenues typifies how the

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<sup>34</sup> Author interviews with Luis Fernando Ramírez, Bernardo Ortiz, and Juan Guillermo Castro, 2015.

natural resource curse leads to a classic rentier state that deprives the private sector of leverage in policymaking. As the “Dutch disease” predicts, the expansion of oil in the 1920s led to a reduction of the agricultural and manufacturing industries. Along with the overvaluation of the currency, this resulted in “traders [losing] their profitable export business and [having] to rely on imports, using the state as the source of foreign exchange” (Thorp and Durand 1997, 239). Thus, as far back as the 1920s, Venezuela's political economy was defined as one in which “the state had the resources to provide something for everyone, and the private sector had ample access to the flow of benefits” (230).

It was the oil boom of the 1970s, however, that brought about the resource curse of abundance. Figure 5 shows that dependence on oil doubled during this period. As a result, the power of the executive grew at the expense of Congress, political parties, and the central business association—Fedecámaras, while “at the same time there was a growth in individual and personalistic relations with the state” (Ibid). Business success, therefore, was not based on market competition, but rather on establishing relationships to the government to obtain access to state resources. Given that “profits were dependent on appropriate decisions by bureaucrats or party leaders...businessmen became commensurate lobbyists” (Ortiz 2006, 76). Gabriela Febres-Cordero, the former Venezuelan Minister of Trade from 1989-1992, described the business community as beggars, needing the state to survive.<sup>35</sup> The result was a state that was essentially

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<sup>35</sup> Interview with author, 2015.

autonomous through its direct accrual of oil revenue, thereby severely limiting the influence of the business community on government policymaking.

The Presidency of Hugo Chávez further weakened the power of business in both the private and public sectors, including the state-owned oil company, PDVSA.

Constitutional reforms expanded the powers of the president, eliminated the Senate, and expanded the government's role in the economy (Ortiz 2006). In response, the workers and managers of PDVSA held a three-month strike in 2002. Instead of leading to political change, however, Chávez fired “nearly 60 percent of the PDVSA personnel, including most managers, and assigned control of the oil industry to the military” (Corrales and Penfold-Becerra 2015, Kindle Locations 603-604). Loyalty to Chávez became the chief criteria for employment. With this victory, Chávez had completely eliminated the private sector from the regime's “real selectorate” — “the group that actually chooses the leader” (Bueno de Mesquita and Smith 2011, 5).

## **Militarized Incidents in the Chávez Era**

### *2001*

Initially, Chávez pursued a pragmatic economic foreign policy, prioritizing trade with Colombia, particularly when ideologic tensions arose (Campello 2011). This is illustrated in the 2001 incident involving Jose Maria Ballestas, an ELN member wanted for the hijacking of a Colombian commercial airliner in 1999. On February 13, 2001,



Venezuelan and Colombian police made a joint arrest of Ballestas in Caracas. It was expected that “two days later, on Feb. 15, Mr. Ballestas was to have been handed over at the Caracas airport to two Colombian agents, who were to have transported him there” (Forero 2001). Therefore, it was with genuine surprise when just moments before Ballestas was to be flown to Colombia, “Venezuela's interior minister and Mr. Chavez's closest political adviser, Luis Miquilena, ordered the guerrilla's release, arguing that he had requested asylum” (Webb-Vidal 2005).

The Colombian government grew increasingly frustrated when Venezuelan officials denied knowledge of Ballestas's presence in Venezuela, forcing Colombia's defense minister, Luis Ramírez, to release a video of the guerrilla's arrest. In April, Venezuela rearrested Ballestas, charging him “with forging documents and assuming a false identity” (BBC News 2001). After months of unanswered phone calls from Colombia's Ministry of Defense, Venezuela finally extradited Ballestas in December. <sup>36</sup>

Although the incident raised tensions between Colombia and Venezuela, trade remained the top priority. In March, just days after Colombia filed a formal extradition request for Ballestas, Colombian President Pastrana and Chávez held a bilateral meeting to discuss commercial issues. Both leaders stated that the “Ballestas” case has been overcome. At the meeting, Pastrana “stressed the significance of the binational economy, which, according to him, had increased by more than 30 per cent. He added that in this regard, this figure is expected to exceed 40 per cent this year” (Sanchez 2001).

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<sup>36</sup> These events were confirmed in an interview between the author and Luis Fernando Ramírez, 2015.

2005

Chávez's victory over PDFSA and in the 2004 recall referendum was an important milestone in consolidating his power. Upon doing so, he undertook a complete "overhaul of the Venezuelan Ministry of Foreign Affairs" (McCarthy-Jones and Turner 2011, 557). This was one more indicator that "the nature of policy-making had been dramatically altered. The comfortable elite accommodation of the Punto Fijo years has been swept aside and replaced by a system in which the state and especially the president were increasingly the focal points of policy-making and where countervailing forces in society were greatly weakened" (Ibid.).

The consequences of this shift can be seen most clearly by comparing the arrests of Jose Maria Ballestas and Rodrigo Granda. In December 2004, Rodrigo Granda, a senior member of FARC, was captured in Caracas and then "transported to Colombia, and arrested by Colombian officials" (Randall 2011, 148). Venezuela declared this incident to be a violation of its sovereignty and of international law, while Colombia accused Venezuela of "knowingly harboring Colombian guerrillas" (Ibid). With the commercial sector fully excluded from policy at this point in his presidency, Chávez took the unprecedented action of suspending bilateral trade and business accords in January 15, 2005, demanding an apology from the Colombian government.

Initially, Colombian President, Álvaro Uribe insisted that the government had not been involved, rather "Mr. Granda was picked up inside Colombia and that his capture was the result of the offer of a monetary reward" (Webb-Vidal 2005). The suspension of trade and border closure immediately led to a sharp increase in petroleum prices in

Colombia and shortages of foods and essential goods in Venezuela (BBC Monitoring Latin America 2005). The economic shutdown forced Uribe to respond to “growing protests from his own commercial supporters” by conceding to Venezuelan’s demand for an official apology (Raby 2011, 166). Trade was restored on January 28<sup>th</sup>. A bilateral meeting on February 15<sup>th</sup> between the two leaders appeared to heal the rift in their bilateral relations.

