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# **Security and Economic Interdependence in Northeast Asia**

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The recent economic convulsions in East Asia have shown that interdependence can cut both ways. For much of the 1980s and 1990s, the countries in this region prospered by increasing their commercial links among themselves. Transnational flows of trade, capital, long-term investments, and technology had a synergistic effect, spurring industrial development and rapid growth. But the financial turbulence that began in the summer of 1997 with the sharp plunge of the Thai baht showed that interdependence can have a negative impact as well. The crisis in Thailand spread rapidly to other countries in Southeast Asia, especially Indonesia, and even to South Korea in Northeast Asia. This Asian contagion abruptly ended the rosy prognoses of the region's prospects that had been so widespread at the time. Even the most advanced economies will be affected. With its large economic stake in East Asia, the regional slowdown will complicate Japan's efforts to pull itself out of the slump that started after its economic bubble burst in 1991. Despite its robust economic performance in recent years, the United States could also see its commercial opportunities in East Asia dwindle and even face turbulence in its own financial markets. In short, interdependence can transmit bad as well as good trends across states.

This paper seeks not to analyze the complex dynamics of East Asian political economy per se. It aims instead to examine the implications of regional economic interdependence for traditional security concerns—the prospects for war and peace, the threat and occurrence of physical violence between and within states. Does economic interdependence make the security environment more stable and peaceful and less conflictual? Or does economic interdependence exacerbate traditional geopolitical rivalries, complicate the management of interstate disputes, and even weaken the capacity of states to maintain domestic peace?

Instead of covering the entire Asia Pacific region, the geographic scope of this inquiry will be limited to Northeast Asia—the system of states that encompasses China, Japan, the two Koreas, Russia, Taiwan, and the United States.<sup>1</sup> Historically, there has been an intimate

strategic and economic linkage between Northeast and Southeast Asia. Southeast Asia and the South Pacific served as a major theater of military clashes during the Pacific War of 1941–1945. All four major powers of Northeast Asia have exerted political-military influence in Southeast Asia at one point or another. Nevertheless, it does make sense to focus just on Northeast Asia. Competition and cooperation among the great powers of this subsystem have shaped the dynamics of much of East Asia during the modern era. Moreover, conflicts over Korea and Taiwan are likely to be pivotal for the Asia Pacific region as a whole.

In investigating the impact of economic interdependence on security, first a definition of the concept is in order. In their now standard text on the subject, Robert Keohane and Joseph Nye define interdependence as mutual dependence or as “situations characterized by reciprocal effects among countries or among actors in different countries.” These reciprocal effects “often result from international transactions—flows of money, goods, people, and messages across international boundaries”<sup>2</sup> Under this formulation, economic interdependence refers to situations of reciprocal effects resulting from international transactions that involve what is are traditionally considered to be economic objects such as money, goods, and technology.

Keohane and Nye caution us not to consider interdependence as necessarily being mutually beneficial or symmetrical. There are costs as well as benefits associated with interdependence because it does restrict autonomy. An understanding of the concrete forms of interdependence requires examining not only the aggregate cost-benefit implications, but also the relative distribution of costs and benefits. Even if both parties gain from an interdependent relationship in the aggregate, their relative gains may be different. Furthermore, these two political scientists stress that interdependence does not have to be a situation of “evenly balanced mutual dependence.” In the real world, interdependencies can be asymmetrical, giving one party more bargaining power or political leverage over the other. What makes an inquiry into the relationship between economic interdependence and traditional security concerns interesting is precisely these issues of the distribution of costs and benefits and the management of asymmetries.

Various theories offer very different propositions about the impact of economic interdependence on security. At the risk of oversimplification, one can group these theories according to three broad traditions: liberal, realist, and critical.

## **Three Theoretical Traditions**

### **Liberal Perspectives**

Liberal theorists tend to see the security implications of economic interdependence in primarily positive terms. They emphasize how international economic transactions can mutually benefit and constrain nation-states. Countries that trade and invest more freely with each other will both be better off in the aggregate because of a more efficient allocation of resources and more efficient production. Unlike interstate security rivalries, economic competition in the context of international trade and investment is a positive-sum rather than a zero-sum game. As the amount of international trade increases, the absolute benefits from trade will also increase.<sup>3</sup>

As transnational economic interdependence deepens, the mutual economic benefits of peaceful commercial relations will grow relative to the possible benefits of military competition and aggression.<sup>4</sup> In the words of one Japanese analyst, “deepening interdependence has greatly increased the opportunity cost of conducting war for most of the countries in the region, and military options have become a much less attractive tool to resolve disputes.”<sup>5</sup> The recent transformation of economic activity driven by the information-technology revolution and the internationalization of production and investments as well as the inordinately high costs of modern warfare have reinforced this calculus—especially among the advanced industrial countries.<sup>6</sup> Therefore the more economically interdependent the states become, the more they will have an interest in maintaining good political relations in order to sustain the economic interactions. Conversely, each state will be constrained from damaging political relations with a trading partner because of the economic costs such an action might bring relative to the benefits that might be gained. This calculation at the aggregate national level will be buttressed by ruling social coalitions within the trading states themselves that will want to maintain international peace for the sake of their own economic interests.

The positive security implications of economic interdependence derive not merely from cost-benefit calculations regarding war and peace given a certain level of interstate commerce. Economic interdependence can also be a force for peace by promoting international norms of cooperation. Technological advancement is not the only factor behind the dramatic increase in the transnational movement of goods, services, technology, and capital. Liberal international economic regimes have provided the institutional framework for more open trade and investments. Although the process of economic liberalization has often entailed political frictions and intense bargaining, it has also strengthened multilateral institutions by locking states into various liberal trade and investment rules.<sup>7</sup> This experience at multilateral economic cooperation can spill over into the security arena. National leaders who learn how to compromise and cooperate on economic issues have a greater chance of doing the same on traditional security problems—or preventing security disputes from escalating to actual military conflict. Over time, transnational economic interactions can even transform national attitudes, preferences, and the definition of interests so that international accommodation and cooperation become more likely in the security realm.<sup>8</sup> Ultimately, a collective security order might emerge to keep the peace.

Liberals also stress the transformative aspects of international capitalism on politics within states. For example, the economist Joseph Schumpeter argued that capitalism will steer people toward “economic rationalism” and individualism and away from militarism and chauvinism. As a consequence, the popular demand for liberal democratic government will grow.<sup>9</sup> This link between democratization and capitalism feeds into the liberal thesis that liberal democratic states refrain from fighting each other because of domestic checks and balances. Although liberal states have often fought wars with non-liberal ones, the prospects for world peace will increase as the international community of liberal democratic countries expands.<sup>10</sup>

Embracing the notion of developmentalism, Japanese thinkers have offered their own version of this liberal thesis. Even in a world in which states are at different stages of industrial development and in which trade is not universally free and open, international patterns of development can emerge that augur well for peace. Invoking the metaphor of “flying geese,” Japanese developmental economists have argued that the transfer of capital and technology from advanced to less advanced countries in a strategic manner will yield a dynamic international division of labor.<sup>11</sup> In such a regional economic system, not only will

all the countries benefit in absolute economic terms, but also the less developed ones will be able to transform their comparative advantage and move up the industrial ladder. Since all the states will be moving forward technologically and the pattern of industrial progress will be orderly, like the V-formation of flying geese, interstate economic relations will be more harmonious than conflictual. Eventually, the less developed countries will catch up with the leaders. But instead of aggravating international relations, this catch-up process will have positive security implications because as countries become more advanced economically, their middle class will grow in size and their politics will gradually become more liberal and democratic.<sup>12</sup>

### **Realist Perspectives**

By stressing the anarchic nature of international politics and the tendency of nation-states (in particular great powers) to increase their power and reduce their vulnerabilities, realist theorists contest the liberal argument about the positive effect of economic interdependence on security and international stability. Some even go so far as to argue that economic interdependence can aggravate interstate relations and ultimately lead to military hostilities because such commercial ties can make states feel more dependent and vulnerable. According to most realists, the critical factors affecting the prospects of war or peace are the distribution of power in the international system and the capacity and will of states to balance against countries that seek a revision of the territorial status quo and/or to enhance their power through military aggression.

Therefore, in this worldview, relative gains are much more important for security than the absolute gains emphasized by liberals. Interdependence might benefit all states in absolute economic terms, but the distribution of these benefits across states is often unequal. Less advanced states can pursue mercantilist economic strategies even in the context of a liberal international economic order to move up industrially and technologically relative to the leading countries. Changes in economic capabilities will in turn lead to shifts in the military balance of power because states in the anarchical international system will want to translate technological and industrial resources into military might so as to enhance their security, if not increase their power. States that do not behave accordingly do so at their peril.

Realists, however, disagree about what kind of distribution of power yields a more stable and peaceful international order. While some believe that a bipolar power distribution is likely to be more stable because the danger of miscalculation is minimized, others feel that a relatively equal and multipolar distribution of power among the major states is better because no state is likely to get away with aggression without provoking a coalition of states against it.<sup>13</sup> Proponents of hegemonic stability theory claim that a system in which one state has preponderant power is more stable because collective action problems for responding to threatening states in a timely manner would be minimized.<sup>14</sup> And because the less powerful states in the system would be reassured by the capacity and will of the hegemonic state to keep the peace, destabilizing arms competitions are less likely to emerge. Some have even combined the tenets of both balance of power and hegemonic stability theories by positing that there is an inverted U-shaped relationship between the concentration of power capabilities and the occurrence of major-power wars.<sup>15</sup> This intense and unresolved debate among realists suggests that the relationship between international structure (the distribution of power) and prospects of war and peace may be indeterminate.

What may be more critical than the distribution of power as such is the pace of structural change. Rapid power shifts can complicate the task of balancing against threatening or rising states. One danger is that the more advanced powers will not make the necessary adjustments fast enough to sustain a stable balance of power. This could then embolden the rising power to become more assertive, especially if it has a revisionist agenda of challenging the territorial status quo.<sup>16</sup> The other danger is that the more advanced powers will in paranoia overreact. Rather than becoming inhibited by this response, a rising power may then devote more of its resources and energy to building up its military, thus fueling an arms race that increases the possibility of military miscalculation. What emerges is a security dilemma under which efforts by states to maximize their own security provoke hostile responses by others that ultimately make all the states more insecure.<sup>17</sup> Under such circumstances, liberal calculations about mutual benefits and constraints will recede, and states are likely to become obsessed about the vulnerabilities of interdependence.

Some realist thinkers have gone beyond the power distribution notion to argue that economic interdependence can directly exacerbate relations among states. Because the international system is ultimately anarchic, economic interdependence can cause states to become more anxious.<sup>18</sup> Being dependent on another state for economic benefits makes the state vulnerable to the costs that would be incurred if the other state decided to withhold those benefits. Nation-states will fear that during a security crisis, access to critical raw materials and markets might be severed with dramatic negative consequences for their economic well-being and even national survival.<sup>19</sup> A liberal would be confident that interdependent states will be mutually constrained from withholding the benefits of interdependence from each other because each would suffer. But as Keohane and Nye note, interdependence does not have to be “evenly balanced mutual dependence.” An asymmetry in interdependence can give one state more leverage over another. Therefore, a state in this superior position may seek to maximize the benefits of interdependence even at the expense of its trading partner. Conversely, the more vulnerable state, suspicious that its trading partner will pursue such a maximizing strategy, will want to reduce this vulnerability.

A moderate response to the vulnerability problem would be the diversification of foreign markets and resource supplies. But if diversification is not a viable option, a state might intimidate a trading partner militarily so the latter does not withhold the economic benefits of interdependence or seek a sphere of political-military domination so as to secure access to critical resources or markets. This dynamic makes security competition and even war more likely as economic interdependence increases. Under such circumstances, states may adopt what Robert Gilpin has called “malevolent mercantilism,” whereby they seek to maximize the economic benefits of interdependence at the expense of others and pursue “inter-state warfare by economic means.”<sup>20</sup> Such a strategy will hardly promote international trust and cooperation.

