Economic interdependence vs. war with China

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Abstract

The US is on a risky path with its anti-China policy, as its hostility towards the world's second largest economy and the largest trading partner for most countries could see a Cold War turning hot. Dale Copeland's "trade expectations theory" captures this risk, and introduces the expectations of future trade as a causal variable for the likelihood of war. It argues that the optimistic expectations of China's leaders hinge on their confidence that oil and trade flows will remain open and stable—a mindset that might change if the US moves toward a policy of containment and economic coercion. With negative expectations of future trade relations, the likelihood of conflict will increase.

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Analysis

On Saturday at Peking University's Yenching Global Symposium in Beijing, former US deputy assistant secretary of state Susan Shirk warned that Washington's current policy of decoupling the US and Chinese economies could be "apocalyptic," and exaggeration of the China threat "could turn into a McCarthyite[1] Red Scare" that damages American interests.

Shirk said, "Right now there is a herding instinct in the US that is taking us off the cliff with various forms of overreaction to China as a security threat, an intelligence threat, a spy threat, a technological threat, an influence threat" that could lead to de-globalization. Instead of decoupling the two economies, she recommended that the US should engage in "smart competition"[2] to maintain a robust innovation ecosystem and maintain a technological competitive edge over China.

Indeed, the present US posture toward China is one of hostility and blanket opposition to all Chinese-led initiatives, even when allies see benefits in participation. As observed by former US ambassador to China Chas Freeman,[3] while the Belt and Road Initiative (BRI) is seen by the US as a military-strategic challenge, the European Union is "treating it as an economic issue that they need to be cautious about."

Washington is on a risky path, and the cold-war mentality toward the second-largest economy in the world and largest trading partner for many countries may indeed become a self-fulfilling prophesy of a cold war turning hot.

Trade expectations and war

This risk is encapsulated in a new trade-expectations theory put forth by Dale Copeland[4] in 2015 at the University of Virginia. Traditionally in the US, realism and liberalism have been the dominant conceptual framework for examining a rising China. On the key question of under what conditions interstate commerce will reduce or increase risk of conflict between nations, the realist model argues that because of a zero-sum competition for raw materials and markets, war is more likely, while the liberal model argues that economic interdependence raises the cost of conflict so war is less likely.

However, trade-expectations theory addresses the unsatisfactory nature of both the realist and liberal views on economic interdependence and war. It is an amalgam of liberal (commercial ties give actors strong incentives to avoid war) and realist (risks of trade and supply cut-off prompt war to secure access) insights, and introduces the *expectations* of future trade as a causal variable for the likelihood of war.

That is, if there are positive expectations of a future trade environment, then war is less likely because the actor wants to remain at peace to secure economic benefits that enhance long-term power, which is based on the liberal model. However, if expectations of future trade are negative, then war is more likely, and this leans toward the realist model of a zero-sum competition for scarce resources and markets.

Copeland cites the example of Germany in 1914, which had high levels of trade, which according to the liberal logic would have reduced the risks of conflict. Despite this, German leaders expected that rival great powers would attempt to undermine this trade in the future, so a war to secure control over raw materials was in the interests of German long-term security.

[1] https://www.scmp.com/news/china/diplomacy/article/3003973/overreaction-china-threat-could-turn-mccarthyite-red-scare
[2] https://www.straitstimes.com/world/united-states/us-should-engage-in-smart-competition-with-china
[3] https://www.asiatimes.com/2019/03/article/in-europe-us-china-hysteria-falls-on-deaf-ears/
[4] https://www.foreignaffairs.com/reviews/2015-08-13/economic-interdependence-and-war

As such, Copeland's trade-expectations theory could provide a useful conceptual framework on why Sino-US economic cooperation – for example, positive expectations of future trade – could be a constraining factor for conflict, or that if it became apparent the Sino-US trade war would worsen (negative expectations), then there would be a sharp rise in the probability of conflict.

Nonetheless, the US should still protect its interests while shying away from the extreme measure of decoupling the two economies, and adopt a balanced approach toward Chinese investments. To that end, perhaps a "sunscreen" policy is in order.

Screening out 'harmful rays'

In an age of globalization and an internationalized defense industrial base, safeguarding national security while maintaining an open investment climate is a challenge. This is where the Committee on Foreign Investment in the United States (CFIUS)[5] comes in, which is chaired by the Treasury Department rather than the Pentagon.

CFIUS reviews foreign investment for its national-security implications, with a traditional definition of a national-security threat as foreign acquisition of any sole domestic supplier with defense contracts. This is in line with the 1988 Exon Florio Amendment[6] to the Defense Production Act of 1950,[7] and the concern here is defense dependence and a cutoff of supply by a foreign actor.

However, under President Donald Trump's administration, national security has been more broadly defined with the passage of the 2018 Foreign Investment Risk Review Modernization Act (FIRRMA)[8] targeting Chinese investments. While in the past CFIUS evaluated national-security concerns from proposed "merger, acquisition or takeover" of US companies by foreign entities that could "control" the company, now the jurisdiction has cast a wide net to include most economic transactions.

Indeed, there are cases of legitimate concerns that should be reviewed and possibly restructured or blocked if necessary, but casting such a wide net portrays the US as having a hostile investment climate. Instead, a better option might be to replace "protectionist" with a "sunscreen" policy toward Chinese investments – for example, having the right layer of protection to keep out harmful ultraviolet rays (national-security risks), yet still allowing in the healthy sunlight and Vitamin D (foreign investments and economic growth). This way, both countries could maintain positive expectations about future trade, and reduce the likelihood of a military conflict.

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Remarks: Opinions expressed in this contribution are those of the author. This article was first published in *Asia Times* on April 1, 2019.

[5] https://www.nytimes.com/2018/03/05/business/what-is-cfius.html
[6] https://en.wikipedia.org/wiki/Exon%E2%80%93Florio_Amendment
[7] https://en.wikipedia.org/wiki/Defense_Production_Act
[8] https://www.lawfareblog.com/foreign-investment-risk-review-modernization-act-2018

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