The Colombian government had no reason to expect that the Granda incident would not be solved diplomatically as had previous disputes. The political manipulation of trade can only come from a government that is not constrained by business interests. The suspension of trade did not simply punish Colombia, but it also put severe stress on the Venezuelan economy. The strength of the power of business in Colombia is evident in the fact that Uribe conceded with an apology within two weeks of the border closure. He did so in response to strong pressure from business elites, many who were calling and speaking directly to Uribe and his Foreign Minister, Jaime Bermudez.<sup>37</sup> While the fact that Uribe so quickly capitulated made the tactic initially successful, it also fundamentally changed the relationship from one of mutual benefit to a tool of political coercion.

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<sup>37</sup> Interview with author, 2015.

## **From Economic Interdependence to Mobilizing for War**

The Colombian President Uribe and Venezuelan President Chávez were not always antagonists, and at times it seemed that on a personal level they related well to each other. <sup>38</sup> On August 30, 2007, Uribe invited Chávez to act as a mediator to the FARC in order to release several hostages that had been taken between 2001-2003. Regrettably, this gesture renewed bilateral tensions as Uribe became increasingly suspicious that Chávez was possibly providing financial and other support to the FARC. Uribe terminated Chávez's role in the negotiations on November 21<sup>st</sup> (Mander and Lapper 2007). This event was a prelude to a new era of conflict in which the risk of war became a genuine concern.

On March 1, 2008, the Colombian military crossed the border of Ecuador, targeting a FARC camp, in which Colombian intelligence had just placed one of its highest-ranking members, Raúl Reyes. The pre-dawn raid succeeded in killing Reyes and 24 others (Marcella 2008). Unsurprisingly, Ecuador reacted hostilely to the event occurring within its territory. Venezuela's militarized response was unexpected, however, as Chávez ordered the mobilization of 15,000 Venezuelan troops, sending "10 battalions and tanks to the Colombian border" (Ibid, p. 18). He also threatened to cut off all commerce, and trade slowed along the borders as Chávez began blocking Colombian imports. For its part, Colombia did not respond to the military provocation and attempted to diffuse the situation. The leaders of Venezuela, Colombia, and Ecuador

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<sup>38</sup> Author interview with Laura Gil, 2015.

met on March 7<sup>th</sup> at a “summit in the Dominican Republic in an effort to resolve the dispute before it could escalate further” (Randall 2011, 151). While war was averted at this time, trade between Colombia and Venezuela was not fully restored until July “when Uribe and Chávez met in Paraguaná, Venezuela” (Ibid.). Analysts interpreted the eventual crisis resolution as being “driven by practical economic considerations” given “Colombian-Venezuelan bilateral trade was valued at some \$6 billion per annum” (Ibid.). Future crises, however, would challenge this assumption.

Hendrix cites this incident to support his argument that higher oil prices emboldens the aggressive tendencies of petrostates’ leaders (2015). In actuality, Chávez’s weaponization of trade coincided with an economy that was beginning to falter. Although oil would not hit its historical peak until June 2008, economists were concerned over increasing inflation in Venezuela and shortages of basic food items (Reuters 2008). These shortages worsened with Chávez’s trade blockade given that Colombia was its top source of foodstuffs.

A new crisis emerged in July 2009 over leaked details of a U.S.-Colombia Defense Co-operation Agreement, which would have given U.S. armed forces access to at least three Colombian military bases. Chávez responded by breaking off commercial and economic relations as well as expropriating the assets of Colombian businesses operating in Venezuela.<sup>39</sup> Chávez’s reaction seemed to be a repetition of previous squabbles, and Colombian businesses, as well as most economic analysts, expected that

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<sup>39</sup> In 2015, the Colombians I spoke with were still angry about the expropriation of Exito, joint French-Colombian supermarket chain.

trade would resume within weeks. The president of one of Colombia's most influential business association, ANDI, Luis Carlos Villegas, predicted "that although exports will fall, they will remain 'high' because of the two countries' economic interdependence" (The Economist 2009).

Rather than a restoration of the trading relationship, however, tensions between the two countries continued to climb. In October, the kidnapping of 12 youths playing soccer "in the Venezuelan State of Tachira and the subsequent massacre of 11 of them, including nine Colombians" inflamed emotions on both sides (BBC Monitoring Latin America 2009a). Venezuela followed this incident up with a "protest note to the Colombian Embassy in Caracas," and revived a "theory about a plot to assassinate President Hugo Chavez" (Ibid.). The situation began to be described by some, such as former Colombian President Ernesto Samper, as a "state of pre-war" (Ibid.). Certainly, events seemed to be headed in that direction. In November, Venezuelan soldiers blew up two pedestrian bridges (Hamer 2009). At a public ceremony during the same month, Chávez instructed his generals to "prepare for war" against Colombia (Pardo 2009). A report in the Colombian weekly *Cambio* noted that despite the 1987 *Caldas* incident and numerous armed clashes over the maritime and land border, "'Prepare for war,' had never previously been said in public by any Venezuelan or Colombian president" (BBC Monitoring Latin America 2009b). Unsurprisingly, Colombia's armed forces also began assessing scenarios for a possible attack from Venezuela (BBC Monitoring Latin America 2009c). Similar clashes continued until Uribe's successor, Juan Manuel Santos, took office in August 2010. Both countries suffered from the breakdown in economic

interdependence. Colombia estimated that 170,000 jobs were lost as a result, while basic food shortages substantially worsened in Venezuela (Wells 2009). Although trade was officially restored in late 2010, bilateral trade continued to decline due to the worsening Venezuelan economy. For example, one large obstacle to the resumption of economic ties was the \$800 million owed to Colombian exporters for unpaid products (Reuters 2010).