In recent years, various political scientists have tried to incorporate certain aspects of liberal theories in realist analyses about the effect of economic interdependence on security. For example, Dale C. Copeland has recently argued that the liberal claim about economic interdependence promoting peace may be valid when there is an expectation that trade and its benefits will increase in the future. But if the expectations about future trade are pessimistic, then the realist logic about wanting to reduce economic vulnerabilities will kick in and steer states toward aggression.<sup>21</sup>

In another effort at liberal-realist synthesis, Paul A. Papayoanou has developed a theory that considers the effect of domestic political regimes on state strategies and the patterns of



economic interdependence among status quo powers and between status quo and revisionist powers. He hypothesizes that the security strategies of democratic states are more likely to be shaped by domestic economic interests with positive stakes in interdependence than those of non-democratic ones. Therefore, in order for timely and effective balancing by status quo powers against revisionist ones to occur, two conditions must be met. First, if the status quo states are democratic regimes, there must be a high level of economic interdependence among them in order to solidify their perceptions of common security interests and to facilitate a joint response to the threat from a revisionist power or coalition. Second, the economic interdependence between these democratic status quo powers and the revisionist states must be minimal. Otherwise, domestic commercial interests in the former countries with an economic stake in good relations with the revisionist powers will constrain their leaders from balancing against the revisionist states and deterring aggression. Conversely, if the revisionist states have non-democratic regimes, they will not be similarly constrained to pursue militarily assertive strategies.

### **Critical Perspectives**

Even more pessimistic than realist theorists about the relationship between economic interdependence and security are those analysts who have assumed a critical stance regarding international capitalism.

Perhaps the starkest formulation of this pessimism was V.I. Lenin's theory of imperialism. Building on Karl Marx's analysis of the internal contradictions of capitalism, Lenin argued that a financial-industrial oligarchy with monopolistic control over production will emerge in states at the most advanced stages of capitalism. The problem of underconsumption at home and the need to control markets and raw material sources abroad drive these capitalist states toward imperial expansion. In addition to the domestic class conflict predicted by Marx, this dynamic can cause international wars in two ways: imperial rivalry among advanced capitalist states and nationalist rebellions in the colonies against the yoke of imperial domination. These wars served Lenin's revolutionary agenda because they would weaken the power of the imperialist, bureaucratic state.<sup>22</sup>

One does not have to subscribe to Leninist ideas about war and revolution to be sensitive to the negative security implications of international economic inequality. Dependency theorists have argued that world capitalism can distort the economies of less developed countries and impede their efforts at development. Even without militarily and politically dominating the weaker states, the advanced states can exert control over such countries by informal, economic means. This pattern of economic exploitation also has a domestic dimension whereby the ruling class of an exploited country may in turn exploit the weaker social classes.<sup>23</sup> Such an arrangement is ultimately unstable because it sows the seeds of rebellion and revolution. As elite control in the exploited country weakens, civil wars can break out and spill over into the international arena. For example, the powerful states might be tempted to intervene in these domestic conflicts to protect their economic interests.

The neo-Marxist Immanuel Wallerstein and followers of his modern world system theory see the capitalist world-economy as divided hierarchically into three tiers: the core, the semiperiphery, and the periphery. Systemic integration occurs on the basis of an unequal differentiation whereby the core industrial economies which possess the strongest state capabilities dominate the weaker economies in the semiperiphery and periphery. The economies of the semiperiphery are less diversified and technologically weaker than their counter-

parts in the core, but they enjoy a modicum of economic success through relatively strong, authoritarian states. Those in the periphery, however, have weak states, suffer from domestic strife, and appear unable to lift themselves from poverty.<sup>24</sup>

But in contrast to the original dependency argument, modern world system theory recognizes the possibility (indeed likelihood) of a shift in the hierarchical ordering of the world-economy. The international diffusion of technology, the rise in incomes in the most advanced economies, and strategic state intervention in the economy can provide opportunities for less advanced countries (like those of the semi-periphery) to move up. For Wallerstein, the interstate balance of power system is not autonomous, but rather intimately linked to the dynamics of the capitalist world-economy. Great power “world wars” produce a hegemonic power with a preponderance of economic, political, and military capabilities. Although this hegemonic power can shape the interstate system to establish peace and a liberal international economic order, the logic of world capitalism will inevitably lead to an erosion of the hegemonic power’s economic edge and its alliance network. This hegemonic decline and the concomitant reshuffling of alliances will destabilize the interstate system, spawn contenders for hegemonic succession, and make the world ripe for another great power conflict.<sup>25</sup> In this respect, Wallerstein’s modern world system theory converges with realist theories of hegemonic stability and decline.

Neo-Marxists are not the only ones who are concerned about the destabilizing features of world capitalism. Even those writing in the liberal tradition recognize the potential severity of business cycles and the need to adopt countercyclical demand management policies along Keynesian lines to mitigate them. But the increasing interdependence of national economies makes it nearly impossible for most countries to implement effective countercyclical policies in isolation. Interdependence thus places a premium on macroeconomic policy coordination among the most advanced economies in order to avoid prolonged global stagnation.<sup>26</sup>

Perhaps a more serious challenge than the management of business cycles is the need to cope with international financial shocks. In the real world (as opposed to the world of economic equilibrium theory), financial markets inevitably produce periods of manic speculative bubbles followed by financial panics.<sup>27</sup> Technological advances that now make possible nearly instantaneous transnational capital movements have exacerbated this tendency toward wild swings between mania and panic based on short-term calculations. To stop capital flight, national governments might raise interest rates; but such a response could worsen a domestic recession. To prevent financial panics from becoming crashes followed by economic depression, Charles P. Kindleberger has argued for a lender of last resort. Beyond the question of what countries or international institutions can play this role, this notion of a lender of last resort raises the problem of moral hazard. Knowing that there is likely to be an international bailout, financial speculators might become even more reckless. The inadequacy of transparency and regulations for international capital movements in an era of flexible exchange rates makes the maintenance of global financial stability especially daunting.

Although deepening interdependence and rapid international transactions may spread good economic tidings across state borders, they can also quickly spread bad ones. During boom times, states are usually better able to manage the social adjustment costs of economic change and interdependence and to adopt redistributive policies to ameliorate inequality. But these tasks become much more difficult when the economic pie is shrinking, especially in the context of a worldwide recession. And this has implications for international security. An

unequal distribution of the economic pain within a state might tempt its leaders to use nationalistic agendas to maintain political support or legitimacy. Even if a state does not adopt a Bonapartist strategy of external aggression to deflect domestic social problems, it can become much more assertive about territorial disputes as well as adopt “beggar-thy-neighbor” foreign economic policies. Such developments do not augur well for international cooperation and peace. This political dynamic is particularly worrisome for states in the transitional phase of democratization. Because popular control over foreign policy is likely to be partial in such countries and because the possibility of autocratic deterioration is high, international economic pressures could lead these transitional democracies to become militarily aggressive and even fight wars with democratic states.<sup>28</sup>

Finally, economic interdependence can weaken the state’s ability to provide for security. While liberals might see increasing and deepening transnational economic interactions as constraining states from being militarily assertive, those with a more critical outlook warn of the negative security implications of a weakening state. Interdependence can ease the international flow of weapons, technologies, and capital, which can chip away at the state’s ability to contain non-legitimate acts of violence. Global arms merchants, drug cartels, international criminal syndicates, and disgruntled scientists can facilitate terrorism and make civil conflicts and even domestic crime more deadly. As Susan Strange has noted, the decline of the state in the face of the diffusion of power in the world economy is likely to shift the focus of security from a concern about traditional interstate conflicts to the problem of intrastate wars, strife, and crime with a transnational dimension.<sup>29</sup>

How do the liberal, realist, and critical perspectives fare in capturing the implications of economic interdependence for security in Northeast Asia? Will commercial links within this interstate system establish the material and institutional foundations for peace, or is this region ripe for rivalry, conflict, and insecurity? In addressing these questions, this paper will focus on two sets of concrete issues. The first concerns the strategic interaction among the major powers of Northeast Asia (China, Japan, Russia, and the United States). It goes without saying that these four states will play a critical role in determining the kind of security order that will develop in this region in the post-Cold War era: whether it will be cooperative and peaceful or competitive and war-prone. The second set of issues deals with two major flash points that are remnants of the Cold War: the Korean peninsula and Taiwan. The way each of these conflicts is managed and resolved will shape the security environment for all states in this region. Given the high stakes involved, each issue has the potential of triggering a major power war.

## **Relations among the Major Powers**

Liberal optimism about major-power relations in Northeast Asia hinges on three factors: (1) the positive incentives and constraints that interdependence provides to steer states toward security cooperation and accommodation, (2) the promotion of cooperative international norms, and (3) the spread of liberal democracies. On all three factors, the picture is mixed.

## Economic Incentives and Constraints

Of the six bilateral relationships involving the four major powers of Northeast Asia, the U.S.-Japan dyad exhibits the broadest range and deepest level of mutual interdependence. For Japan, the United States is the largest trading partner; and for the United States, Japan is the second largest trading partner after Canada. As a percentage of GDP, Japan's two-way trade with the United States was about 4.2 percent in 1996, far exceeding its trade with China and Russia (see Table 1). Similarly, U.S. two-way trade with Japan was much greater than its trade with China and Russia (see Table 2). In 1996, U.S.-Japan two-way trade was about \$191.5 billion. Of course, bilateral economic relations are not without problems. Since the 1980s, the United States has had huge trade deficits with Japan, reaching a peak deficit of \$65.7 billion in 1994. This imbalance has caused American leaders to accuse Japan of unfair trade practices and to pressure Japan to open its markets to U.S. goods and services. And at times, the U.S. government has adopted protectionist measures to moderate the flow of Japanese imports. The pattern of foreign direct investments has also been asymmetrical. Whereas Japan's foreign direct investment position in the United States was about \$108.6 billion in 1995, America's foreign direct investment position in Japan was only about \$39.2 billion.<sup>30</sup> This investment gap has helped Japanese companies penetrate the U.S. market while American firms have had difficulty selling in the Japanese market.<sup>31</sup>

Given these enormous trade and investment imbalances, however, what is remarkable is how Japan and the United States have managed to contain bilateral economic frictions and prevent them from damaging the political-security relationship. A big reason for this mutual restraint has been the importance both countries attach to the security relationship, especially during the Cold War. With the collapse of the Soviet threat, however, the security incentive to contain bilateral trade conflicts has weakened. Nevertheless, there are still compelling economic reasons for both Japan and the United States to prevent trade-related disputes from getting out of control.

