Security Rivalry between the US and China under Conditions of Economic Interdependence

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ABSTRACT

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Security Rivalry between the US and China under Conditions of Economic Interdependence

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This thesis focuses on a special sphere of the bilateral relations between the US and China – the problematique of security rivalry under conditions of economic interdependence. This question is central to the theoretical dispute between realists and non-realists, including complex interdependence theorists, about what will dominate the international system in the future. While being mutually beneficial, bilateral trade involves a range of complicated processes related to the military sphere, energy resources, national welfare, and the environment. The main argument of this thesis is that these problems are unlikely to cause a major conflict between the current leader – the US – and the rising power – China. The interdependence that has developed through years between these two nations will minimize the possibility of conflict in both economic and military areas, and will prevent the outbreak of war. I further argue that both sides will make efforts to prevent any existing areas of tensions from affecting their relationship in general. In other words, there are grounds to believe that both countries will prefer to preserve the current state of affairs, and the rules of the game, which constitute the overall predominance of economic issues over security in the bilateral relations.
To my Parents without whom I would never make it to graduate school in America
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CHAPTER 1: INTRODUCTION

The People's Republic of China is not only a country that draws a great deal of attention from the global community nowadays, but it is also the one that provokes a large amount of controversy, anxiety, and questions about the future development of international relations in general. Rising China's potential rivalry with the US, the current world leader, might change the existing world structure and balances of power forever. China is the most populous country in the world and promises to become the world's largest economy in the near future. Today, China has already become the world's largest creditor and one of the major recipients of foreign investment. The beginning of the 21st century marked significant achievements in Chinese industry, urbanization, and living standards. Along with its increased military power, these factors underlie the situation of general growth of the role of PRC in the world and highlight the necessity of considering its opinion in regional and global affairs. The international community does see China as an important player in the world arena, even though the communication process might often be impeded by cultural differences between the Western states and the Asian giant, as well as by the fact that PRC is still a partially centrally planned command economy, and a communist regime.

This research focuses on a special sphere of the bilateral relations between the US and China – the problematique of security rivalry under conditions of economic interdependence. This is one of the most important issues in international relations today. Will the future bring a rise in security rivalry and economic conflict that disrupts the
international order and poisons relations between states, especially between the US and China, or will the future involve security and economic disputes, but disputes that remain muted and restrained because of economic interdependence. This question is central to the theoretical dispute between realists and non-realists, including complex interdependence theorists, about what will dominate the international system in the future. "Rivalry" in this context implies actual military conflict, and major economic problems between two countries are referred as "economic conflict."

While the traditional realist approach would suggest that, as a rising power, China should challenge US leadership in world affairs, the theory of complex interdependence suggests otherwise. Being the world's current largest economy and the global leader, the United States is the first country that has to deal with the growing power of China. Political relations between the two states have undergone different stages of warming and cooling, including the Cold War, the collapse of the Soviet Union – which made the US an indisputable sole superpower – and the revival of international terrorism in the most recent period. Any existing contradictions and disagreements between Washington D.C. and Beijing on world affairs, regional disputes, or problem of human rights in PRC now pale beside their economic interdependence that developed during the last decades. This interdependence has become irreversible and tends to dictate both American and Chinese policies towards each other, as well as within international organizations.

Thus, the conflict between the realists and the theorists of complex interdependence lies in a different interpretation of relations between a world leader and a
rising power, as well as a different expected outcome of these relations. The first group bases their arguments on long historic experience; the second proposes a relatively newer approach and considers substantial changes that have occurred to the global society during the last several decades, along with the irreversible transformation of the world's economy.

The question of this economic interdependence has been a controversial issue that provokes much debate. While being mutually beneficial, the bilateral and interlocking multilateral trade involves a range of various complicated processes related to the military sphere, energy resources, national welfare, and the environment. The total bilateral trade between China and the USA grew from two billion dollars in 1979 to 539 billion dollars in 2011. The US export of private commercial services increased by 393% since 2000 and accounted for 24.7 billion dollars in 2011. China is the second largest agricultural market for the US, and the fourth largest supplier of agricultural products. The US foreign direct investment in China, which is mostly provided by the manufacturing and banking sectors, accounted for 60.5 billion dollars in 2010 (Office of the United States Trade Representative). The major economic conflicts in US-China economic relations include the Chinese trade surplus that threatens the American economy, China's currency – which is widely considered to be undervalued, illegal acquisition of American high technologies and other violations of intellectual property rights by China, and jobs losses in America due to the market being flooded by the Chinese dumping goods. These problems supplement the long-lived security conflict over Taiwan, as well as some other issues related to disputed territories.
The main argument of this thesis, however, is that these problems listed above are unlikely to cause a major conflict between the two nations. The interdependence that has developed through years will minimize the possibility of conflict in both economic and military areas, and will prevent the outbreak of war. Thus, the cases represented in the research are China and the US, and the analysis is conducted using the method of historical comparison with reliance on secondary sources. This method was chosen because, in this case, close examination of the processes of historical development of the two countries with consideration of various economic, cultural, and social factors makes it possible to comprehend and evaluate the realities of today. In this thesis, these issues will be brought together and presented in a new light.

China is definitely becoming a powerful regional military force, and potentially a global power. However, it does not seek to dominate in its region, or in the world. The country is not likely to challenge the US military, and is focused on its domestic problems. However, China does not agree with the increasing military presence of the US in the region. Also, the transformation of China into a global military power will require several more decades. Although China's economy will surpass the US economy by size, they will not be equal in terms of composition due to the existence of underdeveloped regions in China (Nye 2013, 6 March 2013), as well as China's technological backwardness. A similar assertion would be relevant for the military sphere: China's military budget fails to counterbalance the American one, and China's armed forces are inferior to the US forces in both quantitative and qualitative senses.
It also should be mentioned that the US and China are parts of the international community. The global economy will have to be rebalanced in the years to come, because China is not the only country with a growing population and growing economic might. The American public after the challenge of the global crisis will have to make some adjustments to their consumption style, i.e. spend less and save more. The tendency of China's imposing trade barriers and manipulating its currency is going to continue, because it is still more profitable for the foreign multinational corporations than a situation in which China isolates itself (Etzioni 2011, 647-666). China has its own leverage that it uses to neutralize the pressure from the US or other countries; so does the US. The actual conflict is against the interests of both participants of this relationship.
CHAPTER 2: LITERATURE REVIEW

It is understandable that international relations was interpreted in the second half of the 20th century through the lens of realism. Redistribution of power after the Second World War, hostilities between the capitalist world and the communist world, the arms race, and the threat of nuclear war offered a clear set of variables to take into consideration when explaining the situation in the world. A number of scholars emphasized the realist approach in interpreting international relations. However, over the years the way of seeing global affairs only in terms of struggle for power may have lost its relevance, and the current situation requires a new interpretation. That is why Realism is compared and contrasted with a different set of approaches in this chapter.

In order to contrast realist approaches and reveal their shortcomings in explaining modern international relations, the theory of complex interdependence by neoliberals Robert Keohane and Joseph Nye is examined in this thesis. This theory first came to light at the end of the 1970's and was then developed with consideration of the events in a changing world. Views of other authors, writing well after the first works on complex interdependence appeared, will also be presented on economic interdependence and its impact on and implications for international relations. In particular, Mark J. Gasiorowski, as well as Katherine Barbieri were interested in whether interdependence between countries was favorable to cooperative relations or tended to lead to conflict. Michael Mastanduno, in turn, highlighted the forming of linkage between economics and security in US politics in the 1990's.
Therefore, the ideas and theories above are supposed to help analyze one of the major problems in international relations nowadays. Economic interdependence, as well as the increased role of economy in IR in general, have already become natural trends in global politics. Security issues, however, have also acquired importance in the face of new challenges to the democratic states' well-being. Thus, the problem of current and potential security rivalries should be considered while taking into account the reality of economic interdependence among countries.

Realist Robert Gilpin in his book *War and Change in World Politics* asserts that the main objective of states was always to conquer territory, influence other states' behavior, and dominate the world economically (Gilpin 1981). A state's overall power is reflected in its prestige in the interrelated world of international actors, and the weakening of its power causes conflict, and therefore change in the system (Gilpin 1981). More generally, weakening or strengthening of a state causes realignment of forces, and in particular, a rising dominant power should seek to replace the existing, declining dominant power (Gilpin 1981). This suggests that the rise of China should lead it to challenge the US and increase security and economic rivalry.

Similarly, Vladimir Lenin in his work "Imperialism, as a special stage of capitalism," states that annexation is a vital component of imperialist and capitalist politics. Because there is a struggle for hegemony between the few major world powers, each of them endeavors to conquer territory in order to strengthen itself and weaken an adversary at the same time (Lenin 1917, 109). According to him, such struggle took place between Germany, Great Britain, and the US in the beginning of the 20th century as they
were the dominant power. Lenin predicted the future involvement of East Asia in these conflicts, which would be induced by the growth of Asian economies, as well as by general trends in world affairs (Lenin 1917, 115).

Kenneth Waltz asserts that a world structure under hegemony is a basis for stability because the leader in such a structure does not have the need to provoke conflicts, and the other states are not able to do so. Decline in a hegemony, however, should provide the possibility for a rising power to challenge the current position of the hegemon. One of the signs of a declining state would be an aggression towards other actors, which is expressed in foreign wars that are waged in order to distract the population from domestic problems (Waltz 1993, 76). In a more recent work, Waltz also states that the US military presence in Asia indicates American attempts to prevent the formation of a new power balance in the region. However, he claims that these efforts will only provoke the other participants to offer resistance while the US will be running out of its economic, military, and political power. This, eventually, will lead to better possibilities for new rising powers to rebalance the current situation (Waltz 2000, 36).

John Mearsheimer demonstrates an even more uncompromising approach to the future of China as a rising power. It is highlighted that Chinese economic potential is still positively great, and the country's growth rates would be even higher but for certain social and political obstacles. Therefore, the rising China will convert its economic strength into military power (Mearsheimer 2005, 50). Mearsheimer claims that the major goal of any nation is maximizing its power and, subsequently, domination in the world because this is the most effective way to protect itself said nation from the obscure
intentions of other actors. After achievement of hegemony, a state has to eliminate potential competitors and prevent the emergence of another regional hegemon. For China's case, then, the US is aimed at maintaining the balance of several powers in Asia; however, with the rise of China and the decline of Japan (and the US) this balance becomes elusive. Thus, a peaceful rise of PRC is not considered an option, and the security conflict up to a war between China and the US is basically inevitable (Mearsheimer 2005, 47).

However, in the light of the new realities of the 1970s and after the realist approach started to display its weaknesses. A remarkable effort to challenge the established views was made already in 1977 by neoliberal institutionalists Robert Keohane and Joseph Nye in their book *Power and Interdependence*. The authors proposed complex interdependence as an alternative to realism (Keohane and Nye 2001). The theory of complex interdependence is a part of neoliberal institutionalism that focuses specifically on the issue of the connections between security rivalry and economic interdependence. While other neoliberal works by Keohane and Nye discuss such problems as cooperation among countries under anarchy more generally, the complex interdependence theory directly addresses the relationship between security rivalry and economic interdependence.

By questioning all the major assumptions made by realists, Keohane and Nye built their own theory about new world structure. The key points proposed by realists include the idea that the primary integrated unit in the world affairs is the state, and it uses force as the principal instrument for any activities. Thus, in realist thought, military
security of a state is of the first importance and it basically predetermines the well-being and independence of the state. This all also implies that any state acts solely out of its national interests, and interacts with other states for the same purpose. The attainment of military force is an end in itself because it indicates the freedom of action for the state (Keohane and Nye 2001).

As opposed to the realism view, complex interdependence theory suggests that the communication among states is characterized not only by the governments' relations, but also, and probably more importantly, by the whole web of formal and informal ties between actors from each of the sides. In this context, a large role is given to transnational organizations. Most importantly, a hierarchy between security and economic issues does not exist. Security and economic issues might acquire various degree of importance for different participants in the system. Security issues do not dominate the affairs, and moreover, the boundaries between domestic and foreign problems blur. Use of military force as a major instrument recedes into the background, and becomes completely irrelevant in case of many issues, such as economic ones (Keohane and Nye 2001).

The goals each state pursues in the world of complex interdependence are numerous, and no state should be able to dominate in the decision-making process. Powerful states might endeavor to use their military force to influence the developments, but it will often be less effective because other international actors resist their attempts to affect world politics in a way that is only beneficial to themselves. Also, whereas for realists all the issues could become important only if related to security, under the
complex interdependence basically any problem might become prominent. Because of the ever-present interconnections, foreign issues might start to concern any country, and this country might politicize its domestic problem and bring it to the global level as well. Generally, the scale of issues is hard to determine because it is dependent on the perception and interpretation of various groups within the society (Keohane and Nye 2001).

Keohane and Nye, however, leave certain qualifications for the importance of using military power under the conditions of complex interdependence. Such necessity can be caused by dramatic social and political changes within a country, and the force instrument is possible to dominate. Besides, in the case when a more powerful country protects a weaker one, it also might imply the exercise of certain political influence on the protected state. Overall, it should be mentioned that the views presented in the book were impacted by the atmosphere of the 1970's with painful situation around the Vietnam War, decrease in acuteness of the nuclear arm race, oil crises, and such an important shift in the world political economy as the collapse of Bretton Woods system. The complex interdependence approach implies quite different implications for relations between the US and China in the future.

Further development of the interdependence theory and its mutation over the years, as well as the application of the theory to the current situation, should be made after clarification of some crucial points in this discussion. While the constructed "ideal type" of interdependence – the complex interdependence – could oppose the realists view, in reality, the Keohane and Nye's theory was supposed to collaborate with realism,
and in a sense supplement it. This situation is explained by the fact that in practice the interdependence is asymmetrical, and states use their advantages in different spheres as an instrument of power. Interdependence does not imply universal benefits either: it rather describes the structure of the relations that exist among the countries, and does not necessarily result in any forms of cooperation among them (Keohane and Nye Jr. 1987, 730).