This account illustrates how the extent of business influence on policymaking impacts the effectiveness of economic ties to reduce militarized conflict. By substantiating the link between oil dependence and a smaller and less influential private sector, this case study establishes that the lack of business power is a significant cause of petro-aggression. In Venezuela, the “Dutch disease” and the rentier politics of the resource curse resulted in the subordination of the interests of business to the state. In contrast to its neighbor, economic elites, who were greatly profiting from bilateral ties, repeatedly pressured the Colombian government to restore and improve relations when interstate disputes arose. In Venezuela, however, businesses benefiting from trade with Colombia had no ability to constrain Chávez from militarizing conflict, even though the results caused at least as much harm to the Venezuelan economy as to Colombia. Thus, the potential of war returned to the Colombia - Venezuela rivalry.

## CHAPTER SIX: CHINA - JAPAN

The China – Japan relationship is one that perplexes observers and scholars alike. At times, these two powers seem to be on the brink of war; at others, deep economic ties intertwine their mutual welfare. This profound contradiction has its own phrase, “cold politics, hot economics,” challenging both realist and liberal theories of international relations. While deeply integrated economic interdependence should decrease the risk of a military confrontation, the changing balance of power and the equalization of military capabilities are both known causes of fatal conflicts. These conflicting forces have begun to generate an entire body of literature on the China - Japan rivalry, particularly since 2000. While many of these analyses have pointed out the importance of the interacting effect of domestic and international politics, this study makes a unique contribution by investigating government-business relations in the foreign policy-making process.

This chapter examines two periods of heightened tensions over the sovereignty of the Senkaku/Diaoyu Islands. It addresses the central questions at the heart of the dispute’s significance on China - Japan relations. Are both governments willing to put politics over economics or do their interdependence keep relations from deteriorating into a fatal military dispute? Or are economics and politics completely delinked between these rivals. To answer these questions, I look at the responses of the business communities in both countries to these conflicts and to what extent are they able to influence subsequent foreign policy decisions. I find that business power is relatively



strong in both countries despite the contrasting dynamics of democratic and authoritarian regimes. Instead, the shift in the relative balance of power between the two rivals has increased bilateral tensions, while economic elites have been instrumental in preventing the escalation of the hostilities from a serious military confrontation.

## **Overview of the Senkaku/Diaoyu Islands Conflict**

The current territorial conflict over the sovereignty of the uninhabited Senkaku/Diaoyu Islands originates with the end of the U.S. administration of Islands in 1971 as part of its post-World War II occupation of Japan. The official return of administrative control to Japan prompted Taiwan and China to publicly make their own claims to the Islands. It wasn't until the 1990s, however, that the dispute had any salience to China - Japan relations, provoked by political activists in both countries. The most prominent of these early incidents occurred in 1996, when Hong Kong based activist, David Chan, drowned "after he and several other protesters jumped into the East China Sea when Japanese patrol boats blocked their protest ship" (2013). These events were not strategic political calculations, and both states took measures to decrease the opportunities for private citizens to instigate interstate conflict. For example, in the aftermath of the death of David Chan, "the Chinese government acted to clamp down on further activism by forcing "longtime anti-Japanese activist Tong Zeng to depart Beijing for a 2-week trip to Gansu province" and "imposed heavy ideological controls on political discourse at colleges, universities, and research institutes" (Ibid.).

A new phase of conflict began, when on September 7, 2010, a Chinese trawler collided with Japanese Coast Guard boats in the disputed waters. The subsequent arrest and detention of the ship's captain led to Chinese demands for his immediate release and domestic anti-Japanese nationalist demonstrations. This event is notable as it is often used as an example of China's economic statecraft. Regardless of the evidence, which will be evaluated in this chapter, there is a general perception that China used their monopoly power as a supplier of rare earths to Japan's technology industry to pressure the Japanese government. The dispute itself was relatively short-lived. Japan released the captain on September 24 and political relations were subsequently restored to their previous level.

The potential militarization of the Senkaku/Diaoyu Islands dispute became of international concern in 2012 with Japanese Prime Minister Yoshihiko Noda's announcement that "the Japanese government purchased and nationalized three of the islands from a private owner" (Tanaka, Tago, and Skrede Gleditsch 2016, 8). The Chinese government cut off diplomatic channels and "the Ministry of Foreign Affairs of the PRC issued a statement saying that Japan's purchase of the islands was a 'gross violation' and that the 'Chinese government and people express firm opposition to and strong protest against the Japanese move'" (Cho and Choi 2016, 276). Domestically, "anti-Japanese protests occurred in more than 100 cities in China, Japanese shops were vandalized and Japanese-made cars were overturned (p.277).

Unlike the 2010 conflict, relations remained hostile for months. Christopher Hughes echoed many others in academia and the media when he warned that "the

situation is certainly the most serious for Sino-Japanese relations in the post-war period in terms of the risk of militarised conflict” (BBC News 2013). While further escalation of the dispute was avoided, understanding the calculus of how each government assessed the costs of conflict is key not only to the assessment of this dissertation’s framework of the commercial peace but also to the question as to how China’s increasing political and economic power will affect international security in the future.

## **Business Power**

Given the plethora of studies arguing that authoritarian governments are less responsive to economic pressure, determining if and how business influences the China government is of particular significance (Papayoanou 1999; Gelpi and Grieco 2008; Gelpi and Grieco 2003; Takeuchi 2014) .

### *China*

Although China’s authoritarian regime makes it more difficult to collect the information necessary to reliably evaluate the influence of business on foreign policy, the evidence suggests deep and influential ties between political and economic leaders. This is not surprising given the role of State-owned enterprises (SOE’s) in China’s strategic foreign policy. Moreover, as China becomes more integrated into the global economy, the greater the likelihood of increased influence of business and economic interests.