Despite the inroads Japan has made into East Asian markets, the United States remains a critical export market for manufactured products and an important source for agricultural goods. Moreover, Japanese firms depend upon American scientific and technological innovations to develop new products. Therefore, in order to preserve this access to U.S. markets and technology, Tokyo policymakers will tend to accommodate economic pressures from Washington within reason. But there are also strong reasons for Americans to accommodate the Japanese. With its large current account and trade deficits over the last two decades, the United States depends upon steady capital flows from Japan to sustain its standard of living. The surge of Japanese direct investments in the United States since the 1980s has made many American communities dependent upon Japanese companies for local employment. Furthermore, many American manufacturers now rely upon the import of Japanese-made components and inputs. Therefore, despite the imbalances in bilateral trade and investment, economic interdependence between Japan and the United States has become more symmetrical. Neither side can damage the economic interests of the other without harming its own interests. The deepening of bilateral economic interdependence has prompted one noted political scientist to refer to a *Nichibei* [Japan-America] economy.<sup>32</sup>

As for China, ever since Deng Xiaoping launched his economic reforms in 1978, its commercial ties with both Japan and the United States have grown enormously. With the reversion of Hong Kong back to China, Japan and the United States are now China's number one and number two trading partners, respectively, as measured by two-way trade. Relative

to its GDP, China's trade with Japan and the United States has also increased substantially (see Table 3). Japan and the United States have played a critical role in China's recent economic success. Direct investments by American and Japanese firms have enabled China to develop its manufacturing industries, upgrade its technology, and expand its export sector. Japan's annual rate of direct investments into China jumped from \$296 million in 1988 to \$2.56 billion in 1994. Over the same period, U.S. direct investments into China grew from \$98 million to \$745 million.<sup>33</sup> Both Japan and the United States serve as important export markets for China. In addition, Japan's economic assistance to China in the form of concessional yen loans has been essential for infrastructure development. In short, Beijing has a huge economic stake in maintaining good relations and avoiding security conflicts with Tokyo and Washington.

By comparison, the economic stakes that Japan and the United States have in China are not as great. In 1996, Japan's two-way trade with China amounted to about 1.35 percent of its GDP, and America's two-way trade with China was about 0.88 percent of its GDP (Table 1). But in the same year, China's two-way trade with Japan and the United States as a percentage of its GDP was 7.28 and 5.20 percent, respectively (Table 3). Although Japan and America's relative trade dependence on China is still modest, businesses in both countries are attracted by the potential growth of the Chinese market. For the United States, exports to China as a percentage of GDP grew from 0.07 percent in 1986 to 0.16 in 1996. Although this export statistic for Japan fell from 0.50 percent in 1986 to 0.21 percent in 1990, it rebounded to 0.47 percent in 1996. The growing Chinese market has increased the economic incentive for Japanese and American leaders to cultivate stable and cordial relations with China. The business communities in both the United States and Japan have been a moderating voice when issues such as Taiwan, human rights, or nuclear testing have heightened tensions with China. But here again, trade patterns suggest that Tokyo and Washington have the upper hand over Beijing. From 1986 to 1996, China's exports to Japan as a percentage of GDP jumped from 1.81 to 3.74, and its exports to the United States from 0.83 to 3.24. The export stakes, in short, are higher for China. In other words, trade with Japan and the United States has a much greater weight in China's economy than trade with China has in Japan and America's economies. Add to that China's reliance on Japan and the United States for direct investments and technology as well as the huge amount of foreign economic aid coming from Tokyo. Therefore, China would suffer greater economic consequences from a deterioration of relations with Japan and the United States than the latter two states from a worsening of ties with China.

But China is not without leverage. It can maximize the attraction of its large market by playing Japan and the United States off of each other. By having Japanese and American corporations compete with each other for sales and investment opportunities, China might be able to negotiate better deals in terms of price, technology transfers, and local content arrangements. Beijing can also bring the Europeans into the game as it did so well when it agreed to purchase Airbus aircraft during a frosty period of Sino-American relations. China can also expand its economic ties with other East Asian countries to attract investments and promote exports. Nevertheless, on balance, both the United States and Japan have greater economic leverage over China than China has over these two countries. Liberals would therefore argue that there are strong incentives and constraints for China to maintain good relations with both Japan and the United States even as its power increases.

Compared to the commercial ties among China, Japan, and the United States, Russia's presence in the Northeast Asian economic system is minimal. The stake that Japan and the

United States have in trade with Russia is negligible. Trade with China is much more important for these two countries. In addition, relative to their direct investments in China, Japanese and American investments in Russia are meager. The same goes for China: its two-way trade with Russia was only 0.83 percent of its GDP in 1996. Therefore, based on a sheer calculation of economic interest, neither Japan nor the United States is likely to favor Russia over China. Similarly, economic calculations should steer Beijing to put priority on good relations with Tokyo and Washington over those with Moscow. Even for Russia itself, its economic interest in Northeast Asia will be secondary to its interest in Europe.

But this does not mean that Russia does not factor at all in the Northeast Asia economic equation. Given their hunger for energy sources, both China and Japan are interested in tapping the gas and oil reserves in Russia. And for both strategic and technological reasons, they tend to favor development projects with U.S. participation. Moscow also sees the potential of using Japanese aid and investments to develop the Far East region, and Russian trade with China as a percent of its GDP has grown significantly (Table 4). But compared to China, economic calculations are less likely to motivate and constrain Russian diplomacy toward Japan and the United States in the regional context.

To summarize, interdependence among the four major powers in Northeast Asia has created three tiers of relationships. At the core is the deepening economic linkage between Japan and the United States, followed by the growing commercial ties that these two advanced countries have with China. Finally, of the four major powers of Northeast Asia, Russia remains an economic frontier. This pattern reinforces existing strategic alignments and diplomatic trends. Therefore, even after the collapse of the Soviet threat, the economic rationale for Japan and the United States to maintain their alliance has become more compelling. Given the high economic stakes that the two countries have in the other and the lesser stakes they have in China, they are unlikely to let competition for the China market spoil relations between them. The reliance of China on Japan and the United States for its growth policies gives it a strong economic incentive to maintain good political relations and avoid confrontation on security issues. The attraction of China's huge market also has a moderating influence on American and Japanese policies toward China. In short, there is a material basis for Japan and the United States to pursue an engagement policy toward China, and for China to be receptive to such an overture. Russia's peripheral role provides little economic incentive for either Japan or the United States to enlist Russian support in a policy of containing China. And for China, an alliance with Russia against Japan and the United States would be vastly inferior in economic terms to a cooperative relationship with the latter two countries.

### **International Norms and Institutions**

To what extent will economic interdependence nurture international norms and institutions for security cooperation among the major powers? Political scientists have often pointed out that compared to Europe, international relations in East Asia are underinstitutionalized. East Asia lacks the equivalent of the European Community which has recently evolved into the European Union. Unlike the multilateral North Atlantic Treaty Organization (NATO) for Europe, the alliance relationships in East Asia tend to be bilateral. But in 1989, the region took a big step toward institutionalization by initiating the Asia Pacific Economic Cooperation (APEC) process to promote multilateral discussions of economic issues. At President Bill Clinton's initiative in November 1993, the annual APEC conference now encompasses a

meeting of the leaders of the member states and economic units. Although still a fledgling institution based on voluntaristic principles, APEC now has a secretariat and has adopted an ambitious goal of free trade and investment.

APEC has the potential to become a significant force for security cooperation. First of all, it provides an institutional link between East Asia and North America. Despite concerns that Japan might want to resurrect an East Asian economic bloc autonomous of the United States, the concept of "Asia Pacific" embedded in APEC symbolizes a conscious effort to prevent an economic fault line between East Asia and North America.<sup>34</sup> By doing so, APEC reinforces in a multilateral manner the close relationship between Japan and the United States. And it provides an opportunity to ease some of the bilateral economic tensions between Tokyo and Washington by multilateralizing various issues. Second, APEC is one of the rare multilateral forums in which China, Japan, and the United States are members on the basis of equality. Again it provides a multilateral context to soften the blows of any bilateral disputes involving China. And it serves as a mechanism to integrate China into the regional economic community and nurture norms of international cooperation. Finally, the admission of Russia as a full member in November 1998 presents APEC with an opportunity to promote a spirit of amity among all four major powers of Northeast Asia.

Some, however, have found APEC wanting because it has limited itself to the discussion of economics. As U.S. defense officials often comment, APEC is "the right organization talking about the wrong issues." Indeed Secretary of Defense William Perry did float the idea of incorporating security into the APEC agenda. But in light of APEC's ambitious economic agenda, most members gave Perry's suggestion a cool response. Therefore, others have proposed the creation of a regionwide security organization comparable to the Organization of Security and Cooperation in Europe (OSCE).

The precursor of an OSCE equivalent for the Asia Pacific region might be the ASEAN Regional Forum (ARF), which was launched in 1994.<sup>35</sup> The idea for such a forum originally came from Japan in 1992 as part of its effort to promote regionwide dialogues and cooperation through the ASEAN Post-Ministerial Conference as well as APEC. Although support for such a multinational forum to discuss political and security issues was lukewarm at first, the Japanese initiative bore fruit when the ASEAN countries decided to take the lead. ARF has formed several working groups for intensive discussions on confidence-building measures, preventive diplomacy, and the management and resolution of regional conflicts. Although the purpose of these dialogues at this point is to promote mutual understanding rather than to reach binding agreements, ARF has the potential of developing international norms for security cooperation. Unlike APEC, ARF encompasses all four major powers of Northeast Asia in its twenty-country membership. This regional security dialogue is a good example of how multilateralism in the economic realm can spill over into the political-military realm.

The weakness of both APEC and ARF, however, is that their broad geographic reach makes these two forums unwieldy for dealing with security problems particular to Northeast Asia. To rectify this situation, the Institute on Global Conflict and Cooperation (IGCC) of the University of California organized an unofficial "track-two" dialogue specifically designed to focus on this subregion: the Northeast Asia Cooperation Dialogue (NEACD). NEACD's membership encompasses all four major powers of Northeast Asia and South Korea. An open invitation to participate has been extended to North Korea, although Pyongyang has so far declined to send a delegation. NEACD's non-governmental character notwithstanding, senior officials as well as experts from the academic and policy analysis

communities have been attending the annual meetings. Like ARF, NEACD is a consensus-building enterprise, not a formal negotiating body. From its inception, this dialogue has sought to link regional economic interdependence and security cooperation. For example, recognizing the keen interest that its member states have in international trade and secure energy supplies, the forum has been building support for the concept of safe passage at sea. It has also explored ways to enhance cooperation on nuclear energy development to address security concerns such as weapons proliferation, safeguards and monitoring of nuclear production facilities, and the management of spent fuel. Concerning the development of international norms, NEACD participants have agreed on the following: (1) respect for sovereignty, (2) free choice of political, cultural, and social systems; (3) pledge to settle disputes peacefully; (4) promotion of economic cooperation and cooperation on transnational problems; and (5) promotion of dialogue and information exchange on security matters.<sup>36</sup> Although consensus on these norms does not have the imprimatur of state policies, NEACD can help lay the groundwork for an official forum in the future that might yield explicit government agreements as well as tacit understandings.

Certainly by European standards these official and unofficial dialogues and institutions are not well developed, raising doubts about how much they can actually contribute to interstate security cooperation. The governments of the four major powers of East Asia have yet to put their full weight behind either ARF or NEACD. The United States has been relatively passive and more concerned about how multilateralism might constrain U.S. military forces and weaken bilateral alliances. Although an early proponent of multilateral dialogues, Japan has shied away from pushing hard for more substantive discussions and negotiations. China has tended to obstruct any moves in this direction, while Russia's influence in these settings has been minimal. Therefore, for the time being, the development of cooperative security norms among the major powers of Northeast Asia will have to rely on what might be called "concerted bilateralism" rather than explicit multilateralism.

In 1996, it appeared as if a new bipolar divide might emerge in Northeast Asia. In addition to expanding NATO eastward, the United States was strengthening its alliance with Japan. These moves drove China and Russia to speak openly of a "strategic partnership" to check the United States and its allies. But before a new geopolitical fissure could crystallize, the four powers moved quickly in bilateral terms to prevent this from happening. In addition to welcoming President Boris Yeltsin to the G-7 summit in Denver, the United States sought to reassure Russia about NATO expansion through the May 1997 founding act which granted Russia a seat on NATO's Permanent Joint Council. China and the United States worked to repair the damage over the 1996 Taiwan Strait crisis by resuming bilateral summits and even talking about a "constructive strategic partnership" of their own. Not to be left behind, Japan announced in July 1997 its "Eurasia diplomacy" designed to improve relations with both Russia and China. Based on the principles of "mutual confidence, mutual benefits, and a long-term approach," Prime Minister Ryutaro Hashimoto and President Yeltsin agreed to negotiate a peace treaty by 2000 and develop jointly the disputed "northern territories." Hashimoto also reassured China about the U.S.-Japan joint security declaration of 1995 and the new bilateral defense cooperation guidelines by explicitly stating that Japan does not support Taiwan's independence.