A concept related to interdependence theory, which was presented decade few years later, is the concept of international regimes (Keohane and Nye Jr. 1987). This idea embraced the activities related to some sort of collective behavior of the states under the influence of the existing institutional structure of the world affairs. The relevance to complex interdependency theory manifests in the interrelation of international regimes and domestic policies of the states, the situation when international structure affects domestic developments, and vice versa.

The interdependence within international regimes would help decrease the uncertainty, and even eventually affect the perception of self-interests by domestic groups (Keohane and Nye Jr. 1987, 743). Besides, international regimes might impose certain restrictions on the states' behavior, and even if these measures seem sometimes to be ineffective for the powerful states, nevertheless in the long run the effects can be recognized. Such notion as states' reputation becomes more prominent in this context, and this is another evidence of the reduced importance of military power.

In yet another work devoted to power and interdependence, which was presented by the authors in 1998, the same concepts are now considered in the light of the great
achievements of the world's science and communication, as well as other globalization-related trends. Keohane and Nye argue that despite the colossal development of the international society at the end of the 20th century, and in particular despite the increase in availability and expansion of contact channels, which are the necessary requirement for the interdependent world, other aspects still lack major preconditions for the atmosphere of interdependence. It happens because the information revolution still does not connect millions of people all over the world, and because military power still can sometimes play a crucial role in the world affairs (Keohane and Nye 1998, 82).

The most important reason complex interdependence is not universal is perhaps the division of the world into democracies and non-democracies. This fundamental difference prevents the international society from becoming the population of the truly integrated world. Even with the information revolution, the flows of information are controlled, restricted by the political structures, or totally blocked by the governments. A certain role in changing this situation is given to the soft power, the mechanism that uses free information flows to soak into people's minds and somewhat alter their consciousness, and therefore their perception of the reality. The effect of soft power is, though, limited in many cases for various reasons (Keohane and Nye 1998, 86).

An examination of the impact of economic interdependence on conflict among countries was conducted by Mark J. Gasiorowski in 1986. The problem of interdependence was studied by him in regards of its correlation to the conflict outbreak process in international relations. Gasiorowski examined two basically opposite theories, first of them claiming that economic interdependence between two countries leads to a
conflict, and the other one stating that the conflict declines with the strengthening of economic ties (Gasiorowski 1986, 26). These two theories are brought together by the fact that in reality, the relations between two countries are multifaceted, and might have both positive and negative effects for the sides. In particular, the interactions of some trade sectors might be more beneficial for one of the countries, and other might involve more costs. Thus, trade between two countries not necessarily can be characterized as entirely beneficial for a country, and some aspects of it might lead to the trade partners' cooperation, while other aspects might provoke a conflict situation.

Interdependence should not be equated with interconnectedness, the state of relations when there are advantageous for both sides and so do not involve significant costs. An example would be the trade between the US and the Warsaw Pact countries when the relations were clearly mutually beneficial. It might also refer to a trade sector, such as jewelry, that is not important enough for the participants so one of them could use it to derive profits by, for instance, embargo, and threaten the other participant's well-being or national security. Conflict situation caused by interdependence has quite a broad meaning, and might include military actions, but generally rather means tensions in the relations between countries. Conflict starts when one of the sides decides to use its advantage in some aspects to manipulate its trade partner (Gasiorowski 1986, 25).

To sum it up, Gasiorowski concludes that conflict is more likely to occur between countries that have fewer trade partners, and thus are more dependent on each other. The more costly the loss of trade for a country happens to be, the higher the probability of tensions with the trade partner it depends on. On the other hand, the more
benefits appear in the bilateral trade, the higher the possibility of the conflict decline (Gasiorowski 1986, 23-38). Therefore, interdependence might cause tensions but it also might eventually lead to decline in conflict provided that the benefits prevail.

Likewise, Katherine Barbieri questions the assumption that trade facilitates peace in international relations in her work "Economic Interdependence: A Path to Peace or a Source of Interstate Conflict?" in 1996. In the course of investigation, which explores numerous cases of interstate disputes and wars, and the influence of economic ties on them, she comes to the conclusion that economic interdependence between countries is quite likely to lead to a conflict, and the more partners are dependent on each other, the higher the possibility of any kind of collisions, including military clashes. In any case, Barbieri asserts that economic relations, and foreign trade in particular, are an important factor in the foreign policy-making process and it plays a significant role in international political relations (Barbieri 1996, 29).

One of the major points in this discussion is that the nature of trade ties between actors should be examined carefully before the conclusions regarding its influence on the bilateral relations are drawn. One of the crucial characteristic of trade is balance. Barbieri states that symmetrical relations are more likely to facilitate peace between trade partners (Barbieri 1996, 29). It also means that in a balanced trade the benefits and the costs that the participants have to accept are relatively equal, and this provides the basis for smoother relations. Importantly, the sides tend to pay more attention to relative gains in trade, then to the absolute ones, and this may eventually bring about tensions in the security sphere,
as partners see the gains of the others as their own losses, and become reluctant to contribute to the processes that are beneficial to the other side.

Generally, the investigation conducted by Barbieri demonstrated that the expansion of trade between countries might not lead to cooperation, and can rather facilitate conflicts. Interdependence as a cause of war is, though, hard to trace, in part because wars are not that frequent. The analysis also reveals that the probability of war between democracies which resulted from economic tensions are not lower that the war between non-democracies (Barbieri 1996, 29). The best way to peace in the interstate relations seems to be the balanced trade, while the increase of interdependence leads to the increase in costs and decline in benefits. Nevertheless, interdependence itself should not be considered the cause of conflict, but some certain kinds of it should. Thus, the study calls for more careful attention to economic issues in political relations, and their role in the conflict formation.

Michael Mastanduno in his work "Economics and Security in Statecraft Scholarship" (1998) outlines general trends that appeared in the US governmental and scientific approach to the relationship between economic issues and security over time, and specifies the factors that impact those changes. According to him, the linkage between the two spheres used to be ignored up until the beginning of the Cold War, when the US policy-makers saw economy as an instrument to deter Soviet Union, and thus tied the two concepts (Mastanduno 1998, 825). This, though, did not last long, as in the 1970-1980's the economic and security policies were not coordinated. The new wave of
awareness of the linkage between the two is attributed to the Clinton's presidency, when the economic policies were deliberately used to reinforce the national security strategy.

In order to analyze such development of events Mastanduno proposed to look at the variables that determined the approaches of the US policy-makers to the relationship between economy and security. The major factor in this regard is international structure that underlies the US position in the world community. While multipolarity facilitates integration, and therefore interdependence, economic measures are more likely to be linked to security policies under these conditions. Bipolar world order does not promote such measures because the two powers obviously have to be independent (Mastanduno 1998, 825). In the case when there is only one great power, the economic and security issues are likely to be integrated again, for the leading state seeks to protect its position among other countries, and thus develops its economic strategy with the consideration of necessary security structure.

Another variable mentioned by Mastaduno as an important factor in the economy and security integration process is the actual condition and level of development of the economy. The advantage of the US economy in comparison to the economies of the other countries provides the American government with more leverage to actually use it in other spheres of international relations, including security. General atmosphere of strategic environment in the world also significantly impacts the policy-makers decisions to integrate economy and security (Mastanduno 1998, 825). Favorable political atmosphere creates the greater possibility for the governments to separate the
policies. Tensions that appear in the world affairs would urge governments to more careful consideration of various factors in the foreign policy-making process.

In this context, it would also be helpful to mention the discussion of relative gains in international cooperation offered by Joseph Grieco in 1993. Building on the work of Duncan Snidal and Robert Powell, Grieco incorporates realist and neoliberal approaches to international relations by looking at the impact of relative gains and absolute gains. While according to neoliberals cooperation among states might not occur due to both temptation to cheat and fear of being cheated, realists argue that cooperation might be prevented by concerns of states that their partners would gain relatively more, and therefore would become strengthened and threatening. Powell and Grieco's approach to the relative gains problem consists in arguing that cooperation will be more likely avoided if a state anticipates its partner will obtain larger gains. In addition, Grieco states that relative gains are a severe problem for international cooperation, considering uncertainty regarding other states' behavior and the risk involved (Grieco, Powell, and Snidal 1993, 727).

A case can be made that relations between the US and China provide a good case to test the theories offered above. The United States is the current world leader and the biggest economy. It is often referred as a hegemon in world affairs because of the dominating role it plays in the international decision-making process. US military spending exceeds those of other countries by many times, and the US military presence in different parts of the world indicates the state's interest and resources to impose its will on other countries' politics.
China, in turn, is a rising power that might challenge the US hegemony in the near future. The great potential that has been accumulated in the Asian nation for thousands of years started to manifest itself after the assumption of power by the communist party. The consistent economic policies in the presence of considerable natural and human resources allowed China's government to achieve incredible results in economic growth and general development of the country in relatively short terms. By now, China has become the world's second biggest economy, taken possession of a significant share of the world's finances, conducts its own independent foreign policy, and therefore, has started to claim an important role in global affairs.

Historically, the circumstances for US-China interactions appeared to be favorable. The end of the Cold War created the auspicious atmosphere for the rapid economic development and cooperation in the region. This cooperation could be observed in both economic and political spheres, and was consolidated by founding regional organizations such as the Association of South-East Asia Nation (ASEAN). The general well-being of the region was facilitated by both Chinese leadership in the economic development process, and the US presence for the purpose of preservation of security. The economic development in cooperation mostly outweighed the existing tensions over disputed territories and other potential problems.

However, there are deep concerns that with China's growth, the multiple tensions in the bilateral relationship might become insurmountable, and will lead to a conflict. As a rising power, China might demand greater attention from the world community to its opinion, and consequently undermine the authority of the US.
Importantly, any changes in relations between China and the US will definitely occur against the background of the economic interdependence that has developed over the years. The following case study carefully examines the probability of this negative outcome for US-China relations. In the first place, the overview of the economic transformation of PRC is presented to provide a better basis for understanding the internal characteristics of the Asian state. This chapter is followed by the results of the Chinese policies that can be observed today. Then, relations are considered from the American side, and the progress of American policies towards China is offered.

The following chapters examine trade relations and interactions in the financial sphere and the question of currency exchange rate between China and the US, which have been the basis of the existing economic interdependence, views of the both sides on the concept of security in international relations. The results of the investigation of all these aspects will be presented in the final analysis chapter, where the discussion will be summed up and the prognosis considering future implications of the current situation will be made.
CHAPTER 3: ECONOMIC HISTORY OF CHINA SINCE 1949 TILL THE BEGINNING OF 1990'S

This chapter is presented to set the background for the transformation of the Chinese economy since the establishment of the People's Republic of China in the mid-20th century. Acquaintance with the specifics of the reforms that were accomplished during the past decades as well as general trends in the Chinese governmental system are crucial for understanding the rise of China and China’s behavior at the international level. The overview of great changes in PRC's agriculture, industry, financial system, investment, import and export, and the political component that underlies them, will help in clarifying the current situation in the country, as well as interpreting today's behavior and ambitions of China in international affairs. This will also help predict future implications of China’s accelerated development for American-Chinese relations.

The People’s Republic of China was established on October, 1, 1949, when the leader of Chinese nationalists Chiang Kai-shek and about two million of his followers retreated to Taiwan, and the Communist leader Mao Zedong became head of the newly formed state. Once coming to power, the government had to face serious economic problems, the most major of which was rapid inflation. In order to curb it, the state revenue was raised, a unified fiscal system was introduced, and governmental bonds were sold (Roberts 2006). The reality of the continuing Cold War compelled China to take one of the opponents’ side, and due to the dissatisfaction of the Communist party with the relations with US and the ideological similarity with the USSR, it happened to be the Soviet Union. This choice was reflected in the development of events during the Korean
War, after which US-Chinese relations were aggravated and the US became strongly committed to supporting the independence of Taiwan.

Soviet influence also resulted in accelerated development of heavy industry in China and collectivization of agriculture in the 1950’s, as well as general emulation of the Soviet patterns. The Soviet patterns were aimed at creating a centrally planned economy, and an inevitable component of the process was the setting of Five-Year Plans. In the case of China, the plans were initially set for a one-year basis, but by the mid-1950’s, the Chinese leaders found it possible to make more long-term planning. The Northeast, as the most developed region in the country, became the first to be the subject of governmental planning. The first Five-Year Plan was highly successful: there were observed definite improvements in the level of national income and industrial output expansion, as well as in the social sphere: life expectancy increased, wages grew, and life conditions became better. As a result, the ruling elite made a decision not only to start the second Five-Year Plan in 1958, but even to abandon the conventional gradual development proposed by the Soviet Union and to aim for much more grandiose achievements (Roberts 2006).

The Sino-Soviet bilateral relations deteriorated by the end of the decade, due to multiple contradictions including ideological. The Soviet assistance was withdrawn and China proceeded to implement its own development policies. The Cultural Revolution, which started in 1966 and ended ten years later with the death of Mao Zedong, canceled many of the previous economic achievements and hindered the country’s development, as
long as the goal of the campaign was to reveal and eliminate political dissidents and strengthen Chinese socialism.