As authoritarian politicians are less beholden to public interests, there is a tendency to expect a highly centralized approach towards policymaking. So perhaps one of the most surprising elements of China's foreign policy is its highly fractured nature. This is one reason China's policy towards Japan has at times appeared schizophrenic, frequently swinging between promoting stronger bilateral economic ties to increased assertiveness over the Senkaku/Diaoyu Islands dispute.

One consequence of China's increasing global economic integration has been the diminished influence of the Ministry of Foreign Affairs (MFA). Jing Sun argues that the MFA "has lost its status as a core 'legitimate decision unit' – that is, a unit capable of committing the necessary resources and making an authoritative decision" (2017, 419). This has resulted in multiple interests groups, "including the powerful Commerce Ministry; state-owned enterprises; the energy and metals lobbies; the security and ideological arms of the Party, which want to keep 'harmful' foreign influences at bay; and the People's Liberation Army (PLA)," determining often contradictory foreign policy to best represent their own interests (Fenby 2012, 12).

Business power in China is often exerted through personal networks. China's SOE's blur the distinction between business executives and government policymakers as "SOE leaders are members of official decision-making bodies. These executives are consulted because of their specialized expertise and are, therefore, present when relevant foreign policy issues are deliberated" (Jakobson and Knox 2010, 24). Additionally, China's foreign policy is largely formulated at the sub-national level. Coastal provinces and cities are particularly dependent on international economic

interests and play a key role in bilateral relations with those nations with whom China has close economic ties. Reflecting the history of the opening of China's economy, "companies based in Guangdong, Jiangsu and Zhejiang alone...accounted for China's entire trade surplus in 2008" (33). Unsurprisingly, there is even less distinction between commercial elites and governments in these geographical areas. For example, "businesses belonging to city or provincial governments accounted for over one-fifth of top Chinese companies investing overseas in 2008" (32). These local officials promote policies that would increase China's economic liberalization and integration.

This trend has grown under the leadership of China's current President, Xi Jinping, who has been appointing SOE executives as provincial governors. These include Hebei governor, Zhang Qingwei (张庆伟), the former chairman of China Commercial Aircraft Co., Ltd., Shandong governor, "Guo Shuqing (郭树清), the former chairman of China Construction Bank," Liaoning governor, "Chen Qiufa (陈求发), formerly with the Aviation Industry Corporation of China," Hunan governor, "Xu Dazhe (许达哲), who had been general manager of China Aerospace Science and Industry Corporation (CASIC)," Jiangxi governor, "Liu Qi, who had been general manager of a state-run chemical manufacturing plant," and Guangdong governor, "Ma Xingrui ( 兴瑞 ), the former general manager of CASIC," (C. Li and Xu 2017). This influence, however, is a two-way street, as China's political leadership exerts influence over most enterprises, including private companies {Zenglein:2017uq}. This gives China the potential to mobilize business to achieve political objectives.

## *Japan*

As with China, global integration changed the relationship between business and political elites in Japan. For Japan, however, this change was institutionalized in the 1994 electoral reforms. Participation in foreign policymaking became more inclusive. Rosenbluth and Thies explain that “under the changed electoral incentives after 1994, it became not only acceptable but imperative for politicians to have views about foreign affairs as well as other issues of national importance. Foreign policy has become the subject of public interest, scrutiny, and debate” (Rosenbluth and Thies 2010, 157).

Although there is little disagreement in the increase of pluralism in policy-making, Yukihiro Hamada notes that “there is still no significant concept of direct lobbying in the Japanese policy-making process. Japanese business interests are often expressed through informal consultations and other informal means” (Hamada 2010, 331). The lack of direct lobbying as a mechanism for influencing policy, makes it “crucial for firms to maintain an informal relationship with national policy-makers to secure their policy goals and quietly solve any problems. The Japanese business–government relationship is characterized by the extensive use of informal political activities by firms, which integrate their business interests into the policy-making process and make the boundary of public and private spheres blur” (333).

Linking business and politicians is a powerful centralized bureaucracy. Retired bureaucrats typically “move to the private sector and hold responsible and prestigious

positions as second careers. This enables leaders of industries and big businesses to cultivate intimate relations and establish a close-knit social network with bureaucrats” (336). Beyond informal networks, business associations are also an important channel of influence. Hamada explains that “due to a long tradition of business activism and the existence of a hierarchically organized business community, Japanese firms show strong tendencies for collective action through national business associations. These associations are well connected to each other and with politicians and bureaucrats” (333-334).

## **Business and Conflict**

This section examines the 2010 and 2012 Senkaku/Diaoyu Islands disputes through the lens of business-state relations.

### *2010*

On September 7, 2010 the Japanese Coastguard arrested the captain and crew members of Chinese trawler for deliberately colliding with a Coastguard patrol boat.<sup>40</sup> China responded by demanding the immediate release of the trawler and its crew. The Japanese government, however, “claimed to be handling the incident ‘in accordance

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<sup>40</sup> The description of the incident is taken from (Hagström 2012).

with domestic law” (Hagström 2012, 272). Hagström reports that “the trawler and its crew members were released on September 13, but on September 19 the captain’s detention was extended for another 10 days. Zhan was released, however, on September 24, 2010, five days before the end of the term” replace (Ibid.). Naha Vice-Prosecutor Suzuki Toru justified the captain’s release due to the investigation’s potential effect on the future of Japan-China relations. This was followed by a series of claims and counterclaims first from China and then Japan for damages. China further reacted by suspending “intergovernmental talks on matters such as coal, joint gas development in the East China Sea and aviation rights, curtailed Chinese tourism to Japan, and cancelled several Sino-Japanese official and non-official exchanges” (273). The incident is best known as evidence of China’s willingness to use economic statecraft by banning the export of rare earths to Japan during the period of heightened tensions. The following examines the rare earths issue as well as economic consequences of the conflict through the lens of business-government relations.