Although they were by no means the sole motivation, economic interests certainly played a role in the above cycle of "concerted bilateralism." Through these diplomatic maneuvers, each of the four major powers moved forward on some aspect of security cooperation (military exchanges, general security dialogues, or confidence-building measures) with the



other three states. In short, commercial interaction coupled with bilateral diplomacy can lay the political foundation on which to develop shared security norms and construct multilateral security institutions.

### **Spread of Liberal Democracies**

The most problematic aspect of liberal optimism regarding major-power relations in North-east Asia concerns the democratic peace argument. Certainly, the firm establishment of a democratic regime in Japan after World War II reinforces the economic reasons for maintaining and strengthening security cooperation between Japan and the United States. But China is far from becoming a stable democratic state, and Russia is undergoing a trying democratic transition process.

Liberals hope that economic development will lead China to liberalize its politics through constitutionalism, guarantee basic human rights, and institutionalize democratic processes for electing its highest officials.<sup>37</sup> As Chinese incomes rise, the expansion of the middle class could not only pressure communist leaders to accept competitive elections at the national level, but also provide a social basis for democratic governance. But China's political future may not be so auspicious. Economic predicaments such as the insolvency of the financial system and the inefficiencies of the state-owned sector will pose hard choices for Chinese leaders. Although increasing economic inequality and corruption might stimulate political reform, it is far from clear that the present regime will tolerate open opposition. Even if China did move toward limited political pluralism, leaders might use nationalism to sustain power, thereby hindering efforts to manage external security issues in a cooperative manner.

The Russian experience demonstrates how uncertain the process of democratization is. Although President Yeltsin has so far managed to sustain the fragile experiment in free and open elections, his passing could push to the forefront leaders who are less committed to democratic politics, economic reform, and cooperation with the West.

While steady economic growth does not guarantee democratization, it does make the transition to democracy easier and reduces the possibility of backsliding. Therefore, from a liberal perspective, international support for Chinese and Russian economic development will ultimately produce security benefits.

### **Realist Concerns**

How might realists challenge the cautiously optimistic assessment of liberals? The economic gains (or even losses) from interdependence are unlikely to be distributed equally among the major powers. Just as Japan succeeded in gaining on the United States in economic terms after the end of World War II, China is likely to take advantage of its late-developer status to play the catch-up game. Although there is little prospect that China will approach either Japan and the United States in terms of per capita income in the foreseeable future, given its huge population its GDP is likely to surpass Japan's GDP and perhaps even America's by the middle of the twenty-first century even if its growth rate slows. In fact, on a purchasing power parity (PPP) basis, the World Bank has calculated that China's GDP had already exceeded that of Japan in 1995. The bank projects that by 2020, the GDP of China in terms of PPP will be \$20,004 billion, larger than the combined GDPs of the United States and Japan, which will be \$13,470 billion and \$5,052 billion, respectively.<sup>38</sup> Russia's economic

prospects look less bright at the moment with the World Bank predicting that it will not even rank in the world's ten largest economies in 2020. Nevertheless, one should not dismiss entirely the possibility that Russia will recover its international economic position. Even if the World Bank projections based on PPP are faulty, the preponderance of America's economic and technological capabilities is likely to wane *relative* to the other major powers even if the United States maintains its number one status. Will hegemonic decline then lead to instability?

For a realist, this shift in the distribution of economic power matters because economic capabilities can be translated into political influence and military might. Most experts agree that for the next fifteen to twenty years, China will still be unable to challenge the United States in the Western Pacific in terms of air or naval power although the modernization of its nuclear arsenal might give China a secure second-strike capability for deterrence purposes.<sup>39</sup> But after that period, China is likely to become a "peer military competitor" of the United States in the littorals of the East Asian continent. Russia could also reemerge as a political-military player in the region. And with Japan's technological ability to quickly become a first-class military power, many realists predict a multipolar power balance in Northeast Asia with all its attendant dangers of shifting alignments and miscalculation.<sup>40</sup>

But how volatile is this multipolarity likely to be? Much will hinge on the sustainability of the U.S.-Japan alliance. From Japan's perspective, the rise of China and the reemergence of Russia should reinforce its interest in the security relationship with the United States. Not only does geographic proximity make these two states more threatening to Japan, but economic interests and shared democratic values make the United States by far the more attractive strategic partner. And the option of strategic autonomy will prove to be costly both economically and diplomatically given the burden of its militarist past. The greater uncertainty is America's willingness to sustain its defense commitment to Japan because the United States has the geopolitical luxury of disengaging from Northeast Asia with minimal negative security consequences. But if the United States did terminate its alliance with Japan and shifted to what some have called an "offshore" balancing strategy, then Japan would be inclined either to adopt an independent defense strategy that included a nuclear arsenal as well as power projection capabilities or to bandwagon with China. In geopolitical terms, the temptation for U.S. military retrenchment from Northeast Asia will be greatest *after* the resolution of the Korean conflict and *before* Chinese military modernization becomes threatening to the United States. As the regional security environment becomes more benign, trumpeting the commercial and diplomatic benefits will be critical for sustaining American public support for the defense commitment to Japan.

Another concern that arises from a shift in the regional power distribution is the emergence of a revisionist power with the capability to disturb the peace. But which major powers in Northeast Asia might be interested in changing the territorial status quo through the use of force? Despite its claim to the "northern territories" off of Hokkaido, Japan with its strong pacifist tradition after World War II would have to change fundamentally before one could imagine it threatening Russia militarily to recover these islands. The United States may be assertive about spreading its political values and extending its commercial reach, but it no longer has an interest in territorial expansion. Russia has territorial disputes with China and Japan, but it is unlikely to challenge the status quo militarily. That leaves China. At present, China is a conservative power interested in a peaceful international environment so that it can concentrate on economic development.<sup>41</sup> But of the four major powers, China has the greatest potential to become a revisionist power. It wants to overcome what it sees as

centuries of humiliation by the Western powers. It desires international recognition and respect commensurate with its long history, great culture, and mammoth size. China has an irredentist agenda of aiming to regain control over Taiwan, the last piece of territory of the great Manchu empire that has yet to be recovered. And unlike postwar Japan, China lacks strong domestic constraints on the use of military force.<sup>42</sup>

Although the economic gains from foreign trade and investment now encourage China to avoid external behavior that might alarm its neighbors as well as Japan and the United States, economic and social factors might motivate Chinese expansionism in the future. Its growing hunger for energy sources is likely to cause China to intensify its claims over the disputed islands and reefs in the South and East China Sea because of potential oil and gas reserves in the seabeds.<sup>43</sup> Demographic pressures might trigger the flow of northern Chinese into the underpopulated areas of the Russian Far East. In short, in the eyes of a realist, as China develops its economy and modernizes its military, the expansionist urge may intensify. While China's present economic and military backwardness makes a containment strategy unnecessary, a stronger China of the future may require effective balancing by the other major powers to deter conflict. Even with the rise of China, however, the power distribution will be such that a strategic partnership between Japan and the United States should be sufficient to persuade China to forgo expansionism. But realists will be worried that economic interdependence might inhibit such balancing behavior.

Following the logic of Papayouanou's theory discussed earlier in this paper, the economic interests that Japan and the United States have in China might constrain these countries from standing up to China on security matters for fear of losing commercial opportunities. The democratic political systems of both countries will enable their respective business communities to persuade their governments to avoid antagonizing China. But an authoritarian Chinese state would be relatively immune from domestic economic interests that might have a stake in good relations with Japan and the United States. As a result, interdependence would not effectively constrain China from being internationally aggressive, while interdependence will restrain Japan and the United States from balancing China in a timely manner. If this analysis is correct, there may be two ways to avoid the dangerous situation that flows from it. One is for China to evolve into a democratic state in which international economic interests constrain security policy as much as they are likely to do in Japan and the United States. The other is to ensure that China has an optimistic outlook about the future of international trade and access to critical resources. Reducing the sense of vulnerability will ameliorate any temptation to use military means on behalf of its economic interests.

Finally, a realist might be worried less about ineffectual balancing against a rising, revisionist power and more about an exacerbation of the so-called security dilemma. Efforts by the various Northeast Asian powers to enhance their security interests might be perceived as threatening by the other major states in the strategic quadrangle. For example, the recent strengthening of the U.S.-Japan security relationship provoked Chinese fears of containment. If these fears persist, China is likely to become even more aggressive about increasing its military capabilities as its industrial and technological power grows. This Chinese response might in turn trigger precisely the U.S.-Japanese containment strategy that China had feared. The unfortunate result would be a spiraling arms race and insecurity for all. So far the "concerted bilateralism" mentioned earlier has dampened this tendency. Both Japan and the United States have sought to reassure China about their intentions, and China has reaffirmed its interest in good relations with both of these major powers. The recent improvement of Russo-Japanese relations and the maintenance of Russo-American coopera-

tion have in turn reduced the possibility of a tight Sino-Russian strategic partnership against the U.S.-Japanese alliance. But sustaining this virtuous cycle of bilateral relations may ultimately require the establishment of multilateral security norms and institutions.

### **Critical Perspectives**

The East Asian economic crisis that began with the fall of the Thai baht in July 1997 demonstrated how interdependence can cause economic problems to spread across borders. All of this would come as no surprise to analysts who have viewed capitalism critically and emphasized its unstable features. An analysis of the origins of this crisis falls outside the scope of this paper. Suffice it to say that the causes are multiple. They include shifts in exchange rates, financial liberalization in many East Asian countries without the required regulatory regime to ensure transparency and an effective operation of market principles, asymmetries in regional trade and investment patterns, and collusive ties between government and business.<sup>44</sup> But what implications does this have for international security, in particular strategic relations among the major powers of Northeast Asia?

Compared to the impact on the various Southeast Asian countries and South Korea, the effect of the crisis on the four major powers of Northeast Asia has thus far been tempered. China has avoided the economic contagion in large part because its financial system has been less integrated with the rest of the world. Although American businesses have complained of a drop in export opportunities to the region, the United States has managed to sustain its robust economic growth, prompting many American commentators to boast about the virtues of the U.S. model of capitalism. The Russian economy continues to falter, but the direct impact of the East Asian crisis has been limited. Although the regional financial turmoil will make it more difficult for Russia to attract international capital, domestic shortcomings are still primarily responsible for Russia's inability to become a full-fledged participant in the East Asian economic community. Of the four major powers, Japan probably has the most to lose. In addition to the decline of export markets, the shrinkage of East Asian domestic demand will jeopardize many of the investments that Japanese corporations made in the region since the mid-1980s. Moreover, the crisis will frustrate Japanese attempts to revitalize their economy since the bursting of their financial bubble in 1991.

Ironically, however, the crisis has given greater impetus for the four major powers to cooperate. Despite the currency depreciations in Southeast Asia and South Korea, China has refrained from devaluing its currency for the time being, a move that has won praise from the advanced industrial countries, especially the United States and Japan. Because of the problems in the rest of East Asia, Japan now has a bigger stake in China's stable development, and will therefore continue to support the latter's efforts to improve its economic infrastructure. Uncertainties in Russian domestic politics notwithstanding, Tokyo and Moscow intend to sustain the positive momentum in bilateral relations, while Washington has a keen strategic interest in preventing the East Asian contagion from damaging Russia's economic prospects. U.S.-Japan relations have become more problematic as American officials have sharply criticized their Japanese counterparts for not doing enough to revive the Japanese economy and help pull East Asia from its economic mess. Although domestic political constraints have prevented Tokyo from responding to Washington's pressures to the latter's satisfaction, Japan has finally adopted a stimulus package that should be adequate enough to avoid a rupture in U.S.-Japanese relations even though it will fall short of solving Japan's structural economic problems. Moreover, Japanese leaders have renewed

their commitment to strengthen the bilateral alliance by drafting legislation to implement the new defense cooperation guidelines adopted in fall 1997.