Initially, the Cultural Revolution was presented as a movement to cleanse the country from bourgeois heritage in art and education, and secure the stable development of a proletarian society in China. The two major centers where this campaign started were the capital in Beijing, and Shanghai, the birthplace of the Communist Party and the power base of Mao Zedong’s wife Jiang Qing, whose popularity as an actress was directed to address political problems. A Cultural Revolution Group under Mao’s strict control was established, and work on the ideological components of people’s lives started. The first step was media: the content of major Chinese newspapers such as Renmin Ribao (People’s Daily), and the Xinhua News Agency became subjected to Mao’s personal authorization. Then the leaders’ attention moved to universities, when work teams were sent there (and then to secondary schools, too) to promote the Cultural Revolution. However, some of the work groups were controlled by moderate political leaders of the Party Liu Shaoqi and Deng Xiaoping, who promoted their views on socialist education. As a result, opposing movements of students developed over the campaign, and inner struggle started between them (Dillon 2010).

The most well-known students’ movement within the Revolution was the Red Guards, who supported Mao’s radical views. Under the pretext of struggle against old ideas they destroyed numerous items of cultural heritage, works of art, and caused irreparable damage to Chinese cultural and educational properties. The intraparty struggle gained momentum when the Red Guards turned into a full-fledged political force, which
started to attack headquarters of the moderate wing of the Party in Beijing and Shanghai. However, when it became obvious that the movement was already hardly controllable and politically dangerous, it was demobilized. Nevertheless, the intraparty struggle and general turmoil in the country continued (Dillon 2010).

The Twelfth Plenary Session of the Eleventh Central Committee of the Chinese Communist Party in October 1968 officially instituted the new organization of the country’s leadership and further perspectives of development. Vice Chairman of the Party, Liu Shaoqi, was accused of treason and had to spend the rest of his life in prison. His supporters and other conservatives were either dissolved or taken into custody. Lin Biao was declared Mao’s successor, and the ideological base for the Party was determined as Marxism-Leninism Mao Zedong Thought (Holcombe 2011). However, there existed ideological contradictions between the two leaders, and their conflict gained strength. Subsequently, Lin Biao was killed in an aircraft crash under unexplained circumstances.

Meanwhile, the confrontation with the Soviet Union was aggravating, and the threat was believed to be so great that the Chinese leaders found it possible to consider a potential alliance with the USA. The relationship between the two countries was slowly recovering in the 1970’s. PRC also needed to win America over on the Taiwan issue, and for the US Chinese support would be helpful in terms of the situation in Asia in general, and in Vietnam in particular. Informal relations between the two countries were restored in 1972 during the visit of President Nixon to China, although diplomatic relations were not established until 1979, when the US broke off diplomatic relations with Taiwan and
started to recognize only one China under the leadership of the communist party and with the capital in Beijing (Holcombe 2011).

Deng Xiaoping returned to his vice-premier position after the purge in 1973, and starting from 1974 the subject of Chinese leaders’ critique and accusation became Lin Biao and Confucius. Two other major events occurred in the middle of the 1970’s: first, the death of Chiang Kai-shek, which marked the end of uncompromising ideological contradictions between Taiwan and the Mainland; second, the end of the Vietnam War, which made it possible for China and the US to further their relations. The most important event of that period of time was the death of Mao Zedong in 1976. His wife and three other radical supporters of the Chairman Mao Zhan Chunqiao, Yao Wenyuan, and Wang Hongwen made an endeavor to seize power. This group, which became known as the Gang of Four, was arrested by order of senior members of the Party, including the new Chairman Hua Guofeng. After the trial they were sentenced to death or long imprisonment (Dillon 2010).

The Third Plenum in 1978 became the turning point to the liberal reformation in China. The major questions to be answered were modernization of economy, cooperation with the developed countries, advance in science and education, and agriculture (Dillon 2010). The latter, agriculture, became the starting point of the Chinese reform that was implemented under the guidance of Deng Xiaoping who had become the de facto leader of the country. One of the main features of the agricultural reforms was the end of collectivization and introduction of the system of responsibility of the peasants for the production. The farmers were organized into collectives through which the control over
the individual households’ work would be implemented. The land of the households composed the collective was pooled and should have been cultivated jointly. Individuals were paid according to the “work points” they received (Naughton 2007). The collectives could consist of over 5,000 households and thus covered the whole village. This system, however, was not efficient enough, and as a result of rural reforms, in the beginning of the 1980’s the responsibility for the output was returned back to households.

During the Sixth and Seventh Five-Year Plans in 1980’s, the gross value-output was increasing 6.4% per year (Ash and Kueh 1996), which marked significant growth in the Chinese agriculture. The important structural change that took place in the sector was characterized by the increasing role of grain. Within the non-crop branches it should be mentioned that meat and fish production achieved a much higher level of development (Ash and Kueh 1996). The structural change in agriculture was to a large extent possible due to the expansion of enterprises in rural towns and villages.

Despite the overall achievements in agricultural sector in the 1980’s, there still was a number of problems, and one of them was the insufficient investment in the rural economy. The investments were mostly implemented by individual peasant households because the state investment was supposed to be saved for large-scale projects, implying agricultural infrastructure, water preservations, and development of production. In the 1990’s, the emphasis in the agricultural strategy was made on the integration of the two existing systems within the sector – household-based farming and collectively-organized husbandry (Lai 2006).
The development of the sector was possible also due to the liberalization of prices on agricultural production in the 1980’s, when market started to play an increasingly large role in the economy. Having the possibility to sell the production that exceeded the quotas at the market prices, the peasants gained the incentive to produce more, and thus favored the development of the agriculture in general. Free markets were also useful in the years of especially rich harvest, when there were not enough state outlets to sell the production.

Nevertheless, regulation policy continued to be implemented, and the households’ benefits of the production were lowered by the soaring costs of inputs, such as fertilizers. The broad introduction of advanced agricultural techniques contributed to the economic efficiency, and the transformation of wide areas of low-and-medium-yielding land made it possible to considerably increase the crops' output by the middle of the 1990’s (Ash and Kueh 1996). At the same time, there was observed a shift from a mainly grain-based diet to animal-based foods, which increased the consumption of non-grain products, especially in urban areas. The subsequent increase in feed grain put a certain pressure on the grain sector in the 1990’s. The major constraint for the agricultural development remained the scarcity of land.

In general, Chinese agriculture in the 1980’s and the first half of the 1990’s had to settle the issues of the contradictions between the planned economy and free market. The importance of this process may be proved by the fact that agricultural sector was recognized as the basis of the national economy and composed up to 50% of the China’s NDP (Ash and Kueh 1996). During the mentioned period of time a shift in the regional
performance in agriculture also occurred. For example, significant improvements in the grain farming in the Northern territories were attained. On the other hand, grain production in the South declined by almost 20%.

Multiple reforms were implemented in Chinese industry starting at the end of the 1970’s as well. The economic processes were greatly liberalized: administration was simplified, and managers of industrial enterprises were granted larger decision-making authority (Ash and Kueh 1996). New types of ownership were established: while before 1980 only state and collectively operated enterprises existed, after the beginning of the reform there appeared individual and joint enterprises. The system of branches of industry was revised, and the number of branches increased from 15 to 40. This change, however, contributed to the vagueness of the statistical data, because the figures were hardly convertible to the new divisions. Besides, the official data were not always reliable in the Chinese case, which makes it difficult to evaluate the economic achievements accurately.

The changes in ownership system are definitely an important part of the Chinese industrialization. As it was in the 1950’s and until 1978, the country’s industry was composed of numerous publicly owned organizations, and state-owned enterprises were providing 77% of industrial output. 14% of the output was produced by collective enterprises that were nominally owned by workers but in fact were governed by local authorities. 9% was produced by township and village enterprises (TVE). TVEs were growing particularly fast during the first phase of the reform, since 1978 till the mid-1990’s (Das 2012, 12). This process was induced by the relaxation of state monopoly on
purchase of the production, the encouragement to cooperate with urban firms, and the general permission to seek and use market opportunities.

Overall, the share of collective enterprises in the output, including TVEs and urban firms, constituted 36% of the total in 1996. The share of state-owned enterprises declined from 77% to 33%. On the other hand, the foreign invested enterprises started to develop quite rapidly at that period. The reform in industry, and the redistribution of ownership in particular, was intended to encourage the development of state-operated enterprises. However, the economic growth rates at this kind of enterprises did not meet the governmental expectations, because the output of collective industry was much larger. Therefore the number of state-operated businesses declined. The number of township, joint, and individual enterprises continued to grow due to the high level of their output.

The development of enterprises was significantly restrained by the defective tax system that existed in the 1980’s. Even though different kinds of enterprises were imposed to certain tax rates, the system of responsibility for the financial losses was not established, therefore, the enterprises did not have much incentive to demonstrate good performance. As a result, the governmental revenues were not considerably large. The reform of 1994 was supposed to solve this problem. As a part of the reform, product and business taxes were abolished, while the coverage of value-added taxes was broadened and applied to all types of business enterprises regardless of ownership. The income tax rates were reduced from 55 to 33% also for all types of enterprises. The changes in the tax system contributed to the increase in governmental revenue. 70% of the inflows were
possible due to the taxes on domestic goods and services, income tax provided 13% of PRC’s income, and international trade taxes accounted for almost 5% of the revenue (Ma 2000).

Banking reform also became an essential attribute of the Chinese reform. Numerous newly established and re-established banks and financial institutions were designed to provide funding to the developing enterprises. All the banks, including commercial ones and especially nonstate-owned ones, were subjected to strict governmental control. The regulations were implemented by creating credit plan which instituted certain credit ceilings for the banks, assigning the banks to run business only in prescribed areas, and controlling interest rates (Ma 2000). However, despite the tight system of control, the banking reform was another step on the way to the overall liberalization of the Chinese economy.

Another contribution to the development of Chinese financial system was the creation of stock markets. Several security trading counters were open in Shanghai in the second half of the 1980’s, but the Shanghai Security Exchange (SHSE) was formally founded at the end of 1990. The number of shareholding companies was rapidly increasing over the 1990’s, and the total Shanghai’s market capitalization raised from three billion yuan in 1991 to 840 billion yuan in 1997 (Ma 2000). Stock markets were also established in the first special economic zone (SEZ) in Shenzhen, where the total market capitalization grew 113 times during six years and reached 903 billion yuan in 1997. In general, stock market system developed significantly in the 1990’s in China,
and, for example, already in 1996, over 10% of productive investment were carried out through it.

The shareholding system was created with the hopes of reforming problem state enterprises. The shares were usually divided into three types: state shares that were held by the state, individual shares that were held by the employees of the enterprises and individual investors, and legal person shares that were available for other enterprises and financial institutions (Ma 2000). Shareholding companies were becoming more advantageous substitution for the state-owned enterprises, because they had more management autonomy than the latter, had to pay less taxes, and enjoyed extra governmental support in the form of special credits. There also were, though, certain disadvantages. For example, transactions on the securities market were now subject to personal interests which did not necessarily coincide with the interests of the state. Also, the wage increase became easier to implement, which resulted in growth in prosperity of employees, and not the state. The enterprises were raising funds, growing rich, but were more inclined to make short-term profits instead of long-term investment.

Another sphere worth examining in regards of Chinese economic development is foreign investment. In this sphere, for China, it appeared possible to combine the need of openness, which would let the country implement its strategies, and the reality of planned economy. In other words, foreign investment in China became one of the ways to provide interaction between closed economy of PRC and the rest of the world. Unlike foreign trade, foreign direct investment is supposed to offer direct help to the sectors of economy that need it, and might be used to create a basis for import substitution and export led
development. One of the problems of foreign investment accommodation for a planned economy consists in the necessity to coordinate the actions with the investors, and consider their requirements. Another issue is the management of the system of foreign exchange, which seeks not to let national currency flow abroad.

The decision of the Chinese government to open the economy provided for the interaction with outer world, and facilitated foreign direct investment. This move can be explained by the benefits that were supposed to be derived from the offered foreign experience. In other words, China saw the possibility to accelerate its industrialization through linking its economy to the world economy. Meanwhile, conventional socialist directives continued to prevail, which means that the government was responsible for the distribution of the incoming foreign investment. An important turn in the Chinese politics in this sphere should be considered the reorientation from import substitution policy to encouraging export-oriented investment (Ash and Kueh 1996). China started to employ the strategy of borrowing foreign advanced technologies to develop its economy. The Chinese markets of goods and services, which had been strictly controlled from above, were now open for foreign partners. The pressure exerted to China by the US at that time, also contributed to the Chinese integration into world economy. The leaders of PRC had to agree with western conditions in order to ensure the country’s future membership of the international organizations.

The area that was chosen by the Chinese government to become the recipient of the foreign investment was the coastal provinces in the East of the country. This strategy to open the region with the highest concentration of the population and the highest level
of development to the world was consistent with the Chinese intentions to maximally control the allocation of resources. The developed East was then supposed to support the rest of the country, and the authorities of the Western provinces had quite a limited possibility to participate in the investment process. However, in terms of investment management by governmental and provincial level, the trend of decentralization is observed through the 1980’s and 1990’s. According to the available data, the share of investment received by local authorities, or investment received by central authorities but allocated to the provincial needs, rose significantly, and marked relaxation of the control over local decision-making process, increasing penetration of foreign capital into the Chinese economy, as well as further liberalization of the economy in general (Ash and Kueh 1996).

In terms of the regional distribution of foreign investment, the region that absorbed the major part of the inflow was the South, particularly Guangdong province and the city of Shenzhen, one of the special economic zones. It should be mentioned that a lion share of the investment was coming from the neighboring Hong Kong, which remained under the British rule until 1997 (Mastel 1997). With the increase of the foreign investment to the other regions of China, the benefits were obtained by the provinces along the coast, from the South to the North. In regards of economic sectors, the investment flows shifted from services to industry in the middle of 1980’s.