### *The Rare Earths Controversy*

Those critical of the commercial peace argument often point to the rare earths conflict between China and Japan. Rare earths refers to “a group of 17 chemically similar elements crucial to the manufacture of many hi-tech products. Despite their name, most are abundant in nature but are hazardous to extract” (BBC News 2012). China maintains a near monopoly on the production of these minerals, and thus there has been concern for some years about the geostrategic implications of China’s economic power in this



market. It is commonly asserted that in response to Japan's detention of the Chinese captain, China embargoed the sale of rare earths to Japan from September 21 - November 19, 2010. Nabeel A Mancheri argues that nature of business-government relations in China [gave] the Chinese unique leverage to carry out unofficial sanctions by demanding that companies halt all rare earths exports to Japan (2015). Mancheri supports this claim with the following account.

It was reported that Chinese regulators urgently summoned the presidents of China's rare earth companies to a secret meeting in Beijing. It was informed to the mining executives that the Chinese Government was about to halt all shipments of rare earths to Japan and if any of their companies stepped up shipments to another country instead, allowing reshipment of rare earths from that country to Japan, then the company would lose its export license, which could mean financial ruin. The assembled executives were also warned against speaking to the news media about the coming embargo (84).

The single source for this uncorroborated account, however, is Keith Bradsher writing for the New York Times and the Deccan Herald. The above narrative can be found in (2012).

Since China has repeatedly and emphatically denied the existence of this embargo, the only means of determining its existence is through trading data that also accounts for the variability that has typically characterized rare earth exports from China. Alastair Johnston argues that if an embargo had existed then Japan's import data from August to December 2010 should reveal "a uniform drop in imports that come through all Japanese customs ports" (2013, 24). Using data from the Japanese Ministry of Finance, Johnston finds "little or no statistical relationship between import figures for each commodity for each port from August to December 2010" (Ibid). He notes that

while, “October did see a decrease in many rare earth imports, in 17 percent of the observations rare earth imports increased from September to October” (Ibid.). Johnston also directly challenges Bradsher’s claim (2010) that the embargo continued in November, finding “41 percent of the observations rare earth imports grew in November over October” (Ibid.).

Linus Hagström challenges whether the rare earths trade data between China and Japan can be tied to Senkaku/Diaoyu Islands dispute. Hagström points out the Japanese newspaper, *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” (2012, 282). According to Hagström, “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” (Ibid.). In response, Japanese government officials, including “the parliamentary secretary of the Ministry of Economy, Trade and Industry, Kondo Yosuke, travelled to Beijing in an unsuccessful attempt to maintain exports at the 2009 level” (Ibid.). Moreover, “in mid-October China ‘quietly’ halted some rare earth shipments to the United States and Europe as well. Beijing stated that it would resume the exports on October 28, and effectively did so to Japan on November 19, 2010” (Ibid.). Further undermining the link between rare earths exports and the Islands dispute, is the fact that “articles in Japanese, Chinese and international media concur that the rare earths issue appeared well in advance of the Senkaku/Diaoyu Islands incident in 2010, and that Japanese

government officials had already expressed serious grievances about it in August 2010” (Ibid.).

China’s 40% reduction in its export quota of rare earths was not limited to Japan and became the subject of a WTO dispute brought by the United States, European Union, and Japan. While China cited environmental concerns, the WTO agreed with disputants who argued that “the restrictions are designed to provide Chinese industries that produce downstream goods with protected access to the subject materials” (World Trade Organization 2015). For all of these reasons, it is unlikely the rare earths dispute between China and Japan was a response to the Japanese detention of Chinese trawler captain on September 7, 2010.

There are several ways in which the rare earths incident might affect the theory developed in this dissertation. If China were able to dictate unofficial sanctions to private companies, it would suggest an unique relationship between the state and business community. To a certain extent this already exists within state-owned enterprises. More work on how the authoritarian nature of governments with strong business communities is likely to be a fruitful avenue of research in the future. With respect to this case study, the following demonstrates that the Chinese government’s leverage over business also comes with a high responsiveness to business concerns.

The economic repercussions of the 2010 event were limited. In mid-October nationalist demonstrations broke out in both countries, but these were much smaller in size and impact than the 2005 Japanese textbook protests. Fisman et al. find that neither the

Nikkei nor the Shanghai Composite declined overall (2014, 2628). While bilateral trade declined slightly during the crisis, it reached new highs in December. George Brown epitomizes these results, writing that “despite the heightened political rhetoric, and despite the publicity surrounding the “rare earth” exports from China to Japan, on the whole, business seems to have proceeded more or less as usual during this crisis” (2011, 140).

Even so, China demonstrated its sensitivity to the economic consequences of the 2010 incident by pursuing a more placatory approach to a similar incident in December 2011 when Japanese coast guards arrested a Chinese trawler captain for fishing in Japanese waters. Jonathan Fenby observes “China's response was limited to a statement by its consul in Nagasaki urging the authorities to ensure the safety of Chinese fishermen and to respect their legal rights — a sharp contrast with the top-level anger displayed in 2010 (2012, 17).

## *2012*

The territorial conflict over Senkaku/Diaoyu Islands reignited in the middle of 2012 when the Japanese government announced that it would nationalize three of the islands owned by a private Japanese citizen. Multiple accounts corroborate that the Japanese government did so reluctantly to prevent the conservative governor of Tokyo, Shintaro Ishihara, from purchasing them as part of a hyper-nationalist public campaign launched in April (Fackler and Johnson 2012; Fravel 2016; Takeuchi 2014). Although a seemingly provocative action, the Japanese government’s decision was consistent with the history

of both governments attempting to restrain their citizens from using the Islands to generate popular nationalist movements that would strain China - Japan relations.