As impressive as this display of restraint and cooperation has been, dangers lie ahead. If its domestic demand does not revive, Japan could export its way out of its economic troubles, causing its trade surplus with the United States to balloon. If this growing trade imbalance emerges at a time when the American business cycle is heading downward, Washington and Tokyo could once again lock horns on trade issues, weakening the goodwill between them. Without a common threat to keep the alliance together, economic tensions could easily spill over into the security realm. While a formal abrogation of the security treaty remains unthinkable, the security relationship could be hollowed out. The Japanese may become less willing to provide large amounts of host nation support for U.S. forces stationed in Japan, and may even push for a substantial reduction of American military bases on their territory. At the same time, more and more Americans may question why they must continue to guarantee Japan's security. There is also the danger that the U.S. trade deficit with China will grow at the same time that the trade imbalance with Japan worsens. Although some American commentators have argued that Washington usually avoids having bad relations with both Beijing and Tokyo at the same time, economic frictions with both Japan and China could steer the United States in that direction.

More worrisome is the possibility that China will experience a financial crisis on its own accord that exacerbates the economic problems in the rest of East Asia. As Nicholas Lardy has recently argued, such a scenario is certainly conceivable.<sup>45</sup> Now that economic growth is the main source of legitimacy for the communist regime in China, an economic downturn, not to mention a financial collapse, would have traumatic political and social consequences. Compound that with continuing stagnation or even deflation in Japan, and then one has a highly volatile situation. States could drift away from cooperative action to deal with regional economic instability toward nationalistic behavior to gain an economic advantage at the expense of other states. The rise of malevolent mercantilism would certainly undermine security cooperation. In such an environment, territorial disputes, even over minuscule patches of land in the open sea, could become dangerous tests of national will and honor.

Even if the above pessimistic scenarios do not come to pass, economic problems in the other countries of the Asia Pacific region could pose security challenges that will require great care by the major powers of Northeast Asia to avoid miscalculation and conflict. Indonesia presents the greatest risk. Further political instability there could trigger large flows of refugees and migrant workers or more violence against ethnic Chinese and foreigners. The major powers, in particular the United States and Japan, may be compelled to engage in rescue operations. China may become more assertive about the mistreatment of ethnic Chinese. Political repression in Indonesia to deal with the social unrest could strain relations between Washington and Tokyo as Americans express their outcry over the suppression of democratic forces and Japanese see a military crackdown as the necessary price of political stabilization and economic reform. Furthermore, turmoil in Indonesia would imperil the Association of Southeast Asian Nations (ASEAN), which has been a valuable factor for regional cooperation and stability.

Quite apart from the unstable features of international capitalism, a critical perspective on interdependence also focuses attention on how state capabilities to provide security have declined.<sup>46</sup> The 1995 sarin gas attack by the bizarre religious cult Aum Shinrikyo in central Tokyo vividly demonstrated how vulnerable even a country like Japan is to mass terrorism. This incident revealed how easily a fringe element could acquire deadly instruments of

violence in the international marketplace. As economic transactions have become more global, so have the operations of organized crime, drug cartels, and terrorist groups. In this era of globalization, a clear distinction between internal and external security has become harder to sustain. Northeast Asia is not immune to this phenomenon. Russia has seen the proliferation of mafia-type enterprises, the Chinese have their international crime syndicates, and Japan the yakuza. Pirates can threaten critical routes of maritime commerce, and terrorist organizations using up-to-date technology can operate transnationally without being easily detected by state law enforcement agencies. These nontraditional threats to security certainly increase the incentives for states to cooperate, but what remains to be seen is whether the major powers of Northeast Asia have both the will and means to do so.

## **Flash Points in Northeast Asia**

Whether or not security relations among the major powers of Northeast Asia evolve in a cooperative or conflictual direction will depend to a large extent on how the Korean and Taiwan questions are managed. Because each of these two flash points carries the danger of triggering war among the major powers, an overall assessment of the security implications of regional economic interdependence demands a close look at both issues.

### **The Korean Question**

Changes in the patterns of economic interdependence have affected state calculations regarding the uneasy peace on the Korean peninsula. Despite its *juche* ideology glorifying self-reliance, North Korea has always been economically dependent upon outside powers. During the Cold-War era, Pyongyang played off Moscow and Beijing to extract economic benefits from both while trying to avoid becoming too reliant on either one of its communist patrons. But after the collapse of the Soviet Union and the move by China and Russia to normalize relations with South Korea, North Korea suffered from a sharp decline in Chinese and Russian food and energy assistance. Even so, North Korea still relies upon some aid from China and financial remittances from Korean relatives in Japan.<sup>47</sup> Pyongyang used its nuclear card to initiate talks with Washington and to gain access to petroleum and light-water reactors in order to cope with the country's energy needs. Now it appears to be using the specter of widespread famine and even regime collapse to get food aid from the international community.

Notwithstanding this external dependence, North Korea remains by far the most economically isolated country in the region. But rather than instilling a sense of confident autonomy, this isolation has intensified a feeling of vulnerability among North Korean leaders, ironically making them more willing to engage in brinkmanship to get what is necessary for regime survival. While South Korea has developed its diplomatic and economic relations with both China and Russia, North Korea has been unable to move forward on normalizing relations with Japan and the United States. Therefore, not only has the balance of economic power shifted dramatically in South Korea's favor, but North Korea also finds itself in a diplomatically inferior position relative to the south. No wonder Pyongyang wants to improve relations with Washington and Tokyo before it focuses on a meaningful dialogue with Seoul.

Given their common interest in avoiding another Korean war or even a violent North Korean collapse, the other countries of Northeast Asia face the strategic challenge of how to use economic incentives most effectively to steer North Korea toward internal reform, external moderation, and dialogue with South Korea. This process involves more than simply using interdependence to constrain North Korea; it means dangling possible economic benefits to alter North Korean preferences, behavior, and policies. In short, the Korean question provides an excellent test for liberal ideas of linking economics and security in a positive manner.

Pyongyang now appears interested in expanding foreign trade and even investments. As Marcus Noland has recently argued, North Korea has three general choices: (1) implement major reforms to revitalize the economy at the risk of setting in motion forces that will undermine the regime itself, (2) try to ride out the current economic crisis by doing nothing at the risk of precipitating a collapse later, and (3) muddle through by making some marginal adjustments in response to economic imperatives.<sup>48</sup> Given the political risks of the first two options, Pyongyang probably prefers the third. The trick is to use North Korea's desire to make marginal adjustments for the sake of regime survival to elicit cooperation in the political-military as well as economic realm.

Both humanitarian reasons and an interest in preventing a collapse of the North Korean state suggest that the international community—especially South Korea, Japan, and the United States—should provide food relief with no or minimal conditions as long as there is adequate monitoring of where the aid is going. The seriousness of the North Korean situation has now made Seoul more receptive to providing such assistance. Pyongyang's recent willingness to permit the Japanese wives of North Koreans to visit their home country may open the way to the flow of food from Japan as well. But for agricultural help beyond what is necessary to avert widespread famine, conditions could be attached, such as Pyongyang's serious participation in the Four-Party Talks (the two Koreas, China, and the United States) and a resumption of the North-South dialogue.

How conditional should be the relaxation of South Korean and American restrictions on trade and investment with North Korea? Given the subversive potential of such commercial linkages, Pyongyang wants to sterilize these ties as much as possible by restricting them to geographically isolated special economic zones such as the one in Rajin-Sonbong. But from the South Korean and American perspective, trade with and investment in North Korea could support their general political-security objectives by nudging Pyongyang in a reformist direction. Therefore, as long as such commercial activity does not strengthen North Korea's military capabilities, Seoul and Washington could probably relax the existing restrictions with minimal conditions without much risk. A policy of economic engagement could encourage Pyongyang to move toward "soft authoritarianism" consisting of economic liberalization under an authoritarian political system.<sup>49</sup>

Perhaps the most attractive economic carrot for North Korea is the large aid package that is likely to come from Japan as part of the settlement of colonial claims. Estimates of this settlement run from 10 to 20 billion dollars. Although this financial settlement will emerge in the context of normalizing relations between Tokyo and Pyongyang, Japan could contribute to regional security by tacitly linking this aid to progress in the North-South dialogue and discussions on confidence-building and related security measures to reduce military tensions on the peninsula.

None of these efforts to develop economic ties with North Korea can be guaranteed to promote stability on the peninsula. They could even undermine the regime in Pyongyang and

ultimately lead to its collapse. But what economic interdependence can do is to make North Korea somewhat less desperate and therefore less prone to acts of terror and sabotage. And if the northern regime does eventually collapse, the social and economic effects might be somewhat less catastrophic. Therefore, as Robert A. Manning has argued, it makes strategic sense for the United States, South Korea and Japan to present North Korea with a “coordinated game plan” whereby North Korea would receive economic benefits in exchange for a willingness to reform its economy and reduce the military threat it poses.<sup>50</sup>

With the December 1997 election of Kim Dae-jung as president of South Korea, the political environment might be more conducive for an improvement in relations between Seoul and Pyongyang. Kim Dae-jung himself appears more willing to reach out toward the north, while Pyongyang probably finds the new South Korean president a much less offensive counterpart than his predecessor, Kim Young Sam. Shortly after his election, Kim Dae-jung stated that he would encourage private-sector trade and investment if Pyongyang would reduce military tensions and resume North-South talks.<sup>51</sup> But whether or not such a bargain can eventually emerge will depend not only on developments within North Korea, but also on the political spillover of South Korea’s economic crisis.

This crisis vividly demonstrates how unforgiving international financial markets in an era of global interdependence can be if a country mismanages its economy. Despite its relatively brisk growth rates, South Korea had not done enough to improve its indigenous technological base and its managerial efficiency. The cozy government-business relationship permitted the large business conglomerates (*chaebol*) to invest and diversify excessively with minimal sensitivity to market signals. A loosely regulated banking sector that was too closely tied to the *chaebol* provided no effective check on this behavior. Financial liberalization that began in the early 1990s permitted a massive inflow of short-term capital that further fueled the dubious investments. As a result, South Korea’s current account deficit climbed to \$23 billion by 1996 while its gross foreign debt grew threefold between 1990 and 1996. As in Thailand and Indonesia, an erosion of confidence in the South Korean economy prompted foreign investors to withdraw their money and to refuse to roll over short-term loans. This caused a plunge in South Korean stock prices, a sharp devaluation in the Korean won, and a rapid drain of the country’s foreign exchange reserves.<sup>52</sup>

Intervention by the International Monetary Fund (IMF) made it possible to get foreign financial institutions to agree to roll over the short-term loans. But the price of the IMF bailout has been a South Korean commitment to improve its external accounts through internal monetary and fiscal discipline and to reform its financial sector so that it is more transparent, better regulated, and more market-oriented. Although President Kim Dae-jung has vowed to implement the IMF measures, the political and social consequences are likely to be severe. Before the South Korean economy can get back on track, it will have to weather massive job losses, a significant decline in real incomes, a credit crunch, and widespread business failures. As a president elected without either a popular or parliamentary majority, Kim Dae-jung faces an uphill political battle that might undermine his ability to deal creatively with security issues.