An important factor that impacted foreign financial flows to China is the domestic situation in the country. For example, the incident happened at the Tiananmen Square in 1989, when students’ demonstrations were brutally suppressed and several
thousands of people were killed, deterred the international community from expanding cooperation with the communist regime. When quantifying the foreign investment, it is also crucial to consider not only the fact that the available information might be not fully reliable, but also who the factual investors were. Thus, virtually the biggest ‘foreign’ investor to China was Hong Kong (Mastel 1997). Besides, there are reasons to believe that Taiwan’s help played an important role in the development of the Chinese economy. In this case, it is even more difficult to gauge it because the Chinese statistics does not provide separate information for the island, which is considered illegally seized part of the Chinese territory. Meanwhile, such factors as territorial proximity with China, high level of foreign exchange reserves, and the intensity of foreign trade of Taiwan create a basis for the island to invest capital in the Mainland (Ash and Kueh 1996).

When talking about Chinese economic development, it is impossible not to discuss the foreign trade. With the opening of the country to the world in 1980’s, the volume of trade significantly increased, which not only marked the progress in this sphere itself, but also promoted overall advance in development of PRC. As other planned economies, before the reform period Chinese regime could be characterized by intensive protection of domestic industry, fixed exchange rates, overvalued domestic currency, and a strict control of export and import. During the reform period, the Chinese government revised its directives, and made changes to the economic system, which helped derive maximum benefits from the economic cooperation.

The first distinctive feature of the changed approach of the Chinese government is the focus on exports. One of the major products that had been decided to contribute to
the economic growth was petroleum. China started to export both refined petroleum and crude oil in the middle of the 1970’s, and this became a major revenue item that constituted one-third of China’s export earnings (Ash and Kueh 1996). However, the oil production growth rates did not meet the expectations of PRC’s leaders, and eventually, in the middle of the 1980’s, the export of oil lost its importance for the economy. Not only had the share of oil in the Chinese export changed at that period, but also the general composition of exports mutated over the years. After 1985 the share of primary goods which accounted for more than a half since mid-1960’s, and almost a half of the export in the 1970’s and the beginning of the 1980’s, decreased. On the other hand, the share of manufactured goods was increasing and exceeded 75% by 1991 (Ash and Kueh 1996). It should be partly explained by the growth of the light industry in China, and as a result, the increase in exports of, for example, textiles. It also means that the Chinese export became more labor-intensive, because the light industry requires more labor force than export of petroleum, and thus, more people became engaged in export-oriented sectors of the economy.

The changes in the foreign trade were possible due to the provision of local authorities with a wider range of powers and functions, relaxation of the exchange rate system, and alteration of the pricing policies. Since the establishment of PRC the whole process of determining what to produce, export, and import, was in the hands of the central government. The ruling elite was stating what products in what amounts should be manufactured, which products would compose exports, and which ones had to be imported. Trade reforms were introduced in the mid-1980’s that initiated the
establishment of multiple corporations and companies to be involved in the foreign trade. Besides, the process started to be less based on planning, and more on the real situation and necessity. The system became more flexible: the shares of planned exports and imports were declining, and the plans themselves started to represent recommendations rather than mandatory requirements (Ash and Kueh 1996).

The price-making process also saw significant changes during the reform period in China. Traditionally, the prices on the goods produced for both domestic consumption and for export were set by the government and were not interconnected with the prices in the world market. About 80% of prices on import production were based on the world market prices in the mid-1980’s, and about 90% in 1990. The changes with the prices on export were going slower, however, by the end of the 1980’s, almost 80% of the prices were not pre-planned. The relaxation of exchange system became one of the crucial components of the Chinese reform. Since 1978 to 1991 the US dollar grew three times in comparison to the Chinese yuan. The alterations of the exchange system created favorable conditions for the exporters. The reform of 1991 abolished the quota of 20% for foreign currency that had to be remitted to the center and required 50% instead. However, the government was buying the foreign currency from the provinces for the swap market prices, and not for the official exchange rate. Thus, the role of the market also increased (Ash and Kueh 1996).

Chinese economic progress during the reform years definitely had an impact on the population’s quality of living. The consumption doubled during the period since 1978 till 1991, however, this process was more visible in the first half of the 1980’s, while in
the following years a certain stagnation was observed. In terms of other social indicators, consumer satisfaction should be considered increased due to the significant expansion of the range of goods. The structure of consumption also changed, as with the increased income the share of necessities in the purchases lowered. Life expectancy and the level of education among the population were also growing with incomes, but at extremely slow rates. The income inequality also started to emerge quite sharply. Another negative aspect that appeared during the reform years is environmental degradation (Ash and Kueh 1996). Because of the unformed system of responsibility for the pollution damage in China, and the insufficient attention to the environment from the government, the situation with the abuse of environment dramatically worsened.

Nevertheless, despite the negative consequences for the society and environment, the state's growth during the first forty years under the communist government was outstanding. This underdeveloped agricultural country with its large population was put on the road of maximum economic advantage and has progressed incredibly ever since. The government's attention was directed not only to growth of China's agriculture and industry, but also to the process of its interaction with the world. China's opening policies played a prominent role in the country's development, and at the same time they brought drastic alterations to the whole structure of the world economy.
CHAPTER 4: CHINA IN THE 21ST CENTURY

This chapter summarizes the achievements of the Chinese reform that can be seen today. The level of some indicators of economic success (for example, GDP and foreign direct investment) demonstrates the remarkable growth of PRC's economy to date. The current structure of the Chinese economy and the roles of different sectors within it are presented. The accompanying social trends such as urbanization and migration processes complete the picture. The problems, which the Chinese government still has to overcome, are also highlighted in this section.

Today's China is not the same as it was thirty, twenty, or even ten years ago. The special path China has been proceeding along since the start of the reform seems to have paid off. This poor agrarian country with the population that was already large back in the day, now claims to become the world's biggest economy within next ten or fifteen years. The life conditions have significantly improved, and China's opinion on any international issue definitely has to be regarded. PRC underwent a test by global economic crisis and came out on top. Its GDP growth rate was 9.2% in 2009 and 10.3% in 2010. China is the world's largest creditor, and fastest-growing economy, even though it is still a partially centrally planned command economy, and a communist regime (Das 2012, 9).

China's opening process was slow, even though the importance of export was stressed from the beginning. Nevertheless, the trade volume growth was outstanding: the total trade was $20 billion dollars in 1977, $475 billion dollars in 2000, and $2,208 billion dollars in 2009. Foreign direct investment played a crucial role in the development of the Chinese economy. In the mid-1980's it accounted for about $2 billion dollars
annually; in 1993 it exceeded $30 billion dollars, and in the mid-2000's China was already among the top three FDI recipients of the world after the US and Great Britain (Das 2012, 7-38).

China started the development of its economy from the coastal provinces, the reason why the Chinese East is the most prosperous area now. There also could be identified two regions where the initial energy of the authorities was directed – Yangtze River Delta (the river flows into the ocean near Shanghai, the world's busiest container port), and Pearl River Delta, which implies the Guangdong province area, the world's center of light industry. These regions receive the lion's share of the foreign direct investment, but due to the investment spillovers, the other regions also started to benefit from the financial inflows coming from abroad. Moreover, this factor highly contributed to the integration of the Chinese firms in the national market, and then to the integration of the Chinese market into the global market. Today and last ten years, PRC is still the most investment attractive destination in the world (Das 2012, 21).

Regarding the structure of the Chinese economy, agriculture along with the extractive sector, which were attached great importance since the beginning of the reform, now has reduced significance in the country's GDP. It used to account for around a quarter of GDP in the 1970's, reached one third in the mid-1980's, but declined from the beginning of the 1990's. As of 2008, the share of the primary sector was a little less than 10% in the China's gross domestic product. The most important sector of the Chinese economy was and remains manufacturing and industry which accounted for around a half of the GDP during last thirty years, and 48% as of 2008, with the exception of the first
half of the 2000's when it exceeded 50%. As for service sector, its importance is gradually growing. The share of services in the Chinese economy constituted a quarter in the 1970's and 1980's, around 30% in the 1990's and in 2000, and exceeded 40% in 2008 (Das 2012, 24).

The Chinese share in the world's economy should also be mentioned. When the reform was launched, PRC contributed less than 0.1% to the growth of the world's economy, but in 2010 it was already one third of it. In 2009, China became the world's largest exporter, the largest energy consumer and importer, the largest foreign direct investment recipient among developing countries, and the largest producer of, for example, steel, ships, and automobiles. China not only maintains the highest GDP growth rate, but also achieved considerable results in raising the standard of living of its citizens. The urban population more than doubled within thirty years, from 20% when the reform started, to almost 50% today. The share of the population living below the poverty line also declined to a large degree (Das 2012, 33).

One of the sharpest problems PRC had to face during the reform period was inflation. It was mostly conquered in the mid-1990's, the prices somehow stabilized, and the competition among companies became much higher. In the first place this situation affected state-owned enterprises, because the government reduced its support to them, and encouraged their restructuring, downsizing, and privatization. Thus, ten years later, 55 million workers were employed by the urban private sector, which is almost twice as many as by the state-owned corporations (Naughton 2007).
In terms of policy-making, a remarkable change took place in PRC as well. Hu Jintao became a new leader of the country, and Wen Jiabao became a new premier in 2003. The new ruling elite had to face the challenge of the current stage of the transition of the Chinese economy, deal with the coming global economic crisis, and create a strategy of the country's development in the future. Although the interdependence of the Chinese and the world's markets leaves little doubt, PRC's further liberalization remains slow. The financial system is still vastly controlled by the government, because most of the banks are owned by the state. The fiscal system also lacks independence and coherence, as well as the regulatory agencies, which are supposed to contribute to the smoother integration of the Chinese market into the world's economy. In fact, with the new government, the Chinese economy became even more politicized, more issues fell under the leaders' supervision, which was supposed to provide more support to less developed regions and spheres, but at the same time complicated the promotion of the liberalization, transparency, and anti-corruption drive in the China (Naughton 2007).

Rapid urbanization has been one of the prominent components of the China's development in the 2000's. Since agriculture ceased to be the dominant sector of the economy, the migration of the population to the urban areas became swifter. In the mid-2000's the level of urbanization was 43%. The distinguishing feature of the Chinese urbanization during the decades was that it was highly controllable by the government. The population was encouraged to move to the cities in the 1960's, then millions were forced to get back to the rural area in the 1970's. The policy of control was relaxed with
the beginning of the reform, even though up until the 1990's the government sought for restricting the growth of big cities (Das 2012, 34).

Migration is another noticeable phenomenon in today's China. At least 10% of the citizens might be defined by the term "floating population", which implies that they reside in the areas different from the permanent registration for more than six months. In the beginning of the 2000's, more than a half of the migrants were accumulated in the southern coastal provinces. The urban-rural divide in China is wide. Because of the growth of the standard of living in the cities, and also due to the gradual integration of the Chinese economy into the world's economy, which put certain pressure on the farmers, the gap between urban and rural population continues to grow. Regarding the measures taken by the government in order to support the agrarian sector, a number of policies were implemented, including, for example, the abolition of the agriculture tax in 2005, and the provision the farmers with a set of subsidies to protect their incomes (Naughton 2007).

Even though agriculture, the starting point of the Chinese reforms, is the not that important for the China's GDP as is used to be, Chinese village is still a crucial component of the Chinese economy. The level of development and living standards vary through the places, but farming is the major activity for almost all village residents. During the last several decades of the 20th century, much attention was paid to the promotion of new technologies in the economy, farming modernization, green revolution, overall intensification of the Chinese agriculture. As a result, in the 21st century agriculture became a science-intensive sector of PRC's economy. About two-thirds of the
land under crops are planted with grain, rice being the most important one. The second-largest crop is maize, also because it is used as animal feed, and the crucial non-food crop is cotton (Naughton 2007).

However, with the improvements in the quality of life, the population's diet and, therefore, the structure of the agriculture are changing. While in the beginning of the reform period, grain constituted more than 90% of the consumption, nowadays such products as, for instance, meat and vegetables, play an increasingly important role in the people's ration. As for the plant cultivation, the production becomes more diverse because, besides the traditional crop production, the farmers are now also engaged in the growing of higher-value crops, such as horticultural ones. Horticultural production is the sector being set most hope on in terms of further development of agriculture and its integration in the world's market, as its export is growing. At any rate, China remains the world's largest agricultural producer (Naughton 2007).

The industrial sector also sees a significant transformation in the 21st century. The township and village enterprises became more independent from the governmental control, and had to face the competitive environment of the modern market. The novelty is the emergence of industrial clusters that are composed of a number of firms, usually several large and up to several hundred small ones. They all constitute industrial chains which are mostly involved in light consumer goods production. For example, sock industry cluster in Zhejiang province not far from Shanghai is claimed to produce one third of the world sock output (Naughton 2007).
Regarding the state-owned enterprises, the governmental control over them has been slowly declining. The transformation of the SOE into joint-stock companies reached 42% in the mid-2000's. The large state corporations, even though underwent privatization, are still controlled by the government. For example, Sinopec Shanghai Petrochemical Company, one of the three major Chinese oil companies and Asia's biggest refiner of oil by volume, is still 55% owned by the government, which controls the prices through delaying the reaction to the world's price movements, and thus benefiting from the difference. The government also provides subsidies to the company, which makes it possible to indirectly influence the management decision-making process and personnel assignment itself (SPC 2013).

The solution for the smaller enterprises became the creation of the State Asset Supervision and Administration Commission (SASAC), which has a highly branched structure in order to control the firms on each level. In the first place, the commission is intended to cover five major sectors of the Chinese industry: petroleum and refining, electricity, metallurgy, military industry, and telecommunications. In general, state control has been mostly applied to the larger firms, and in 2004 the share of state-controlled companies constituted less than one-third of industrial sales.