Regardless of the Japanese governments intensions, the incident led to the most significant bilateral tensions since World War II (BBC News 2013). Stephen Nagy describes the Chinese backlash, “at the government level, China cut off communications and began a vocal campaign that blamed Tokyo for the dispute because it had ‘failed to liquidate militarism.’ At the popular level, there were widespread anti-Japanese riots, boycotting of Japanese products, and vandalism directed against Japanese businesses and Japanese business interests throughout mainland China” (2013, 50). One of the central questions for this case study is the extent to which the Chinese government encouraged the anti-Japanese demonstrations despite their economic impact or whether they acted to limit the economic costs in response to Chinese business concerns. Nagy describes five ways this territorial dispute affected trade relations:

Territorial tensions have affected trade relations between Japan and China in at least five ways. First, there were immediate import/export effects associated with Chinese abstention (voluntary and government-encouraged) from buying Japanese brands. JETRO’s month-by-month and year-by-year data on import/export trade relations demonstrates significant impact on the sales of Japanese brands in China as the dispute intensified in the fall of 2012. Second, Japanese companies located in China that were victims of anti-Japanese vandalism of their businesses had to temporarily shut down to avoid further damage and accrued the cost of repairing their business as the violence dissipated. Third, some Japanese companies in China temporarily closed their businesses to wait out anti-Japanese sentiments and protect their interests. Fourth, there was a decrease in travel between Japan and China affecting businesses associated with the tourism industry. Fifth, Japanese businesses investing in China have deliberately slowed down (2013, 52).

The industry that was hardest hit was the Japanese car industry. Nagy reports that “at the height of the anti-Japanese movements, the sales volume of Japanese-made cars in China dropped 2% year-on-year” (53). In comparison, “sales of cars produced by Germany, US, South Korea, and France went up 25%, 19%, 12%, and 4% year-on-year, respectively” (Ibid.). These economic losses were not entirely one-sided as all companies making cars in Japan are required to partner with a Chinese firm (Yang and Tang 2014, 364). Tourism to and from China was also significantly affected (Nagy 2013, 54). Nagy and Tim van Vliet look at statistics from the Japan External Trade Organization (JETRO, 2013) to show that this dispute had a negative effect on trade volume between China and Japan, which dropped 3.9% in 2012 and continued to drop 5.1% in 2013 (JETRO, 2013)” (van Vliet 2016, 8; Nagy 2013, 53). IMF monthly data displayed in Figure 12 shows exports declining in both countries in the end of 2012 but recover significantly after February 2013.<sup>41</sup> Overall trade volume numbers, however, can be misleading as it does not control for other factors impacting the national economy, particularly the export sector. Figure 13 shows each country’s export dependence on each other on a monthly basis from January 2012 to December 2013. Japan’s export dependence on China did decline significantly and continuously from August 2012 to February 2013, but then substantially increased for the remainder of 2013. China’s export dependence declined notably from November to December 2012 and continue to decline slightly through the rest of 2013. It is important to keep in mind that since

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<sup>41</sup> IMF Direction of Trade Statistics

Japan's export dependence is much higher than China's, any shift in volume is likely to be more impactful in Japan.

Figure 12: China - Japan Monthly Exports 2012 - 2013

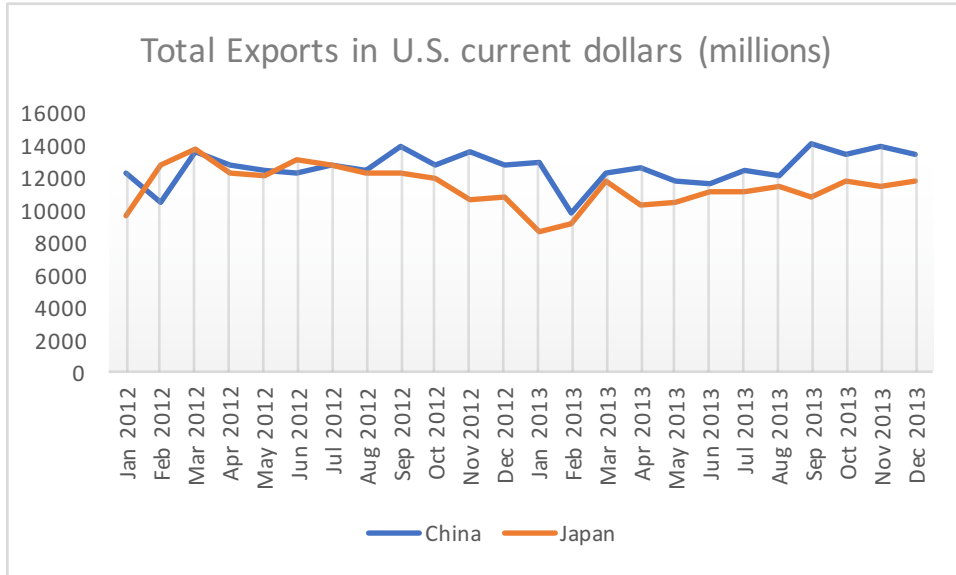
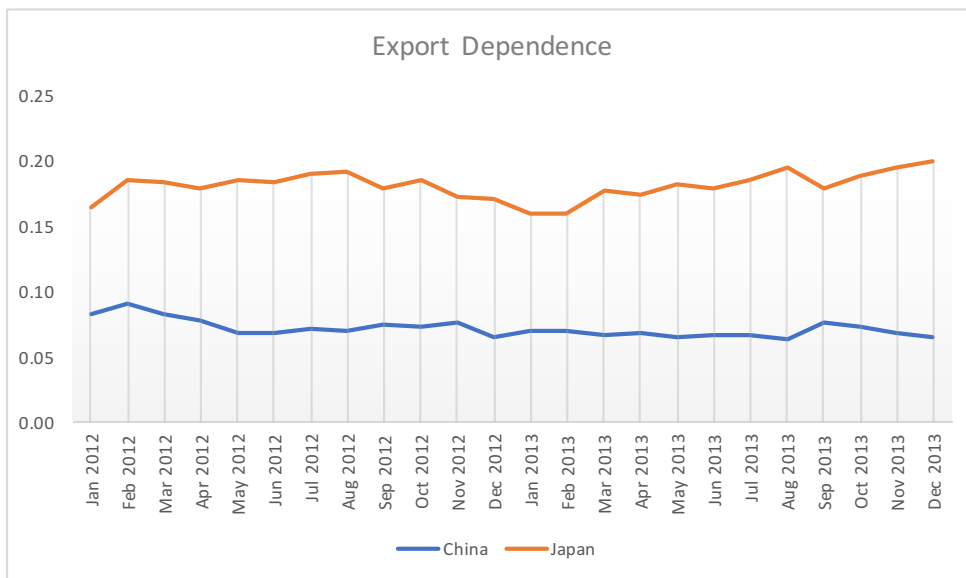