The economic crisis poses a vexing dilemma for South Korean policy toward the North. On the one hand, with the problems they now face at home, the last thing South Koreans would want is to bear the economic and social burden of dealing with a collapsing North Korea and an abrupt reunification process. Therefore, they have a strong incentive to increase the prospects of stability and moderate reform in North Korea. On the other hand, the domestic economic challenges make it even more difficult for South Korea to offer the



North much in the way of economic incentives to move forward on North-South relations. South Korean businesses are likely to be reluctant about investing in North Korea as a way to entice Pyongyang toward economic reform and security cooperation. Some have even raised the possibility that Seoul might not be able to provide its large share of the financial support for the Korean Peninsula Energy Development Organization (KEDO)—the mechanism for implementing the October 1994 “Agreed Framework” between the United States and North Korea regarding the latter’s nuclear programs. Given this situation, a bold strategy of economic engagement will require the resources of Japan and the United States. But letting Tokyo and Washington take the lead in an economic overture to North Korea will rub against Seoul’s long-held interest in being the focal point in dealings with Pyongyang. In short, despite Kim Dae-jung’s declared intention to push forward on a dialogue with the North, the South Korean economic crisis makes close coordination among Seoul, Tokyo, and Washington regarding policy toward Pyongyang even more essential.

The problem could become further complicated if economic restructuring in South Korea leads to political instability. Political turmoil in the South might embolden North Korean leaders to engage again in terrorist and sabotage operations. Their motive might range from a wish to gain a diplomatic advantage vis-à-vis South Korea to an objective of destabilizing the South Korean regime itself. Moreover, to avert a political crisis at home, South Korean leaders might be tempted to mobilize nationalism—whether against North Korea or against American and Japanese meddling in peninsular affairs—thereby undermining a concerted campaign to engage the North. All of this suggests that deterrence and military vigilance will continue to be critical for preserving the peace on the peninsula even while exploring the use of economic incentives to get North Korean cooperation on efforts to reduce tensions. There is, however, one silver lining under this turbulent economic cloud. South Korea’s problems may make North Korea less averse to resuming the North-South dialogue. With Seoul preoccupied with internal economic challenges, Pyongyang may feel less anxious about being overwhelmed by the large gap in economic power between the two Koreas.

What are likely to be the security implications of economic interdependence after Korean reunification? A resolution of the Korean conflict will inevitably lead to some reductions of U.S. military forces in Korea and perhaps even in Japan. Americans may be eager to bring troops home, Koreans for nationalistic reasons may seek at least a partial U.S. military withdrawal, and China is likely to oppose a robust U.S. force presence on Korea without the existence of the North Korean buffer. All of this does not mean that the U.S.-ROK alliance will be terminated and that all U.S. forces will leave the Korean peninsula. But it does mean that the alliance might become looser and strategic alignments more fluid.<sup>53</sup> Under such conditions, economic factors could play a larger role in shaping the regional security configuration than in the pre-unification period.

A critical element in this equation will be the evolution of relations between Japan and a reunified Korea absent a common security threat (North Korea) and a robust U.S. military presence in the peninsula. Trade might help to mitigate the mistrust that still exists between Japan and Korea because of the legacy of Japan’s colonial rule. Japan is South Korea’s second largest trading partner (after the United States); and South Korea is Japan’s third largest trading partner (after the United States and China). But the asymmetry of bilateral interdependence could complicate political relations after reunification.

Even according to Japanese statistics, Japan’s trade surplus with South Korea has risen from about \$3.6 billion in 1988 to \$14 billion in 1995 before declining slightly to \$13.4

billion in 1996.<sup>54</sup> Although neither country has been that receptive to foreign direct investments, Japan has invested much more in South Korea than the reverse. As of 1994, the total direct investment stock from Japan to South Korea was \$5.268 billion, whereas the stock from South Korea to Japan amounted to only \$232 million.<sup>55</sup> At the microeconomic level, major South Korean corporations have relied enormously upon Japanese technology and capital equipment. Although South Koreans see Japanese business success as something to emulate, they also resent their economic dependence on Japan.<sup>56</sup> Upon reunification, Japan's financial and commercial presence on the peninsula may grow even more because South Korea would be hard put to deal with North Korea's economic reconstruction and integration on its own. The strain that West Germany has felt in absorbing East Germany has indeed been sobering to South Koreans.

To counterbalance Japanese influence, Koreans would prefer to have the United States play a major economic role in post-unification Korea. But it is by no means clear that American businesses will flock to the Korean market or that the U.S. government and financial institutions will underwrite a significant portion of the costs of invigorating northern Korea. There is even a danger that Washington could vigorously press Seoul as it has pressured Tokyo to open its markets to American goods and services. Therefore, a reunited Korea might be tempted for both economic and political reasons to offset Japanese commercial power by leaning diplomatically toward China. An attempt to balance between China and Japan would not be worrisome if Sino-Japanese and Sino-American relations are stable and cordial. But if a Korean diplomatic tilt toward China occurred in the context of Sino-Japanese tensions, then Korean-Japanese relations will become even more problematic and could spill over into the security arena. This danger suggests that strong American military and economic links ties to a reunited Korea will be critical for developing a cooperative security environment.

The future evolution of America and Japan's relations with a reunified Korea will be an important test of the liberal argument about a "democratic peace." If the liberals are right, the institutionalization of stable liberal democratic politics in Korea as well as Japan should lead these countries to prevent issues of historical memory, territorial disputes, and economic imbalances from triggering military competition and conflict between these two countries. Moreover, if China remains non-democratic, relations among Japan, a reunified Korea, and the United States should be more cooperative than relations between any one of them with China. But the question still remains whether security cooperation among these Northeast Asian liberal democratic states will require the institutional overlay of formal alliances with the United States and the forward deployment of U.S. forces in both Japan and Korea.

### **The Taiwan Question**

As in the case of Korea, the security implications of economic interdependence for the Taiwan question are ambiguous. From the beginning, economic relations across the Taiwan Strait reflected an intertwining of economic and political calculations on the part of both Beijing and Taipei. The normalization of U.S.-China relations in 1978 provided a favorable context for commercial links to develop between Taiwan and mainland China. In recognizing the People's Republic as the government of China, Washington severed diplomatic ties with the Nationalist government in Taipei and abrogated the defense treaty with Taiwan. But at the same time, the United States decided to maintain unofficial economic and cultural

links with the people on Taiwan through private agencies. Moreover, the Taiwan Relations Act of 1979 required that the executive branch provide Taiwan with the military capability to defend itself and to consult with Congress if Taiwan's security came under jeopardy. Although this formula for Sino-American normalization shocked Taiwan at first, it eventually encouraged Taiwan and the mainland to interact commercially. As China's relations with the United States and Japan improved, Beijing became less compelled to pursue an aggressive policy toward Taiwan. With Washington signaling its intent through the 1982 Sino-American communiqué on arms sales to Taiwan to gradually disengage itself from the Chinese civil war, the leaders in Taipei had strong incentives to relax tensions with the mainland.<sup>57</sup>

As Barry Naughton has pointed out, Beijing and Taipei approached the issue of cross-strait economic relations from diametrically opposed perspectives. With the admission of the People's Republic to the United Nations as the sole sovereign representative of China and Beijing's normalization of relations with both Tokyo and Washington at the expense of Taipei, the communist regime in China had emerged victorious in its diplomatic competition with its Nationalist counterpart in Taiwan. Therefore, China saw commercial ties with Taiwan as not only a way to harness the island's economic capabilities for mainland development, but also a means to drive home the notion that Taiwan was merely a province of China. Taiwan, on the other hand, sought to use its economic assets to extricate itself from its diplomatically weak position by strengthening its political status in the international arena and even seeking some flexibility from Beijing regarding the sovereignty issue.<sup>58</sup> In short, political and security considerations shaped cross-strait economic interactions from the start.

The initial overture came from Beijing. After the normalization of Sino-American relations and China's switch to an economic reform policy, Beijing sought to entice Taiwan economically. The National People's Congress proposed direct mail service, shipping, and trade between the mainland and Taiwan. In 1980 Beijing decided to permit the entry of Taiwanese manufactured products on a duty-free basis. Although Taiwan businesses leaped at this opportunity (Taiwan's exports jumped from \$21 million in 1979 to \$390 million in 1980), the Taiwanese government reacted icily with its "three no's" policy: no contacts, no negotiation, and no compromise. Given the booming exports to the U.S. market, there was little reason for Taipei to soften its tough diplomatic stance toward Beijing. When relations between Beijing and Washington soured in 1982 because of the issue of U.S. arms sales to Taiwan, China rescinded its policy of duty-free imports from Taiwan.<sup>59</sup>

During the mid-1980s, however, the incentives on both sides of the Taiwan Strait for commercial relations became stronger. Since other Asian countries began to compete for the U.S. market, Taiwan needed to upgrade its industries technologically and shed some of its labor-intensive sectors. By transferring production to low-wage countries, Taiwan businesses could develop overseas export-oriented networks and thereby continue to harvest a good return on their economic assets. Geographic proximity and cultural affinity made mainland China the most attractive target for this commercial strategy. Around the same time, the PRC government was shifting to a coastal development strategy. Although trade liberalization led to a surge in imports and a worrisome fall of China's foreign exchange reserves, a reinstatement of trade restrictions did not offer a viable long-term solution. While the drop in oil prices in 1986 intensified the need to reduce dependence on natural resource exports, the appreciation of the Japanese and Taiwanese currencies presented an opportunity to cultivate manufactured exports. From Beijing's perspective, an inflow of Taiwanese

investments into China's coastal regions provided an efficient means of developing export-oriented manufacturing industries. This convergence of Chinese and Taiwanese interests cleared the way for cross-strait economic relations.<sup>60</sup>

In 1986, Beijing adopted measures to facilitate Taiwanese investments on the mainland for labor-intensive light-manufacturing plants. Foreign firms could now invest in China without the requirement that technology had to be transferred; and once in China, these enterprises could import raw materials more easily. The central government also ended its practice of trying to micromanage foreign investment and devolved authority on such matters to local governments. Around the same time, Taipei relaxed its restrictive policies toward the mainland. In 1985, the government decided not to interfere in indirect exports to the PRC via Hong Kong. Two years later, it allowed Taiwanese citizens to visit the mainland and eliminated the need for prior approval on overseas remittances under \$5 million. Then, in 1989, Taipei explicitly authorized indirect investments to the mainland under certain conditions.<sup>61</sup>

As a result of these policy shifts, Taiwanese investments in China (much of it handled through Hong Kong) skyrocketed from about \$100 million in 1987 to over \$13.6 billion by October 1993. Two-way trade between Taiwan and the mainland also expanded from \$265 million in 1983 to about \$9.3 billion in 1993. This increase in cross-strait trade and investments yielded economic benefits for both sides. Investing in the mainland enabled Taiwan businesses to take advantage of low labor costs, develop good sources for raw materials, and access a growing market for their products. Many of the Taiwanese investments in the mainland were assembly or processing centers for manufacturing inputs shipped from Taiwan. From the mainland perspective, the commercial interactions with Taiwan contributed tremendously to the development of southeastern provinces such as Fujian and Guangdong.<sup>62</sup>

As liberal theorists might predict, these trends at first had positive security consequences. According to Jia Qingguo and Susan L. Shirk, economic interdependence transformed the cross-strait political relationship into a *détente regime* with the following features: "(1) political commitment to a peaceful international environment to promote domestic economic development; (2) development of a non-zero sum, pragmatic approach to relations; (3) emergence of a framework for competition and coexistence; and (4) acceptance of incrementalism in the development of relations."<sup>63</sup> Symptomatic of this change was the initiation of a quasi-official cross-strait dialogue.