With the larger number of different companies in the market and increased competition, the profits of SOEs significantly declined, which influenced the governmental incentive to invest in them. If in the beginning of the reform the government provided 62% of all the investments in SOEs, twenty years later it was only 3%. The decision for the SOE was to turn to the banks that could extend short-term trade
credits. Since the enterprises were not able to raise their profits and became heavily in
debt, part of them were simply closed by the end of the 1990's, and with the government's help, the banks wrote off bad loans (Naughton 2007).

The traditional Chinese enterprise represented a highly bureaucratic structure that was completely integrated in the state. In order to implement the transition of the economy and approximate it to the market economy, the Chinese government has chosen the methods different from those practiced by, for example, ex-Soviet countries where the whole bureaucratic systems were broken and privatization was forced on the faith of the incentive of the new owners to develop their companies in the competitive environment. The Chinese government preferred to keep the existing structure, transform the ideas and functions, and regulate the prices somewhat relying on the market ones. Thus, the current stage of the Chinese economy might be characterized as system of corporations which are oriented mostly on profit, with the budget limited quite hardly but not totally, and with market prices that are controlled by the government.

The control over the whole system, however, is not absolutely consistent. The government may arrange the stakeholders, the finance comes from the banks that are limited in their capability to put pressure on the debtors and are owned by the government, and various bodies are created to observe the corporations' activities. Besides, the smaller companies, generally, have parental corporations above them, which creates a multi-level structure of support and control, and which, eventually, provides companies' management with the possibility to act with a certain degree of freedom. On the one hand, this contributes to the approaching to the real market, but on the other hand,
the corruption remains a massive issue in China. In reality, a small number of the Chinese firms now achieved significant results in corporate governance. This list includes the electronics companies Lenovo, Huawei, and Haier. (Naughton 2007).

Foreign direct investment started to play an increasingly large role in the Chinese economy since 1992. At that time, PRC's government made a decision to open domestic marketplace for foreign partners, while before that FDI was mainly intended for export manufacturing. In 2004 the foreign financial flows to China accounted for 500 billion dollars. Even though due to the traditional high level of domestic savings FDI constituted only about one-tenth of the GDP, the foreign investment extremely contributed to the further development of the country's economy. In fact, FDI became a major source of western technology transfer, and promoted the considerable progress in foreign trade as well (Naughton 2007).

The necessity to extend cooperation with the outer world, and to provide the structure to implement investment strategies in the reform period predetermined the emergence of the Chinese Special economic zones (CEZ). Today, the importance of CEZ in the Chinese interaction with the global economy decreased because of the general relaxation of the rules, but these areas still operate on their special and slightly different laws, and still attract a great portion of the whole foreign investment. The first four Special economic zones were opened in 1980 in Shenzhen, Zhuhai, Shantou, and Xiamen – places that were close to Hong Kong, Macau, and Taiwan, and thus, they were supposed to link closed Chinese economy with the foreign potential investors. Among the conditions created for the investors were the opportunity to import raw materials and
components duty-free, and export the production without sales taxes, the light income tax
duty, light bureaucratic regime (Naughton 2007).

In the mid-1980's, when the SEZ experience was judged as successful, fourteen coastal cities such as Shanghai, Dalian, Tianjin, and Qingdao, were chosen to be included in the special area (Hofstra University 2009). Later on, special conditions were established also for Pearl River Delta and Yangtze River Delta, as well as on the Hainan Island, a popular tourist destination in China. By 2003, the Chinese government opened over a hundred investment zones in the country. However, today, the conditions for the foreign investment are favorable through the country. The lower taxes are available, and the system is generally decentralized, which encourages local authorities to attract foreign investors with various benefits, and this creates some kind of competition for the foreign finance among the regions.

Chinese-foreign joint ventures became the form of business available for the overseas partners of PRC since the mid-1980's. The joint-stock companies were supposed to provide the developing economy with the foreign finance and technologies, while letting the central government retain control over them. The foreign firms, however, experienced certain disadvantages working within that system, because the Chinese side naturally sought to resolve the country's domestic problems at the expense of the guests. The dissatisfaction of the foreign investors and their striving for more independence in their businesses in PRC eventually won them the right to possess two-thirds of the shares in their companies in 2004 (Naughton 2007).
75% of the Chinese banking system is composed of three major categories of banks for – state-owned banks, joint-stock commercial banks, and city commercial banks. The first category, also known as "Big Four," is basically a governmental monopoly on the whole financial system of China. The Bank of China, the Industrial and Commercial Bank of China, the Agricultural Bank of China, and the Construction Bank share different responsibilities and altogether run 55% of all the state's assets. The second category, joint-stock commercial banks, represent about 15% of the assets and are owned by government agencies, and any kinds of enterprises, however, still usually under a certain control of local governments. The third largest category is city banks, which occupy about 5% of the assets, but their importance is much lower because they are regularly only involved in minor local operations, and they are controlled by local governments (Naughton 2007).

Nevertheless, the banking structure in China is being reformed and capitalized as well. In 2004 the ownership of the Bank of China and the Construction Bank was transferred to the Huijin Corporation, and they were turned into joint-stock corporations. Even though the Huijin Corporation is an organization under the central government, almost 30% of the shares were sold out, including 8.7% to the Bank of America. Generally, due to the development of the Chinese stock market, capitalization of the economy was about 50% in 2005. The second half is owned by the government. The achievements in the economy capitalization, and in the opening for foreign bank in particular, were to a large extent possible after the China's accession to the WTO in 2001 (Naughton 2007).
The two independent stock exchanges in China are Shanghai Stock Exchange and Shenzhen Stock exchange. The former's market capitalization for 2011 was 2.3 trillion dollars, and latter's was about one trillion dollars. Even though the Shanghai Stock Exchange is the world's fifth largest stock market, it is still controlled by the government (SSE 2013). Among the requirements for listing in the SSE is the improvement of China Securities Regulatory Commission. For the Shenzhen Stock Exchange the situation is even stiffer – most of the companies listed are directly or indirectly owned by the Chinese government (SZSE 2013).

In the 21st century China has most of the components of a great power. It is leading the world in exports and imports, and will become the world's biggest economy in the near future. Its development is constantly in progress, and the government has proved to be flexible in terms of the communist ideology. Although China still has to face a large number of problems, including old and new, its status among other countries becomes more and more significant. Thus, the Chinese challenge to the US consists of both the economic power of PRC and overall political power, which results from the country's economic achievements.
CHAPTER 5: AMERICAN POLICY TOWARDS CHINA FOR THE RECENT THREE DECADES

This chapter outlines general trends of American policy towards China since the establishment of PRC, and, most importantly, after the opening of diplomatic relations between the two countries in 1979. The American policies varied through different governments, and were affected by multiple factors, such as the issues related to China’s communist regime, as well as other contradictions regarding world affairs. Nevertheless, the great potential of the Asian state was already clear in those years, and the economic interdependence between the countries was already taking shape. That is why, both before and after the collapse of the Soviet Union, China was one of the major orientations of American foreign policy.

By now US-China relations had already been through various epochs and phases, and it was never simple. The difficulties had been caused by fundamental differences in historic experience, culture, mentality, and worldview of the two nations. At the same time, the importance of bilateral relationship was always obvious due to the place each of the countries held in the world arena. Today, this importance is even greater because of their irreversible economic interdependence and the necessity to cooperate on resolving numerous international issues.

Political realities of the 20th century did not contribute to the reduction in uncertainty and mutual suspiciousness between the Asian and American powers. The establishment of the People's Republic of China in 1949 became the threshold of the new era in Sino-American relations. Ever since, the United States had to develop its foreign
policy with the consideration of the socialistic principles and the communist regime of the eastern state. The whole situation was aggravated by the atmosphere of the Cold War, and the changing relations between China and the USSR. As long as PRC sided with its ideological fellow, the American foreign policy, up until the beginning of the 1970's was aimed at containment of communism.

Even though communist China was seen by the US as a threat to the existing world order, its potential as a future economic partner was already visible. However, the embargo placed by the US on exports from China after its entry in the Vietnam War, the Chinese commitment to the Soviet Union as its major trading partner and model of development, and the implementation of Mao's policies of isolation made it impossible for the countries to launch significant economic relations. The situation changed in the beginning of the 1970's: when the gold standard system collapsed in 1970, the US dollar was overvalued and expected to depreciate. The whole international economy was under the threat of breakdown. It was the time for America to revise its policies towards PRC (Cheung 1998).

In 1972 the famous visit of then-US President Richard Nixon, preceded by a secret preparatory visit by national security adviser Henry Kissinger, opened a new chapter in the history of American-Chinese relationship. The event resulted in the signing of the Shanghai Communiqué, which was more of a symbolic character but definitely indicated the mutual intentions to normalize and develop the relationship between the two states. It should be mentioned that, of course, the US had not only economic motivation to build bridges to China. The Cold War was still on, and the US sought for a military
ally close to the Soviet border. Later, in December 1978, the Joint Communiqué on the Establishment of Diplomatic Relations legitimized bilateral relations. The United States recognized the Government of PRC as the sole legal government of China, and cut diplomatic relations with Taiwan (Dillon 2010).

This significant step in the relationship was followed by the visit of Deng Xiaoping to Washington D.C. in 1979, which laid the foundation for extensive cooperation in scientific, technological, and cultural spheres. Agreements on trade also gave a stimulus to the development of mutual economic relations. Trading volume started to rise at a rapid rate: from 391 million dollars in 1977 to 6.07 billion dollars in 1982; by more than fifteen times (Neelankavil 2008). Thus, the decade before 1989 may be considered the time of most favorable development for Chinese-American relations. A comprehensive mechanism of economic ties formed during that period. The American economy was becoming more and more connected to the Chinese economy due to the transferring of portions of factories to the Chinese territory, the growing dependence of the American consumer market on the Chinese import of goods, the Chinese possession of large dollar balances, and China's purchases of American bonds. Additionally, by the end of the 1980's, as a result of socialist camp breakdown and the reduction of Soviet influence in the world, both the Soviet-American and Soviet-Chinese contradictions were relaxed, which means that the previous geopolitical triangular system also collapsed.

The economic ties between the US and China were further established through economic cooperation among Taiwan, Hong Kong, and Chinese Southern regions that were opened with the start of the reform in the late 1970's. The trade volume between
China and Hong Kong increased from 5.6 billion dollars in 1980 to 26.3 billion dollars in 1987. Taiwan, whose biggest trade partner was the US, entered cooperation as a third party, and its indirect trade with China increased from 30 million dollars in 1977 to 7,400 million dollars in 1992 (Gereffi and Korzeniewicz 1994).

A concrete example would be the production organization of Nike, Inc. in China. The company used to place most of its orders through three China-Taiwan joint ventures. The raw materials came to Chinese southern provinces from Taiwan through Hong Kong, and the finished production was shipped to Taiwan also through Hong Kong, which was additionally responsible for accounting and design. The management in the factories and other participating sides was mainly Taiwanese. This commodity chain provided the major supply of shoes for the US (Gereffi and Korzeniewicz 1994).

In June 1989 the Chinese government shocked the international community via its murderous suppression of a students' demonstration on the Tiananmen Square in Beijing. The protesters demanded the liberalization of the existing political system and eradication of corruption. The demonstration was quelled with the help of military forces, which resulted in death of several thousand people. This incident marked the beginning of a crisis in American policy towards China. In response to the brutal actions of Beijing towards the civilians, the US government suspended its upcoming visits and exchanges between American and Chinese officials, commercial exports of weapons and government-to-government sales, peaceful nuclear cooperation with China, and froze the consideration of new loans and investments for PRC (Sutter 1990, 6).
Despite an overall negative public opinion and sharp criticism of China by both the media and human rights organizations, the administration of George H.W. Bush strove to smooth over the contradictions, maintain contact with China, and persuade Beijing to take steps to reconcile the dispute. This policy, even though it was considered soft by the public, was determined as a necessity by the government because of the importance of further economic and strategic cooperation with China, as well as the general instability of the transition period in the world political structure. Thus, delegations led by National Security Advisor Scowcroft were secretly sent to Beijing twice in 1989, and China continued to enjoy the most favored nation trading status. Even though China's attractiveness for investors was definitely shaken, trade itself was not much affected: the US trade deficit in 1990 accounted for 10.4 billion dollars. However, the unwillingness of China to yield to most of the American requirements resulted in the expression of frustration by the US administration, and furthered the crisis in the relationship. The American perception of China significantly changed: acute divergence of the two nations' views on morality, human rights, and social values became even more obvious (Sutter 1990, 9).

Nevertheless, America had to face the need to find a balance between economy and politics in its policy towards China. The situation was further complicated by the collapse of the Soviet Union in 1991. The starting thaw in the Russian-Chinese relationship, as well as the US support of Taiwan facilitated intensification of the rivalry between America and PRC. Approximately at that period, concerned discussions about the place and role of China in the world started with renewed seriousness in the American
scientific and political communities. They also impacted to a certain extent the course of US policy towards China. The increasing power of the Asian country contradicted the American concept of global responsibility for the world's democracy, and, thus, it was extremely important to choose the right political strategy in relationship with the emerging state (Friedberg 2005, 7).

The result was the inconsistent policy of Bill Clinton's administration. On the one hand, the development of economic, cultural, scientific, and educational cooperation was highly encouraged in the hope that it would facilitate mutual understanding, priority inversion and reform in China. On the other hand, the American government kept to its traditional views on the military presence in the region and maintained a large naval command there (Kissinger and Kissinger 2002).