Figure 13: China - Japan Export Dependence 2012 - 2013



The more immediate ramifications to Japan's economy may explain why the Japanese business community and government made the earliest overtures to refocus the bilateral relationship on their economic ties. After a weekend of anti-Japanese protests business leaders in Japan pressured the government to resolve the conflict. "We must get the economic relations back on track," Hiromasa Yonekura, the chairman of Japan's largest business lobby group, the Keidanren, told reporters on Wednesday after a trip to Beijing was canceled because of the protests" (Fackler and Johnson 2012). In October, the Japanese government reacted to the decision by China to "not to send its finance minister or central bank chief to the annual meetings of the International Monetary Fund and the World Bank" held in Tokyo with disappointment. The Japanese government even signaled that it might alter its current policy position refusing "to recognize that a territorial dispute even exists" by making "a subtle concession by acknowledging that China also makes a claim to the islands, something that it has previously refused to do" {Fackler:2012tq}. Days later Japan expressed its hope for bilateral talks at the vice minister level as a "first step toward lowering tensions" (Fackler 2012).

It was not until January that China seemed receptive to high level talks, coinciding with the period that the Chinese economy was beginning to feel the pain of declining trade. In January, "China's new leader, Xi Jinping, offered Japan a conciliatory tone," saying that "the Chinese government remains committed to China-Japan relations," and urging "both sides to 'look at the larger picture' and 'push relations forward,' the Foreign Ministry said, language markedly more restrained than



the combative statements from military officials and state-run news media since the dispute over the islands erupted last year (Perlez 2013). Shinzo Abe, who had just been elected prime minister, reciprocated by saying “that he is willing to meet with Chinese leaders to cool tensions in an emotional island dispute, asserting that the two countries should not let the disagreement further damage their huge economic relationship” (Fackler 2013). He went on to say that “the two countries, which have Asia’s largest economies, should rebuild what he called a ‘strategic partnership of mutual benefit,’” (Ibid.). Richard Katz contends that Shinzo Abe abandoned his previous hawkish campaign positions on the bilateral relationship because he “knows that his popularity hinges on Japan’s economic recovery, and lest he forget it, Japanese businesses have been urging him to refrain from any provocations while still seeking a resolution that maintains the country’s sovereignty over the islands” (2013a).

Initially, the Chinese government seemed to tolerate the anti-Japanese boycotts. The official position, however, appeared to moderate considerably as summarized in a September 28, 2012 in a People's Daily editorial

In recent years, whenever China's relations with another country took a turn for the worse, calls for a boycott of that country's products would ring out. So it has been with the Diaoyu Islands dispute.

Any major disruption to bilateral trade would hurt both countries. Yet some scholars argue otherwise. They say Japan is more reliant on the Chinese economy than vice versa. Hence if China were to pull the "economic trigger", it would cripple the Japanese economy.

This is more guesswork than fact-based analysis. Let's not even consider what a sluggish Japanese economy will do to the world economy.

Japan is at the high end of the global industrial chain, while China is at its low-end manufacturing base. Every year, China imports parts and components or the assembly of

products that are then exported worldwide. These Japanese made components include hi-tech and high-value-added products that are not easily replaced. Just recall how the tsunami and nuclear accident in Japan last year set back the electronics and auto industries in the US, Europe and China (Yahuda 2013, 135).

As early as September 19th, terms such as “anti-Japan,” “protest,” and “demonstrate” were blocked on the web” (Cho and Choi 2016, 278). Corresponding with the uptick in trade trade between China and Japan in late March, the two countries joined South Korea “in long-anticipated talks aimed at forming a trilateral free-trade agreement” (Katz 2013a).

For their part, most Chinese businesses did not join in on the boycotting of Japanese goods in 2012, in contrast to the anti-Japanese riots of 2005 (van Vliet 2016, 25). Moreover, substantiating the claim that business-government relations are strongest at the provincial level, “Chinese provincial governments hungry for jobs and tax revenue, [were] imploring Japanese companies to expand their operations in China” (Katz 2013a). For example, “in February, the city of Chongqing hired the Mitsui Group, a Japanese conglomerate, to develop an industrial park aimed at attracting foreign investment” (Ibid.). Higher level Chinese government officials, including China’s new vice president, Li Yuanchao, were also lobbying for greater Japanese investment (Ibid.). In November, “the Chinese press publicized a comment by Xu Dunxin, former Chinese ambassador to Japan: “We hope the communication between high profile business entrepreneurs will help result in a turnaround of the strained China-Japan relationship” (Katz 2013b). These events support Katz’s conclusion that “Beijing has acquiesced to

business and provincial leaders' drive to better economic relations in spite of a hard-line security policy" (Ibid.).

## **Conclusion**

While war is rare and difficult to predict, the determinants that have been most closely associated with serious militarized conflicts are abundant in the China - Japan relationship. In particular, the shift in the balance of power between China and Japan as China grows into an economic and military power while Japan's economy slowly declines in size is thought by some international relations scholars in the realist tradition to be a common precursor for war. Moreover, China's rapidly developing military is leading to an equalization of war capabilities between these rivals, which is another common instigator to militarized conflict. Further fuel for conflict can be found in bitter historical memories that are regularly expressed in popular nationalist mobilizations, and periods of instability in internal power transitions in the ruling parties. Taken together it would be unwise to take for granted the remarkable fact that there has not been a serious military confrontation between China and Japan in the past two decades.