After his 1990 election as president of the Republic of China in Taiwan, Lee Teng-hui signaled his willingness to open up completely the channels of academic, cultural, economic, and scientific exchange with the mainland on the basis of equality as a preparatory step for discussing reunification "when objective conditions are ripe." As part of this initiative, Taiwan established in February 1991 the quasi-private Strait Exchange Foundation (SEF) as the vehicle to coordinate contacts and negotiations with the mainland. After some initial misgivings, Beijing reciprocated by forming the Association for Relations Across the Strait (ARATS) as the counterpart institution in December. In April 1993, representatives from SEF and ARATS held direct talks for the first time in the neutral location of Singapore. The meeting yielded agreements on the cross-delivery of registered mail, a schedule for future contacts, and a list of topics for future discussion. Despite deep differences concerning Taiwan's foreign arms purchases, its quest for participation in international organizations, and the treatment of the sovereignty issue, the SEF-ARATS process held the promise of easing tensions across the strait.<sup>64</sup>

But subsequent developments demonstrated emphatically that increasing economic interdependence was not sufficient to overcome divergent political and security interests. To its dismay, Taiwan found that its economic contribution to mainland development did not produce concessions from Beijing on the issue of political sovereignty. The PRC instead acquiesced to Taiwan's membership in such regional economic organizations as the Asian Development Bank and the Asia Pacific Economic Cooperation (APEC) forum only under the condition that it participated under the name "Taipei, China" or "Chinese Taipei."<sup>65</sup>

Frustrated by Beijing's inflexibility, Taiwan launched an energetic campaign to achieve greater international recognition and to extricate itself from the diplomatic wilderness to which it had been banished. This effort resonated with the local populace. Although the cross-strait commercial interactions increased Taiwan's economic stake in good relations with the mainland, they also ironically accentuated for the Taiwanese the sharp differences the two sides had in terms of both culture and levels of economic development.<sup>66</sup> As a result, the ultimate objective of Chinese reunification lost its appeal, especially among the indigent population; and Taipei gradually dropped its sovereignty claim over the mainland.

Countries that were eager to receive Taiwanese investments became more receptive to visiting Taiwan authorities—even those states which had diplomatic relations with the PRC and not the government in Taiwan. Perhaps an even greater international asset for Taiwan was its successful transition to democratic politics. The sharp contrast this evolution made with the repression at Tiananmen enhanced Taiwan's stature abroad, in particular in the United States. Therefore, under pressure from the U.S. Congress, the Clinton administration was forced to permit Taiwan president Lee Teng-hui to make an "unofficial" visit to the United States in June 1995.

This diplomatic coup by Taipei alarmed Beijing that Taiwan might succeed in breaking out of the "one-China" framework that had been the basis of Sino-American normalization and even cross-strait détente. The PRC responded with military intimidation. Soon after President Lee's trip to the United States, the Chinese conducted a series of military exercises, including missile tests near Taiwan's northern coast. The missile firings in March 1996 were timed to threaten the Taiwanese psychologically just before they voted in their first popular presidential election. But Washington demonstrated its support of Taiwan by dispatching two carrier battle groups to the area. In the wake of this crisis, Beijing stopped the ARATS-SEF dialogue.

Despite these tensions, economic interactions across the strait have continued to develop. In 1996, two-way trade was over \$21 billion, and Taiwanese investments in the mainland amounted to about \$30 billion.<sup>67</sup> But fear on both sides has hindered attempts to translate this economic interdependence into positive political dialogue.

Taipei fears an increase in the mainland's economic leverage over Taiwan. In many ways, Taiwan is now economically more dependent on mainland China than the latter is on the former.<sup>68</sup> Cross-strait trade assumes a larger portion of foreign trade for Taiwan than for the China mainland. Being a much smaller entity, Taiwan relies much more on international trade generally for its economic well-being than China does. Of course, a break in its economic interactions with Taiwan would have significant negative repercussions for China, especially the provinces with extensive commercial links across the strait. But in strictly economic terms, China is likely to weather such a rupture better than Taiwan. This asymmetry could make Taiwan vulnerable to Chinese economic coercion. Taiwan's political leaders fear that Beijing will drive a wedge between the Taiwanese government and the island's business community as it did in Hong Kong in the context of reversion. By

encouraging investments in the mainland, Beijing may try to get influential Taiwanese business leaders to openly oppose Taipei's tough policies toward Beijing.<sup>69</sup>

This concern has prompted President Lee to sustain the policy of no direct economic links between Taiwan and the mainland despite growing support among some quarters of the Taiwanese business community for relaxing this prohibition. In 1994, the Taiwan government launched a "go South" campaign of encouraging economic ties with the Southeast Asian countries. In the wake of the 1997 East Asian economic crisis, the Lee government has revived this policy by seeking to use financial assistance and investments to nurture friendships with neighboring countries in distress. Taipei has also used checkbook diplomacy in Latin America to buttress diplomatic loyalty to Taiwan. The overall purpose of these efforts is to prevent a further slide in Taiwan's position in the international community and to shore up its diplomatic leverage vis-à-vis the mainland.<sup>70</sup>

But this international campaign by Taipei worries Beijing because it could strengthen the pro-independence forces in Taiwan, especially in the context of the island's democratization. Therefore, contrary to the liberal thesis about a democratic peace, electoral politics in Taiwan could aggravate, rather than ameliorate, cross-strait tensions. Beijing fears that the Taiwanese majority will become increasingly vocal about its desire for political independence and less supportive of the Kuomintang's platform of ultimate reunification with China. The stunning victory by the Democratic Progressive Party in Taiwan's November 1997 local elections has certainly reinforced these concerns. There is now a real possibility that this pro-independence party might capture the Taiwan presidency in 2000.<sup>71</sup> Beijing's nightmare would be a Taiwan referendum vote for independence after the election of a DPP president. Arguably, democratization of mainland China might make it easier to resolve the Taiwan question because the Taiwanese may become less adverse to reunification with the mainland and Beijing may be more willing to accept some sort of loose Chinese federation. But given the widespread support in China for reunification and opposition against Taiwan's independence, it is more likely that Chinese political liberalization will make it even more difficult for Beijing to compromise on this issue.

If liberal optimism about Taiwan is misguided, realist arguments about how to handle the Taiwan question also encounter problems. Realists would stress the importance of military deterrence, rather than economic interdependence, for preserving peace across the Taiwan Strait. At this point, Taiwan according to most experts has the military capability to resist aggression from the mainland.<sup>72</sup> Moreover, the implicit security relationship between Taiwan and the United States via the Taiwan Relations Act and American arms sales to Taiwan should be enough to deter Beijing from trying to reunify China through the use of force.

But from the mainland's perspective, the salient issue is not how to achieve reunification at an early date, but how to prevent Taiwan from moving toward formal independence. Although economic inducements might be helpful in this regard, Taiwan's campaign for international recognition and political uncertainties due to democratization have convinced mainland leaders that such measures are insufficient and that military intimidation might be necessary to keep Taiwan at bay.<sup>73</sup> But the crisis of 1995-96 demonstrated that such intimidation could be neutralized by U.S. military power. In fact, the danger for Beijing is that the more it intimidates Taiwan militarily, the more it might strengthen the security link between Washington and Taipei. This will in turn weaken Taipei's incentives to accommodate Beijing's interests on the sovereignty issue. In fact, it might even buttress Taiwanese desire for independence.

One way out of this dilemma is for China to develop the military capabilities, including nuclear weapons, that could effectively challenge the United States in a military face-off over Taiwan. Beijing's calculation would then be that Americans have less of an interest in risking a Sino-American military conflict over Taiwan than the Chinese do. But such a course entails the danger of an arms race not only between Taiwan and the mainland, but also between China and the United States. To prevent a military miscalculation in this context, some realists on the American side might favor an *explicit* U.S. defense commitment for Taiwan to deter a Chinese threat. While this might make sense in pure military terms, the political cost would be the collapse of the "one-China" framework that has been the basis of Sino-American normalization and subsequent relations.

The crux of the problem lies in the difficulty in determining which side has the revisionist agenda: Taiwan or mainland China. Beijing believes that it is Taipei that is trying to change the "status quo" of the "one-China" framework. But Taipei insists that it is merely seeking international recognition for the reality that currently exists: Taiwan as a prosperous and democratic entity that has de facto independence from China. As long as this core issue is hotly contested, the power of commercial ties to dissolve political differences will be limited.

To reduce the risk of a military clash, the prudent course would therefore be to develop a modus vivendi that might be acceptable to the three key parties in this conflict: the United States, China, and Taiwan. One possible formula is the one proposed by Joseph S. Nye. As part of its policy of "one China" and "no use of force" for reunification, Washington would state it would neither recognize nor defend Taiwan if it declared independence. Beijing, in turn, would not oppose Taiwan's quest for "more international living space" including participation in various international forums. It would also expand its "one-country, two systems" approach by recognizing Taiwan's right to maintain its political and social as well as economic systems. Finally, Taipei would renounce its "steps toward independence," move forward on the cross-strait dialogue, and encourage more investments and exchanges of people between Taiwan and the mainland. Such a deal would certainly improve the chances that economic interdependence will be a force for stability, rather than instability, across the Taiwan Strait.

## Conclusion

On balance, increasing economic interdependence in Northeast Asia has fostered a more stable and peaceful regional security environment. It goes without saying that it is much better to have nation-states focus on economic development through foreign trade and investments than on enhancing national power through military expansion. Mutual economic interests have played an important role in improving relations among the four major powers of Northeast Asia—or at least encouraging restraint regarding trade, political, or even territorial disputes. Although the region lacks multilateral institutions comparable to Europe, the recent "concerted" improvement of bilateral relations will help promote military exchanges and cooperative security norms that might eventually evolve into formal institutions.

So far, the East Asian economic crisis has not caused the major powers to pursue malevolent mercantilism. Instead they have tried within the constraints of domestic politics to cooperate explicitly and implicitly to deal with this regional turbulence. Of course, if the

economic situation worsens, interstate relations could deteriorate under the strain of trade conflicts. The temptation to adopt “beggar-thy-neighbor” policies would become harder to resist—especially since interdependence in Northeast Asia is still too asymmetrical and shallow to produce the kind of economic and political integration that is emerging in Europe. This danger suggests that while economic interdependence might ultimately support mutual security, it would be imprudent to rely solely on this factor for regional stability and peace and to abandon existing security alliances and military postures designed to deter aggression.

Over time, differential rates of economic growth will inevitably shift the regional balance of power, most likely in China’s favor. The challenge will be adjusting to this power shift in a manner that minimizes the danger of great-power rivalry and war. Since China is unlikely to have the capacity to match the United States militarily in East Asia during the next fifteen to twenty years, there is now a window of opportunity to convince China that its long-term interests are better served by cooperating with the rest of region and by eschewing aggressive military behavior. This can be best done by bringing China into the international economic system, showing how transnational commercial ties can benefit the Chinese people, and persuading Chinese leaders that cooperative security norms (including military transparency and other confidence-building measures) will make their nation more secure than unrestrained military modernization. If China evolves toward a stable liberal democracy in the course of its economic development, so much the better. The liberal dream of a democratic peace might eventually become a reality even in Northeast Asia.

If a liberal strategy to engage and incorporate China into a cooperative regional order fails, a balance of power may become necessary to deter China. In a multipolar system, the efficacy of such a realist strategy will depend in large part on the sustainability of the U.S.-Japan alliance. In the face of a rising China, Japan will have strong geopolitical reasons to maintain its alliance with the United States. More worrisome will be American policy. After Korean reconciliation or reunification and *before* China’s emergence as a military challenger, the United States might be tempted to downgrade its security ties with Japan and other East Asian countries, even to disengage itself militarily. This danger implies that the U.S.-Japan alliance should not be based primarily around a common military threat. It needs to have a firmer foundation in mutual economic interests and shared values. Although the existing pattern of regional interdependence does reinforce the strategic partnership between Japan and the United States, both Tokyo and Washington must do a better job of mitigating bilateral economic imbalances and managing trade disputes so as not to dissipate the reservoir of mutual goodwill. Otherwise, the attraction of a growing Chinese market could lull Americans and Japanese into neglecting or even diluting their security relationship.