In 1993, Deputy Secretary of State Robert Zoellick announced the strategy of involving China in the new world order. At the same time, Clinton advanced a course of establishment of a new "Pacific Community" based on principles of security, economics, and human rights (The New York Times 1993). Along with the Asia-Pacific Economic Cooperation and the Association of Southeast Asian Nations, it was supposed to help prevent a new split in the Pacific. In the mid-1990's, the White House started to adhere to the "China containment" policy. This policy was corroborated in detail in "A National Security Strategy of Engagement and Enlargement" published in 1995 (White House 1995). The maintenance of US bilateral alliances with Japan, South Korea, Australia, Thailand, and the Philippines should have become a basis for it, along with a military component in the form of at least 100,000 troops deployed in the Asia-Pacific Region. As
a final touch the US also sought to normalize its relations with Vietnam: Bill Clinton visited Hanoi in July 1995.

By the end of Clinton's term there were opinions that the Pacific region was likely to become the future arena of an aggressive clash of interest (with the probability of a military conflict) between the US and the regional powers there, with China in the first place. The aggravation of the Taiwan issue, scandals related to China's export of arms to Iran, and the illegal gaining of American technologies by PRC also confirmed the emergence of the "China Threat" in American political circles, further emphasizing that that threat would have be struggled against.

The administration of George W. Bush came to the White House in January 2001 expressing quite a commanding attitude in its approach to China, which had already surfaced during the pre-election period. In one of his most detailed speeches on the subject of external policy in November 1999, Bush Jr. sent a clear message that China is not a "strategic partner" of the USA, but its "competitor". He suggested to American society that it should be realistic in assessing the negative actions by China in years past: step up development of nuclear missile potential, including new generations of ICBM and increase capabilities of the navy and long-range aviation (Bush 1999).

In an early stage of his presidency the new USA leader also dramatically shifted the position of the White House in the matter of Taiwan. In spring 2001 when answering the question of the Associated Press correspondent on the determination of Washington to employ military force for the defense of Taiwan, Bush stated that the US would do "whatever it took" to help the island defend itself, and that military force was "certainly
an option'' if China attacked Taiwan (Stout 2001). This announcement gave rise to confusion and criticism in the democratic wing of the USA, to say nothing of the overreaction of PRC.

The terrorist attacks of September 11, 2001 in New York and Washington put the development of American-Chinese relations within a new foreign policy scope. After these events the USA and China felt a particular rapprochement, even accordance of interests towards the threats of political extremism, in this case, of the orthodox Muslim kind, the ones that were spreading globally and threatening the world with serious political and economic conflagrations. The White House realized the whole gravity of the posed threats and deemed it necessary to conduct a large-scale military operation in Afghanistan. As Americans could not predict its duration and outcome, or the complicated reactions it might trigger in Muslim world, they were undoubtedly interested in an at least neutral, or better yet, positive attitude of China towards their actions.

From the Chinese perspective the situation that occurred after September 11, 2001, gave the country additional advantage in relations with the USA. Beijing could use Washington's difficulties and need for diplomatic support to its benefit, particularly, in the Taiwan issue. China and the USA began seeking to avoid open conflict about the island more actively, and the situation was softened. In December 2001 the Bush administration declared support for China joining the WTO. In February 2002 President Bush paid a visit to China to celebrate the 30th anniversary of signing the Shanghai Communiqué by China and the USA confirming that the US would keep conforming to the ''One-China'' policy (The White House 2002; O'Connor 2002).
Another fundamental concept of bilateral relations development was suggested a week after the meeting between American and Chinese leaders was held in New York on September 13, 2005. Addressing a meeting of the National Committee on US-China Relations — the biggest American non-governmental organization engaging in China relations — the Deputy Secretary of State Robert Zoellick suggested constructing an American strategy towards China on the grounds of motivating the latter to become a "responsible interested participant" in the system of international relations. According to him China was interested in the current system which would allow it to achieve considerable goals on its way to becoming a great power (Zoellick 2005).

In his speech R. Zoellick stated in details the reasons why the US must not employ strategy of isolation towards China, similar to the one used towards the USSR. In his opinion, modern China differs from the USSR because it does not strive to spread anti-American ideology around the world, not being a democratic country itself, China does not display aspirations towards potential conflict with democratic countries, practicing mercantilism, China is not prepared for mortal battle with capitalism; finally, the future of China is connected with preserving the current system of international relations prevails in China.

However, despite an evident thaw and mutual disposition to rapprochement after the attacks of September 11, relations between PRC and the USA on the subject of the military area were not restored to the extent existing before the Tiananmen Square protests. The American party expressed evident discontent with actions of China in terms of arms trade, accusing it of providing Iran, Iraq, North Korea, and Pakistan with
technologies. The USA was also concerned about the growing influence of PRC in Latin America, China's close relations with ideologically aligned Cuba, and active development of relations with Venezuela and Brazil. Even though 2005 and 2006 annual reports of the Pentagon on the military potential of China demonstrated that the attitude towards aggression of the US in Iraq within the military establishment of China was deeply negative, a thesis on the "peaceful rise of China" prevailed among Washington civil political elite after September 2001 (Office of the Secretary of Defense 2005; Office of the Secretary of Defense 2006).

In March 2005 the Chinese Parliament adopted the Anti-Secession Law, which entitled Beijing to apply force in terms of the Taiwan matter. Although the law interprets actions of force as a last resort measure in the conditions when "possibilities for a peaceful reunification ... [are] completely exhausted", non-peaceful measures might now be taken to prevent the separation of the island. The response of the White House to the fact of the law's adoption was unambiguously negative, and while China and the US managed to avoid significant escalating of tensions at that point, generally, the confrontation between the US and China was dramatically intensified (Xinhua News Agency 2005; Xinhua News Agency 2005; Xinhua News Agency 2005).

The year of 2006 marked an abrupt turnabout in the US policy towards China. Three months after appointing Henry Paulson the Minister for Finance the US President George W. Bush and the Chairman of PRC Hu Jintao signed an agreement on a "Strategic economic dialogue" (SED). Paulson became the Co-Chairman on the
American part. Paulson contributed to the creation of the urgent plan for the American economy rescue, which influenced further development of Chinese-American relations and made a certain impact on the US policy towards its Asian partner. With the financial crisis in full play, the Foreign Affairs magazine of September-October, 2008, published an article by Henry Paulson “A Strategic Economic Engagement: Strengthening U.S.-Chinese Ties”. At the very beginning of the article Paulson says: “One of the first challenges the next U.S. president will face will be how to respond to China's emergence as a global power. Some people suggest that China is a threat that must be countered or contained. Others argue that its growth is an opportunity for the U.S. economy and that Washington should manage this rising power through engagement. I believe that engagement is the only path to success” (Paulson 2008).

In March 2009 the Pentagon annual report was issued. It was concerned about the development of new weapons in China, which, according to the information of the American Department of Defense, would influence considerably both the Pacific Rim and the whole world. The document stated that even though the intentions of China to use its military power were unclear, ultimately the potential of a major conflict was limited. In the context of the world economic crisis a desire to iron out any differences in international relations and contribute to their development in every possible way came to the fore. As Bush Jr. announced in 2008, commitment of the US to diplomacy, trade and opposition to common challenges had become especially important for the relationship with China. In terms of security the president approved of the leading role of China in Six Party Talks with the purpose of convincing North Korea to stop using nuclear weapons.
Bush also confirmed Washington's commitment to the "One-China" policy in the matter of Taiwan, three collective communiqués and successive commitment to Taiwan's democracy in compliance with the Law on Taiwanese relations (Kan 2011).

The commitment of the US to the policy was also repeatedly reiterated by the Obama administration in 2009, 2010, and 2011. Generally, the new administration has not made significant changes to the US policy towards China. During numerous meetings in recent years the leaders of the two countries continued to agree on the necessity of keeping to the strategy of developing of the bilateral relations. American orientation to this constructive attitude was also manifested in the 2010 National Security Strategy (The White House 2010), although the dissatisfaction related to the Chinese currency, military power, and America's external deficit still exists and promises to grow.

It might be concluded that despite the varied policy of the US towards China since the establishment of diplomatic relations between the two countries, the last decade was marked by mostly positive tendencies and an inclination to the further cooperation between the US and PRC. To an extent this was caused by the terrorist attacks in September 2001, a tragedy that cardinally changed the course of American politics ever since. The rising economic power of China was an essential component in this process as well, and the still flourishing Chinese economy after the economic crisis was one more demonstration of Beijing's new status in the world affairs. Such concerns as China's relations with some US-unfriendly countries, social policies, or the environment are still on the agenda. However, they do not determine the US politics towards China, and are
just some of the multiple factors that are considered and used by American decision-makers.
CHAPTER 6: ECONOMIC RELATIONS BETWEEN CHINA AND THE US

This chapter discusses the evolution of economic relations between the US and China, as well as the mechanisms that were employed in this process. As major part of economic relations between countries, trade has become one of the most important determining factors of the policy-making process. Trade also underlies the interdependence between the US and China. Such an important sphere of economic relations as energy is also illuminated here.

After the establishment of the diplomatic relations between China and the US, and especially after PRC began the liberalization of its economy, the two countries gradually became bound together with deep economic ties that created a situation of mutual dependence not only in terms of trade, but also politically. The question of the economies' interconnection has been a controversial issue provoking debate that has already gone on for years. While being mutually beneficial, the bilateral trade nevertheless involves a range of various complicated processes related to the military sphere, energy resources, national welfare, and the environment. The question is complex because even though China turned into the world's fastest growing economy and seems to be in the road to prosperity, numerous aspects of its development and fulfillment of obligations towards the external world still cause concern.

A stereotyped notion of the "China threat," which is quite common across many countries, is relevant for the United Stated in the economic sense in the first place. The potential negative consequences of PRC's ascent imply the possibility of the country's domination of the economic and political sphere of the Pacific and, subsequently, the
whole world. One of the major indicators of this possibility for the US is the multibillion trade deficit with China which grows from year to year. The objections to this negative perspective include the fact that although the imports from PRC do significantly exceed the US exports to the Asian country, the kinds of items that the Chinese sell in the American market are not produced in the US anymore, or produced in small quantities. After selling its output in the US, China gets the opportunity to purchase American goods, including such capital- and labor-intensive production as aircraft. This in turn generates the employment of many thousands of Americans.

Before the Asian economic crisis, which took place at the end of the 1990's, more than one third of the US total trade deficit was related to China and Taiwan. This was partially caused by the closed nature of the Asian economies. For example, the tariffs imposed on tobacco products imported in China used to be around 150%, on beer and cosmetics – 120%, and on most types of consumer electronic – about 100%. According to some estimates, if there were substantially more trade liberalization the American exports in China and Taiwan would grow by no less than 90 billion dollars, which would increase the US GDP by almost 150 billion dollars (Gereffi, Spener, and Bair 2002).

Trade

Trade plays a crucial role in the US-Chinese economic relationship. When the reforms in PRC began, the country was the 23rd largest export market and the 45th largest importer to the US. Over time, it became the US largest importer, the second largest trade partner, and the third largest export market. The US exports to China
accounted in 2009 for 69.6 billion dollars. The major export items were oilseeds and grains (increased four-fold over five years from 2.3 to 9.3 million dollars), waste and scrap (increased twice from 3.6 to 7.1 million dollars), semiconductors and other electronic components (increased half as much from 4 to 6 million dollars), aerospace products and parts (increased by almost 20% from 4.5 to 5.3 million dollars), and rubber and synthetic fibers (increased almost twice from 2.1 to 4 million dollars) (Morrison 2011). In 2011 the US exports accounted for almost 104 billion dollars, the major increases were observed in exports of vehicles, aircraft, pulp and paperboard, and organic chemicals (The US-China business council).

The US imports from China also increased dramatically during the last two decades. PRC was the eighth largest supplier for America in 1990, the fourth in 2000, and is currently the first. In 2001 China provided goods for 102 billion dollars, in 2004 for 196 billion dollars, in 2006 for 287 billion dollars, in 2008 for 337 billion dollars, and most recently in 2011 for 399 billion dollars. There was observed a decline in imports from China in 2009 due to the world's economic crisis, but the already a year after the numbers show a surge in imports again. In 2011 the US imported from China electrical machinery and equipment for 98.7 billion dollars, power generation equipment for 94.9 billion dollars, toys, games, and sports equipment for 22.6 billion dollars, furniture for 20.5 billion dollars, footwear and parts for 16.7 billion dollars, knitted and crocheted apparel for 15 billion dollars, and not knitted or crocheted apparel for the same amount, plastics for 10.9 billion dollars, iron and steel for 8.6 billion dollars, vehicles for 8 billion dollars (The US-China business council).
Not only the volume of trade, but also the sector orientation switch, which occurred during the last two decades, should be stressed. Already in 2003, the Chinese exportation to America could be divided into four large categories: miscellaneous manufactured articles to the amount of 28.5 billion dollars, office machine and automatic data processing equipment to the amount of 24.3 billion dollars, telecommunications and audio recording equipment to the amount of 17.5 billion dollars, and electrical machinery to the amount of 12.6 billion dollars. Thus, the highest categories of the import from China are related to technologies. This is in contrast to the end of the 1990's, when the first places were taken by the products of light industry, such as textile. In 2003, the apparel and footwear categories accounted for about 24 billion dollars, which means they moved to 5-6 place in ranking, although the volume of this production has stayed exceptional (Shenkar 2005).

Overall, the total trade between China and the USA grew from two billion dollars in 1979 to more than 450 billion dollars in 2010. In 2011 the bilateral trade accounted for 539 billion dollars, about 36 billion of which was for trade in services, the rest for trade in goods. The US exports of private commercial services increased by 393% since 2000 and accounted for 24.7 billion dollars in 2011. China is the second largest agricultural market for the US, and the fourth largest supplier of agricultural products. The US foreign direct investment in China, which is mostly provided by the manufacturing and banking sectors, accounted for 60.5 billion dollars in 2010. The Chinese side, represented mostly by the wholesale trade sector, invested in the US 3.2
billion dollars in 2010, which indicated the growth by 171% in comparison to the previous year (Office of the United States Trade Representative).