Thus, it is not surprising that there has been a great deal of scholarly interest in the ongoing dispute between China and Japan over the territorial sovereignty of the Senkaku/Diaoyu Islands. Within this context, a body of literature has begun to explore the extent to which the deep and complementary economic ties between these two

countries have a pacifying effect on their bilateral relations. As with more general studies of the commercial peace, the results are divided between those who either find no support for the influence of economic integration on foreign security policy or those who concur the evidence supports that commercial ties are pacifying to bilateral tensions. Often the disagreement is over the threshold that economic interdependence must meet in providing a basis for long term resolution of political disputes or whether success might be constituted as preventing military conflict. Yet, even qualitative case study assume rather than identify the causal power of trade and investment exchanges. In contrast, this chapter investigated each government's responsiveness to business, particularly during periods of conflict.

China is a least-likely case to expect business interests to be represented in foreign policy. The strong state of China's authoritarian leadership would appear to have much capacity to weather economic losses due to political aggression towards other nations. Yet, as China has grown more integrated into the global economy, the composition of the CCP is increasingly shifting towards entrepreneurs. This is especially true in coastal provinces that generate most of China's international trade. This is not to say that business does not contend with other prominent party factions, such as the PLA, but the integration of entrepreneurs into the party means that the members themselves bear some of the economic costs or benefits that result from interstate relations.

In both 2010 and 2012 Islands disputes, the Japanese government responded to business concerns by eagerly seeking quick resolution of the political conflict and urging

that both countries prioritize their mutual welfare gains from economic interdependence. While Japan's trade volume is more dependent on China than vice versa, the other side of those numbers is often Chinese employment, a sensitive issue to the Communist Party that fears social instability. On the other hand, it is difficult to determine whether China's slightly slower willingness to restore bilateral relations is due the nature of a single-party authoritarian regime or the fact that employment losses have a delayed effect on the economy.

The evidence presented in this chapter demonstrates that neither China or Japan are willing to provoke a conflict that might lead to a military confrontation. While this is an encouraging result, I also find that the appeal of increasing mutual economic benefits is not enough to harmonize interests or completely overcome the political conditions that typically generate disputes. Furthermore, as some realists have predicted, trade itself may lead to increasing the issues of conflict even while substantially decreasing the likelihood that these disputes would escalate into interstate violence. This study has further implications for China's rise as a major power in international affairs. Understanding the degree and conditions under which business's economic interests are translated into China's foreign policy is significant to managing its rise in a manner that ensures the greatest benefits to general welfare.

## CHAPTER 7: CONCLUSION

In this dissertation, I have argued that the successful of economic interdependence in reducing interstate militarized conflict depends on the inclusion of business interests in the formulation of foreign policy. I develop a two-level framework of the commercial peace theory which incorporates this domestic level political process within interstate bargaining. In its assessment of this model, my dissertation makes several contributions towards a greater understanding of the link between economics and security in bilateral interstate relations. Statistical analyses demonstrate that private sector strength mediates the effectiveness of economic interdependence to reduce the likelihood and severity of militarized disputes. Detailed process tracing case studies of the Colombia - Venezuela and China - Japan rivalries reveal the pathways used by business and economic elites to influence foreign policy-making. Moreover, this work is one of the first studies to substantiate that economic elites are involved in national security policy and can be a determinant to the outcome.

The Colombia - Venezuela case study provides insight into the substantive effects of establishing economic ties between strategic rivals mired in repetitive territorial disputes. The pattern of military confrontation between these rivals was replaced by establishing diplomatic channels to ensure the prioritization of maintaining mutually beneficial trading ties. Additionally, variation in the degree of business power in Venezuela illustrates the impact on bilateral relations of economically interdependent rivals when commercial interests are eliminated from the selectorate of the governing

regime. It might be tempting to attribute the reduced influence of business interests on policy as a characteristic of authoritarian governments. China, however, demonstrates that economic elites may still have strong causal pathways to influence foreign policy within single party autocracies.

The China - Japan rivalry is a particularly difficult case for the commercial peace because of the shift in their relative balance of power and the equalization of military capabilities, which are known to be significant instigators of militarized conflicts. Furthermore, it is nearly impossible to observe the present dynamics in East Asia without noting the similarities to the first wave of globalization that preceded World War I. While the comparison may invoke comparable levels of economic interdependence, my theory based in the causal power of business influence on foreign policy highlights the distinctiveness between these two periods. While it is encouraging to see the influence of entrepreneurs in the Chinese Communist Party, the China - Japan case also makes clear the limitations of commercial ties in constructing long-term resolutions to disputes.

I have also demonstrated the applicability of this two-level theory of the commercial peace to understanding why petrostates are one of the most significant threats to international security. Although international relations scholarship has only recently begun to consider the relevance of the natural resource curse to interstate conflict, the comparative political economy literature has established that oil dependence leads to an expanded role of the state in the national economy while also reducing the size of the private sector, especially in manufacturing and agriculture.

Using the same models developed to test the interactive effects of private sector strength and trade interdependence on militarized conflict, I find that commercial ties appear to have no impact on reducing militarized disputes within petrostate dyads, while having a substantial pacifying influence on their counterparts.

These findings do not advocate for complacency — that we can simply expect China’s economic interdependence with its rivals to prevent a significant military confrontation between global powers. Instead, by identifying the causal actors of the commercial peace, my theory can contribute to building better strategies to embed the welfare gains of economic ties into the policymaking process, develop institutions to deepen trust in the continuation of these mutual benefits, and increase the number and influence of stakeholders benefiting from economic cooperation.



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