The Korea and Taiwan questions illustrate how complicated the interrelationship between economic interdependence and security is. At first sight, North Korea’s problems suggest an opportunity to use positive economic inducements to encourage reform in North Korea and to reduce tensions on the Korean peninsula. But Pyongyang’s sense of vulnerability has driven it to play a dangerous game of brinkmanship even while being desperate for international assistance. The economic crisis in South Korea has increased its incentives to prevent a sudden collapse of the North Korean regime, but it now has fewer resources to pursue a bold strategy of economic engagement toward the north. Regarding Taiwan, commercial interactions did promote détente between Beijing and Taipei up to a point. But divergent political and diplomatic objectives not only prevented the two sides from moving



toward reconciliation, but also provoked military tensions across the Taiwan Strait even as economic links between Taiwan and the mainland deepened.

In short, the impact of economic interdependence on security is not as straightforward as many international relations theorists imply. Much depends upon the concrete political and diplomatic context. Although economic forces have the potential to mitigate geopolitical tensions under certain circumstances, they can also exacerbate them under other conditions. While economic interests might moderate state behavior in the security arena, they are unlikely to eclipse the core political and security interests of nation-states. Since so many factors can and do come into play, the task of constructing an overarching theory that is elegant and parsimonious is daunting, if not impossible. Therefore, in a region as dynamic, uncertain, and complex as Northeast Asia, prudence suggests that policymakers adopt an eclectic approach tailored to particular situations that draws upon the insights of all three theoretical traditions (liberal, realist, and critical) summarized at the beginning of this paper.

## Notes

<sup>1</sup> One might also include Canada and Mongolia in this regional system for geographic reasons, but their strategic impact is much more limited than those of the other seven states.

<sup>2</sup> Robert O. Keohane and Joseph S. Nye, *Power and Interdependence: World Politics in Transition* (Boston: Little, Brown, and Company, 1977), 8–9.

<sup>3</sup> The classic formulation of this argument is, of course, Adam Smith, *Wealth of Nations*.

<sup>4</sup> Richard Rosecrance, *The Rise of the Trading State: Commerce and Conquest in the Modern World* (New York: Basic Books, 1986); and John J. Weltman, “On the Obsolescence of War: An Essay in Policy and Theory,” *International Studies Quarterly* 18, no. 4 (December 1974): 395–416.

<sup>5</sup> Mataka Kamiya, “Hopeful Uncertainty: Asia-Pacific Security in Transition,” *Asia-Pacific Review* 3, no. 1 (Spring/Summer 1996): 114.

<sup>6</sup> John Mueller, *Retreat from Doomsday: The Obsolescence of Major War* (New York: Basic Books, 1989), 217–244.

<sup>7</sup> For a discussion of how the United States has promoted multilateral institutions for international cooperation as part of its liberal international agenda, see John Ikenberry, “The Myth of Post–Cold War Chaos,” *Foreign Affairs* 75, no. 3 (May/June 1996): 79–91.

<sup>8</sup> Joseph S. Nye, Jr., “Neorealism and Neoliberalism,” *World Politics* 40, no. 2 (January 1988): 245–251.

<sup>9</sup> Joseph Schumpeter, “The Sociology of Imperialisms,” in *Imperialism and Social Classes* (Cleveland: World Publishing, 1955), 3–98.

<sup>10</sup> Michael W. Doyle, *Ways of War and Peace: Realism, Liberalism, and Socialism* (New York: W.W. Norton & Company, 1997), 205–300.

<sup>11</sup> Kaname Akamatsu, “A Historical Pattern of Economic Growth in Developing Countries,” *The Developing Economies*, no. 1 (March/August 1962): 3–25; Ippei Yamazawa, *Economic Development and International Trade: The Japanese Model* (Honolulu: East-West Center, 1990); Watanabe Toshio, *Kaihatsu keizai 2nd edition: Keizaigaku to gendai Ajia* (Tokyo: Nihon Hyoronsha, 1996). For a critical analysis of the flying-geese model, see Mitchell

Bernard and John Ravenhill, "Beyond Product Cycles and Flying Geese: Regionalization, Hierarchy, and the Industrialization of East Asia," *World Politics* 47 (January 1995): 171–209.

<sup>12</sup> Takuma Takahashi, "Economic Interdependence and Security in the East Asia-Pacific Region," in Mike M. Mochizuki, ed., *Toward A True Alliance: Restructuring U.S.-Japan Security Relations* (Washington, D.C.: Brookings Institution Press, 1997), 96–133.

<sup>13</sup> A case for bipolarity is made in Kenneth Waltz, *The Theory of International Politics* (Reading, MA: Addison Wesley, 1979); and an argument for multipolarity appears in Arnold Wolfers, *Discord and Collaboration: Essays on International Politics* (Baltimore: The Johns Hopkins University Press, 1962), 117–131.

<sup>14</sup> Robert Gilpin, *War and Change in World Politics* (Cambridge: Cambridge University Press, 1981).

<sup>15</sup> According to this theory, when the distribution of power is relatively uniform, states do deter aggression by balancing against threatening states. Likewise, when the power distribution is skewed toward a single state, wars will be prevented or at least contained by the hegemonic power. But the most problematic power distribution is one in which there is a moderate imbalance. Such a system makes timely balancing behavior more uncertain and can lead to miscalculations that trigger war. Edward D. Mansfield, *Power, Trade, and War* (Princeton: Princeton University Press, 1994), 17–21, 71–116, and 226–230.

<sup>16</sup> Donald Kagan, *On the Origins of War and the Preservation of Peace* (New York: Doubleday, 1995).

<sup>17</sup> Robert Jervis, "Cooperation under the Security Dilemma," *World Politics* 30, no. 1 (January 1978): 167–214.

<sup>18</sup> Kenneth Waltz, *Theory of International Politics* (New York: Random House, 1979), 106.

<sup>19</sup> The security effect of interdependence will depend on the value that states place on different factors of interdependency. Some factors of international economic transactions may be more important to national survival and core values than others. The realist logic is more likely to operate than the liberal one when critical economic factors are vulnerable. For example, states will be more assertive in the political-military realm to reduce vulnerabilities regarding food supply, critical raw materials, and vital technologies (especially with direct military implications) than trade in non-essential consumer items. Wars have often been fought to secure oil supplies, but it is hard to imagine that a country will go to war to preserve access to foreign automobile markets. But the importance of factors of interdependency may depend not only on their intrinsic value, but also on their political implications. The cutoff of auto trade may not be a direct cause of security assertiveness, but it could impose severe social costs that feed into the political process, ultimately producing aggressive nationalism.

<sup>20</sup> Robert Gilpin, *The Political Economy of International Relations* (Princeton: Princeton University Press, 1987), 404–405.

<sup>21</sup> Dale C. Copeland, "Economic Interdependence and War: A Theory of Trade Expectations," *International Security* 20, no. 4 (Spring 1996): 5–41.

<sup>22</sup> Paul A. Papayoanou, "Interdependence, Institutions, and the Balance of Power: Britain, Germany, and World War I," *International Security* 20, no. 4 (Spring 1996): 42–76.

- <sup>23</sup> Robert C. Tucker (ed.), *The Lenin Anthology* (New York: W.W. Norton, 1975), 204–274. For a good discussion of Lenin's views on war and revolution, see Michael W. Doyle, *Ways of War and Peace: Realism, Liberalism, and Socialism* (New York: W.W. Norton & Company, 1997), 340–364.
- <sup>24</sup> André Gunder Frank, *Capitalism and Underdevelopment in Latin America* (New York: Monthly Review Press, 1967). For a critical survey of dependency theories, see Anthony Brewer, *Marxist Theories of Imperialism: A Critical Survey* (London: Routledge & Kegan Paul, 1980), 131–257.
- <sup>25</sup> Immanuel Wallerstein, *The Capitalist World-Economy* (Cambridge: Cambridge University Press, 1979), 1–36, 66–94; and *The Politics of the World-Economy* (Cambridge: Cambridge University Press, 1984), 13–26.
- <sup>26</sup> Immanuel Wallerstein, *The Politics of the World-Economy* (Cambridge: Cambridge University Press, 1984), 37–46; and *After Liberalism* (New York: The New Press, 1995), 25–45.
- <sup>27</sup> Lester C. Thurow, *The Future of Capitalism* (New York: William Morrow and Company, 1996), 211–220.
- <sup>28</sup> Charles P. Kindleberger, *Manias, Panics, and Crashes: A History of Financial Crises* third edition (New York: John Wiley & Sons, 1993); George Soros, *The Alchemy of Finance* (New York: John Wiley and Sons, 1994); and Lester C. Thurow, *The Future of Capitalism* (New York: William Morrow and Company, 1996), 220–231.
- <sup>29</sup> Edward D. Mansfield and Jack Snyder, “Democratization and the Danger of War,” *International Security* 20, no. 1 (Summer 1995): 5–38.
- <sup>30</sup> Susan Strange, *The Retreat of the State: The Diffusion of Power in the World Economy* (Cambridge: Cambridge University Press, 1996), 69, 73, 81–82, 110–121, and 189–190.
- <sup>31</sup> U.S. Department of Commerce data cited in “Statistical Profile: International Transactions of Japan and the United States in 1995,” *JEI [Japan Economic Institute] Report* No. 34A (September 13, 1996): 35.
- <sup>32</sup> Dennis J. Encarnation, *Rivals beyond Trade: America versus Japan in Global Competition* (Ithaca: Cornell University Press, 1992).
- <sup>33</sup> Robert Gilpin, *The Political Economy of International Relations* (Princeton: Princeton University Press, 1987), 6, 328–339.
- <sup>34</sup> OECD, *International Direct Investment Statistics Yearbook* 1996.
- <sup>35</sup> Yoichi Funabashi, *Asia Pacific Fusion: Japan's Role in APEC* (Washington, D.C.: Institute for International Economics, 1995).
- <sup>36</sup> Michael Leifer, *The ASEAN Regional Forum*, Adelphi Paper of the IISS No. 302 (Oxford: Oxford University Press, 1996); and Sato Yukio, “1995-nen no fushime ni mukatte: Ajia Taiheiyo Chi-iki no anzen hosho,” *Gaiko Forum* No. 64 (January 1994): 18–22.
- <sup>37</sup> *IGCC Newsletter* Vol. 12, Nos. 1 & 2 (Spring and Fall 1996).
- <sup>38</sup> Andrew J. Nathan, “China's Constitutionalist Option,” *Journal of Democracy* 7, no. 4 (October 1996): 43–57.
- <sup>39</sup> World Bank growth estimates as reported in the *Central Intelligence Factbook*, 1995.
- <sup>40</sup> Ronald Montaperto and Karl Eikenberry, “Paper Tiger: A Skeptical Appraisal of China's Military Might,” *Harvard International Review* 18, no. 2 (Spring 1996): 28–31; Paul H. B.

Godwin, "From Continent to Periphery: PLA Doctrine, Strategy and Capabilities," *The China Quarterly*, no. 146 (June 1996): 464-487.

<sup>41</sup> Aaron L. Friedberg, "Ripe for Rivalry: Prospects for Peace in a Multipolar Asia," *International Security* 18, no. 3 (Winter 1993/94): 5-32.

<sup>42</sup> Robert S. Ross, "China II: Beijing As a Conservative Power," *Foreign Affairs* 76, no. 2 (March/April 1997): 33-44.

<sup>43</sup> Arthur Waldron, "Deterring China," *Commentary* 100, no. 4 (October 1996): 17-21.

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