*Trade Deficit*

One of the major American problems in trade with China is the constantly increasing trade deficit. The trade surplus of Greater China (including PRC, Hong Kong, Macao, and Taiwan) with the US increased from 50 billion dollars in 1996 to 139 billion dollars in 2003. Regarding the surplus of Mainland China with the US, it accounted for about 10 billion dollars in 1990, almost 23 billion dollars in 1993, almost 50 billion dollars in 1997, 83 billion dollars in 2001, 103 billion dollars in 2002, 202 billion dollars in 2005, 268 billion dollars in 2008, and 295 billion dollars in 2011. The surplus dropped to 226 billion dollar in 2009 because of the world economic crisis, but recovered quickly and accounted for 273 billion dollars the very next year (U.S. Department of Commerce).

The Chinese trade surplus with the US has been a pressing and controversial issue for years. Although not all the experts consider this import-export balance fatal to the US, it does impact the condition of the national economy, and promises to aggravate in the future. The reasons why the American deficit with China soared are complex. The US traditionally has been inclined to import more than it exports, firstly. The deficits also exist in the trade relations with the European Union, Japan, and Canada, though they are much less than the one with PRC. The difference between the American and the Chinese approaches to free trade partly explains this. As the US adheres to the rules of open market, and is committed to less on nontariff trade, its partners, specifically China, might
take advantage of this behavior, while trying to protect their own economies as much as possible. Additionally, China continues its flagrant violations of intellectual property rights, and the US, being a global leader in innovation and technology, suffers from this behavior (Shenkar 2005).

Currency

One more problem in the US-Chinese economic relations is PRC's currency which is widely considered to be undervalued. Even though China shows its readiness to gradually revalue the yuan in the future if necessary, generally the position of the government against increasing the currency in value is quite firm. The undervalued Chinese currency is also supported by American companies that are involved in importing of Chinese products since the yuan's increase in value would significantly affect their profits (Shenkar 2005). In July 2005, China agreed to revalue yuan by 2% and announced that it was now pegged to the basket of foreign currencies instead of to the US dollar alone. Although yuan was still kept within the fixed bounds allotted for it, this step by PRC's government was supposed to demonstrate its willingness to compromise in order to reserve the access to the American market.

However, even though the US dollar was appreciated by 21.1% from 2005 to 2009, these measures were taken by the Chinese government mostly before the financial crisis, and once the world's economy showed the indications of decline, the rise of yuan was basically ceased. PRC currency has been kept within quite rigid boundaries ever since. This policy pursued by Beijing in effect implies a subsidy for the goods China sells
to the US, and a tariff on the US imports. This situation creates additional difficulties for some US manufacturers who have to face a more severe competition with the Chinese producers, which often results in numerous jobs losses in America. The arguments that the Chinese side uses to back its policies include the necessity to maintain economic stability that is crucial for political stability of the country (Morrison 2011).

**Commodity Chains**

The swift development of the Chinese-American trade, and especially the steep increase in PRC’s imports in the US, which, in turn, results in the trade imbalance, became possible, according to many analysts, due to the structure of commercial relations between the two countries. In other words, from the technical point of view, the development of US-Chinese economic ties might be described with the help of a commodity chains notion. Commodity chains represent a structure created to bring a certain item into the market that involves participation of several parties who are engaged in the design, manufacturing, and selling of the product. Commodity chains definitely played an important role in the establishment of the global capitalism in general, as well as in the formation of the economic ties that now in many ways determine the development of US-China relations. Interestingly, in the case of the Asian market, it was the ethnic identification that laid the basis for the future cooperation in the region. The ties of kinship that existed among Mainland China, Hong Kong, and Taiwan made it possible to diversify the methods and structure of trade available there, and also avoid the
obstacles of political systems in the process of the strengthening of the China's position in
the world market (Gereffi and Korzeniewicz 1994).

The globalization of the world economy, and the reinforcement of the US-China
economic ties as a part of this process, became possible also due to the transformation of
the American retail sector in the 1980's and 1990's. The changes started to occur when
the "retail revolution" turned the US marketplace into an oligopoly. Large firms were
driving out smaller independent enterprises from the economy. By the 1990's, the
retailing in the country was basically represented by 2-3 giant companies, Wal-Mart
being the major one. The next stage of the market transformation was characterized by
the segmentation of the market which reoriented the retailers towards different target
groups among the available populations. This process indicated the evolution of the
American society in regards to the lifestyle and life conditions, but it also enlarged the
gap between the lower and upper classes. However, more importantly, such
fragmentation contributed to the increase in the market openness and significant
involvement of the foreign retailers in the American way of life (Gereffi and
Korzeniewicz 1994).

Thus, in order to organize the trade, not only American offices were established
in China, but the Chinese trade missions were also brought to the US. The involvement of
the factories in the process and the opportunities to effect deals between the sides laid the
basis for the expansion of firm international networks. East Asian countries were
especially engaged in activities in that direction, that is why already in the 1980's almost
three forth of the production imported from the Third world countries to the OESD
countries were provided by Hong Kong, Taiwan, and South Korea. The major consumer was the United States that imported almost one half of the production (Gereffi and Korzeniewicz 1994).

This makes it possible to trace the formation of the trade relations between the US and China. Considering the close connections between Taiwan and Fujian Province, and between Hong Kong and Guangdong Province, the solid investment in these regions of PRC made by their ethnic partners, it is appropriate to state that the economic ties between China and the US were established and strengthened starting in the 1970's and 1980's through the agency of other actors. While the producers' side was represented by numerous plants and factories of different size and forms of ownership, the US side was mainly represented by giant retailers like Wal-Mart and Kmart. Their growing influence in the market based on the concentrated buying power was also supported by the excess capacity of the Asian producers. The overproduction allowed the buyers to receive the goods at a lower price which subsequently led to the flooding of the American market with various Asian products.

Joint ventures based on division of labor and commodity chains covering China, Taiwan, Hong Kong, and the USA became customary and spread to different branches of industry. As in the case of Nike shoes, or, for example, toys, which were designed in Hong Kong, assembled in China, and distributed from Hong Kong, American automobile industry, represented by General Motors, was also included in the Asian joint production in the 1990's. While Mainland China and Taiwan were responsible for the supply of components and parts, the assembly stayed in the US territory, and joint venture was
established in Hong Kong. Such layout not only allowed to increase production efficiency and lower the costs, but also created the basis for successful distribution of GM cars in Asia (Gereffi and Korzeniewicz 1994).

One of the major sectors that was affected by the invasion of Asian goods is the apparel industry. Although highly protected by the US government until very recently, due to the high flow of the imported production and relatively lower consumption, the domestic production still started to decline. By the 1990's, 60% of the imported apparel to the US was provided by the East Asian Big Four composed of Hong Kong, Taiwan, China, and South Korea (Gereffi and Korzeniewicz 1994). The US companies were becoming more and more interested in cooperation with Asian manufacturers. Firstly, because the labor costs in the Far East allowed to considerably lower the cost of production. In the 1991, the compensation costs in China accounted for $0.24 per hour. On the other hand, the quality of the production was improving, and thanks to the scientific advance and communications innovations, the coordination between the trade partners on either side of the ocean was significantly ameliorated (Gereffi and Korzeniewicz 1994).

An important feature of the global supply chains is that due to the complexity of the process, and the numerous sides involved in it, the profits of each of the participants are not easily available, and require various calculations. This fact also partially explains the boosted imports from China to the US. As long as about a half of PRC's export is provided by the foreign-invested firms, the imports to the US also might be seen as imports from different countries that go through China. There is an interesting example
with Apple production which is also manufactured in PRC. A research conducted in 2005 illustrated what the costs for a 30 gigabyte video iPod consisted of, and what was the profit from the production. The devises were made in the Chinese territory by a Taiwanese company, and cost 144 dollars for each unit. Out of this amount, only 4 dollars was the cost of assembly performed by the workers in PRC. The rest was attributed to other participants of the process, such as firms involved in making the components for the final product. The retail price in the US was 299 dollars, which means that after subtracting the transportation and other expenses, the Apple's profit on each unit accounted for about eighty dollars, and the company was the single largest beneficiary (Morrison 2011).

Energy

Energy became one of the most prominent spheres of the US-Chinese economic relations in the 21st century. Since 1978 to 1995, China's demand for energy sources increased by 150%. In the 1990's, the economic growth rate accounted almost 10% on the average, oil consumption rose annually by 5.7%, but oil production increased only by 1.67% with coal staying the main energy source (Woetzel 2003). However, in 2003, China was already the second largest oil consumer in the world after the US, and the third largest oil importer. Three Chinese governmental oil companies became major players in the world's energy market due to sound investment in oil extraction and refining in the Persian Gulf, Central Asia, and Africa. This gave Beijing the opportunity to greatly influence the world's oil demand and thus the pricing.
This situation is unfavorable for the US that is the world's main oil consumer. On the other hand, by 2020 China, which is becoming more dependent on the foreign energy sources, is projected to import 70% of the oil used in the country, and the most part of it will be transported from the Persian Gulf region (Woetzel 2003). For China this raises the question about the control over major oil tanker routes that are now controlled by the US. Overall, the Chinese national strategy has become more energy-centered, and governmental decisions, including economic ones, are taken with the consideration of the implications for the energy sphere. This necessity urges China to establish good relations not only with such countries as Ecuador, Venezuela, Angola, Nigeria, Canada, and Australia, but also with problem states such as Iran.

The US Congress veto to sell the Union Oil Company of California (UNOCAL) to China National Offshore Oil Corporation (CNOOC) in 2005 serves as an example of the distrust existing between the two countries (Guerrera 2005). CNOOC is 70% owned by the government, which means that the purchase of the American company would provide PRC with the access to oil and natural gas fields in Gulf of Mexico, Caspian Sea, South East Asia, Africa, and Latin America. This would be another step by Beijing to increase its influence in the world.

**High Technologies**

High technology plays a crucial role in today's US-Chinese economic relations. The adoption of new technologies and innovation were declared priorities in PRC development plans in the 21st century. In the process of China's joining the WTO, the US
government had to face the necessity of providing China with the most favored nation (MFN) treatment on continuing basis instead of annual confirmation of the status by the US congress. This controversial issue provoked many discussions because such turn in the bilateral relations might have negative consequences for US national security. However earlier, two hundred leaders of American corporations involved in high technology ("blue chips") made a request to the US Congress to vote for China's most favored nation status which was determined as of critical importance in high technology industry. Boeing Company was one of the most active supporters of China's MFN status and China's accessing to the WTO (Lane 1994).

American investors in China create basis for the increasing dependence of their business on the manufacturing lines in PRC. US defense industry is no exception: various components for American military-industrial complex are made in the units owned by the US but located in the territory of China. Overall, from 1990 to 2001 American imports of new technology items from China increased from 160 million to 13 billion dollars, which means the growth by 8126%. At the same time, the export of new technology production from the US to China increased by 483% - from 1.24 billion to 7.24 billion dollars. PRC sees the US as one of the major resources to develop its advanced technology base in order to strengthen the military and economic power of the country (U.S. Department of Commerce; Morrison 2012).

However, besides the direct licensed purchase of the American equipment, Beijing uses informal and indirect methods of scientific acquisitions such as attraction of foreign investment on condition of technology transfer, or gaining of information with
the help of Chinese citizens who study or work in the US. American corporations are interested in the Chinese market and are often ready to make certain concessions in order to negotiate long term contracts. These trends evoke profound concern about the national security in US political circles, which creates a dilemma when decisions have to be made relying both on the economic necessity and potential political implication of them.

*China and the WTO*

The World Trade Organization was established in 1995 as a replacement of the General Agreement on Tariffs and Trade (GATT) that had been functioning since 1948. The purpose of the WTO is promotion and coordination of international economic cooperation on the global level, facilitation of mutual profits and control over the compliance with the contracts made by the member-countries. Currently, the organization unites 157 countries. It took China fifteen years to arrange its joining the WTO, from 1986 when the negotiations were started to 2001 when PRC officially entered the organization.

While in the process of negotiations China defended its right as a developing country to protect its economy, the US insisted on maximum observance of the organization's principles. The compromise was found in China's agreement to reduce tariffs on imported agriculture products by 15% and on industrial goods by 8.9% mostly by 2004 and completely by 2010, renounce subsidies on exported agriculture, provide equal treatment to Chinese and foreign firms in the territory of PRC, as well as non-
discriminatory treatment to all members of the WTO, protect property rights and clear the way to the Chinese banking system for foreign financial institutions (Morrison 2011).

Now it has been over a decade since PRC's accession to the WTO. The country's compliance with the rules and commitment to free trade are still questionable and provoke much discussion. Even though the tariffs reductions were mostly implemented by the Chinese government, numerous aspects of the Beijing's cooperation leave much to be desired. The major problem points that induce the dissatisfaction of the US and the international community in general include the continuing discrimination against foreign companies, manipulation with health and safety rules on imports as a leverage to maintain control over the incoming production, flagrant violations of intellectual property rights, and absence of the essential transparency of functioning of the economic system.

The discontent among the members of the WTO is also caused by the fact that the Chinese government still retains its control over large enterprises and banking systems, seeks to protect certain industries, such as automobiles, aircraft, steel, and high tech, and also provides financial support to such sectors as light industry, shipbuilding, and electronics. The US has filled numerous WTO cases against China over related issues in recent years. Even though PRC constantly loses in such disputes, it keeps arranging new forms of supports for the economy, and continues to benefit from this (Morrison 2011).
**Intellectual property rights**

The violations of the US intellectual property rights by the Chinese is one of the major problems in the countries' bilateral economic relations. The failure of PRC to provide effective enforcement of the appropriate regulations causes enormous financial losses of the American industry. Despite the efforts taken by the Chinese side in order to improve the situation, the number of piracy cases and IPR violations are quite large and hardly manageable. According to the International Intellectual Property Rights Alliance information, about 80% of all the business software and 90% of records and music in China in 2009 were illegal, which caused entailed losses by American producers to the amount of over three billion dollars. The piracy in China is disadvantageous for its own economy as well, because it leads to losses in the national budget and facilitates unemployment.

However, the reason behind Beijing's unwillingness to cope with these issues or the current impossibility to do so probably include a combination of various factors. One of them is the national mentality of the Chinese people which prevents the government from successful implementations of the intellectual property laws. Another reason would be the desire of the Chinese leadership to gain access to innovative technologies in the first place, leaving behind these side effects. In addition, China obviously also basically lacks the basic equipment and specialists necessary to repulse all the hackers and fraud (Morrison 2011). Finally, by turning a blind eye to the intellectual property rights violation issues, PRC avoids the possible popular discontent over the restrictions, and a
peaceful political situation within the country has always been considered by its leaders the most important condition for the successful performance in the international arena.

*Implications of the trade with China for the US*

Although different in their estimations, most of the experts agree on the fact that China will in a while become the world's largest economy which means the end of the US dominance in the international market. If it is in fact going to take PRC much more time to approach the advanced countries in terms of the standards of living and other indicators of a highly developed nation, this situation still implies a major rearrangement of the world economy and requires careful investigation of the possible consequences for the US economy. There are both advantages and disadvantages in the fact that China is becoming the world's largest user of cars, computers, Internet, cell phones, aircrafts, and luxury goods. The cheap Chinese labor provides American consumers with a variety of production at moderate prices. On the other hand, it deprives the US of millions of jobs, while the trade surplus to a certain extent gives PRC's government a green light to demonstrate more independence and self-will in global politics.

The process of economic integration and cooperation between the two countries is now highly unlikely to be stopped or even slowed down, however, it is worth exploring how much harm the trade with China causes to the US economy. In regards to the job losses in America, it should be mentioned that it is not always easy to determine the percentage of jobs lost due to the global economic crisis in comparison to the negative consequences of the China's growth. The lost jobs are mostly related to the
manufacturing sector of the economy, and as long as this sector constitutes about 80% of international trade, the growing import from China should be considered harmful for it. On the other hand, the manufacturing sector accounts for less than one-fifth of the whole economy of the US, which means that generally the impact of PRC's goods on the situation in America is not that dramatic. The Chinese competition, however, does have a negative effect on the American workers in terms of wages. Being a cheap labor source, the Chinese workers involve their counterparts in a "race to the bottom," which might result in a pressure on the wages of the US workers (Morrison 2007).

Therefore, the development of economic relations between America and China has been and continues to be rapid and multifaceted. The sophisticated schemes that were used in order to optimize global commodity chains facilitated the integration of the two economies, and thus resulted in mutual interdependence. The sphere in US-China economic relations is currently becoming more prominent and drawing more attention and concerns is that of high technologies. In a world where China is likely to become the biggest economy, the importance of advanced technological development starts to dominate because it will to a large extent determine the distribution of forces. A related sphere involves intellectual property rights, and the necessity of providing a proper protection of the products of creativity, including the high technologies. Overall, the economic power that China developed with the help of the US, has become its major leverage and means to an end.
CHAPTER 7: CURRENCY AND FINANCE IN US-CHINA RELATIONS
AND ANALYSIS OF ECONOMIC INTERDEPENDENCE

This chapter presents a more detailed discussion of the Chinese currency problem, as well the development and current role of China in the world's financial affairs. Since the late 1970s, the role of China in the global economy started to grow, and unlike other developing countries, PRC did not find itself deeply in debt. China did not borrow significant sums of money from the IMF, and, thus did not become financially dependent on international organizations. Also, being a Communist regime, China managed to demonstrate quite a rapid pace of changes and growth. The Asian financial crisis of the late 1990s did not affect the Chinese economy either, and in 2001 PRC was already a full-fledged member of the WTO. However, even though the country became an important player in world affairs, not all the aspects of globalizations touched upon it. This uniqueness, in the first place, applies to the unwillingness of the Chinese government to open its market to a larger extent, suspend control over the national currency, and not manipulate it for the purpose of self-benefits (Webber, Wang, and Zhu 2002).

Chinese openness, however, played a crucial role in the country's development process. Foreign companies, including mostly transnational corporations, flooded PRC's economy with investments, and by the mid-1990s China was already the world's second largest FDI recipient. Moreover, China has also become a large investor: the government highly encouraged its national manufacturers to invest in foreign business. Even though accurate data on Chinese outward investment is hardly available – part of the financial
flows were not registered by the government at all, and it is especially hard to trace private and individual investment – its growth rates were significant. The targets of this investment were spread all over the world, and major recipients included the US, Australia, Canada, and Hong Kong. The process was also characterized by the opening of numerous Chinese overseas branches and companies (Webber, Wang, and Zhu 2002).

China’s undervalued currency represents one of the major problems in the relations between PRC and the US. This question provokes broad discussions in the American political community, because it is claimed to severely affect the American economy, domestic situation, and general well-being of the nation. The large population of PRC, strict governmental control of the exchange rate, and as a result, cheap Chinese goods coming onto American soil do not only create unfavorable conditions for US domestic manufacturers and facilitate mass American job losses, but also threaten the further successful development of American businesses.

In order to accomplish protectionist measures, the Chinese government daily purchases about one billion dollars in the exchange markets and prevents yuan from rising. This artificially creates a weak currency, which in turn results in job losses in the US and all over the world, facilitates trade imbalances, and eventually hampers the recovery process of other economies. The appreciation of Chinese currency by 25-40% would help cut the American deficit by 100-150 billion dollars annually as well as create 600,000 to 1,200,000 US jobs, because every billion dollars of exports generates 6,000-8,000 US jobs (Bergsten 2010).
The exchange rate issue seemed to begin to move in 2005, when the Chinese government announced the new regime for its currency. Yuan now was to be linked to a basket of foreign currencies instead of the US dollar alone, and a certain margin of fluctuation was allowed. In fact, yuan was still mostly pegged to the dollar, though the relationship somewhat loosened in 2006. By May of 2008, yuan's anchoring to the euro was growing, but in this relation it is important to mention that in 2007 the euro was appreciating against the dollar; when the euro went down due to various reasons, including inner EU problems, the yuan also returned to its former stronger linkage to the dollar. Another reason for the yuan depreciation in 2008 would be dissatisfaction from the Chinese firms, who suffered from insufficient competitiveness against American businesses. Even though the American firms were now the ones who suffered, the situation would have been even worse if the Chinese had not pegged the yuan back to the dollar alone because of the condition of the euro (Frankel 2010).

Basically, for the American companies, the most important factor is that they are able to effectively compete with the Chinese, and not the fact that the Chinese currency is much more appreciated. The advantages of the very slowly rising currency for China are inflation prevention, trade facilitation, financial integration, and prevention of speculative bubbles. However, the concession of further flexibility for yuan would be favorable for China for a number of reasons. They include alteration of the overheated Chinese economy that is observed today, the fact that China is at a disadvantage when paying foreign investors more that it is earning from US Treasury bills, and the reality of growing integration into the world economy (Frankel 2010).
The breakthrough moment at the present stage of the undervalued currency conflict would be the official declaration by the US of the PRC as a manipulator of its currency under the 1988 law. This step, which is being demanded by part of the some in the US political community yet still has not been taken by the US government, would allow the US side to take some concrete measures to improve the situation. In particular, expedited negotiations with China on this problem would be started, which would also allow the American government to introduce certain protectionist measures for the domestic economy (Eckert 2010).

However, the reluctance of the American government to accuse China of its currency manipulation is, probably, to some extent caused by the limited possibility of finding sufficient arguments for PRC's violation of rules. Regardless of the loud statements of numerous politicians or President Obama's claim that the Chinese undervalued currency is the major reason for PRC’s trade surplus, it would be hard to prove that China violated any norms of the WTO. First, because, generally, the currency situation does not necessarily have to affect trade: in theory the prices adjust so exports and imports stay the same; the 2005 appreciation did not significantly improved the US deficit; and the labor costs in China gradually rise despite the fixed rate. Furthermore, it is not easy to reliably estimate the degree of the exchange rate misalignment, as well as to assess the subsidy effect of the undervalued yuan (Staiger and Sykes 2010). In other words, it might turn out to be illegal for the US to demand the appreciation of yuan under the WTO laws. In any case, the charges of currency manipulation against China promise to lead to a long and complicated process, which would require massive legal efforts and
might not result in desired changes, but which would definitely aggravate the relations between the two countries.

The Chinese crawling pegged currency stays a controversial issue. Indeed, as it is not the only reason for global economic imbalances, the opinions on its role in the process vary significantly. According to some of them, the debates around depreciated yuan reproduce the situation with the Japanese currency and the American trade deficit in the 1970's-80's. At that time, even though Japan yielded to the pressure – appreciated its yen – and the US improved the deficit, Japan maintained the surplus. Moreover, the economy of Japan entered a phase of decline afterwards (Wyplosz 2010).

The alternative explanation of the US market problems, then, would be other factors; specifically, savings tendencies. It is useless to claim that the Chinese currency and the American deficit are not correlated; however, it might be also important to look at both problems from the inner prospective. Therefore, on the one hand, China uses the exchange rate to stabilize domestic prices and keep inflation at a lower level. At the same time, the Chinese are known for their inclination to save up. The Americans, for their part, demonstrate the opposite trend: US private savings have been declining, and this was also aggravated by general deregulations in the global economy in the early 1990s. In particular, such transformations led to the development of subprime mortgage markets in the US. Thus, the decline in savings eventually resulted in the account balance that can be observed today (Wyplosz 2010).

The important question that should be answered in terms of the exchange rate debate is how much America would prefer China to appreciate its currency. It also should
be noted that some research shows that the real appreciation of yuan in recent years has been higher than its nominal appreciation. While the nominal numbers demonstrate a four percent appreciation from 2009 to 2011, after the consideration of inflation the rate seems to account for about seventeen percent. Additionally, the data on manufacturing wages in the US and China for the period between 2002 and 2008 show that in America wages grew by twenty percent, and in PRC they doubled (The Economist 2011b).

In fact, 2011 brought new realities to the world economy. The decline in Chinese factories' activity, generally lower growth rates in other developing countries such as India and Brazil and European financial problems marked the beginning of a global economic slowdown. The natural trend in this situation is that of undervalued currency and lower inflation rates. The huge Chinese surplus, though, still suggested that their currency should be appreciated, and that was what the international community kept demanding from Beijing. However, the yuan demonstrated a tendency to stay at a lower level when it was practically attached to the lower edge of the daily trading window for several months. This means that the real value of PRC's currency was somewhat close to its fair value in summer 2011 and was actually inclined to go down while Beijing was fixing its rate to be higher. This also means that the yuan was rather overvalued (or was going to become overvalued), instead of being undervalued, and its depreciation was likely to follow (The Economist 2011d; Noble 2011b).

In March 2012, the People's Bank of China announced that the yuan was now close enough to its equilibrium level, which implied the end of the appreciation phase that had been tolerated by the government since 2010. In that period of time the Chinese
currency appreciated by about eight percent against the US dollar. The appreciation since 2005 accounted for 24%. The trade between the two countries is growing: in 2011 the US exported to China goods for more than one hundred billion dollars, even though PRC kept its surplus. Also, although the value of the Chinese currency might be considered much closer to the appropriate level, the economy of the Asian giant could not be regarded as significantly better-balanced. The wages have grown, but consumption lacks the essential characteristics of a healthy economy (The Economist 2012).

The reason why the Chinese surplus has been narrowed while the consumption did not show great results is due to increased domestic investment in China. This situation, however, promises to bring even larger surpluses for China in the future. As it happened in the 2000s when the financial flows mostly poured into heavy industries and then the domestic demand decreased, the overstock was sold abroad, which resulted in the growth of the surplus. The last three years were marked by increased investment as well. This time, though, only about ten percent of the finances went to manufactures, while fifty percent accumulated in infrastructure projects. The lower investment was necessary for the improvement of the situation, but, at the same time, the saving rates had to decrease, too, and possibly at a higher speed. As long as such a combination of events seems to be difficult for Beijing to achieve, the active balance of China is likely to continue and strengthen (The Economist 2012).

In terms of the prospective of US-China financial relationship it is useful to turn to the perception of solvency and the prognoses offered by world's major credit rating agencies. While in 2011 one of the world's biggest credit agencies, Standard & Poor's
(S&P), indicated the US creditability outlook as "negative" and expressed the concern that the US is likely to face certain budgetary problems by 2013, the Chinese main credit agency Dagong went farther and downgraded the US from AA to A+, which marked a significant drop for the world's largest economy. Even though Dagong partners including S&P might not always agree with its views on the current situation and refuse to accept its ratings, the fact that China is the world's major creditor probably obliges the world to take into consideration the evaluation proposed by Dagong.

Meanwhile, Dagong stated that the financial crisis in the US will deepen in the coming years, and that dollar depreciation will be an inevitable trend in the world's economy. The agency also expressed its confidence in the upcoming recession in the US economy, which will weaken American solvency. According to Dagong, the overflow of dollars in this situation will result in growth of speculative capitals in the international financial system, and countries will seek the possibility of avoiding the increase of debts in dollar. However, it should be mentioned that China will have to continue buying US government debt as long as it keeps pegging yuan to the American currency (The Economist 2011c; Noble 2011a).

At the same time, the Chinese government seems to have few options concerning ways to manage its currency. Considering the huge reserve of the American securities in China, it becomes obvious that any attempt to switch to another currency to peg the yuan to (if there are such options at all) will induce a considerable harm to PRC's economy. Also, the American financial situation is not that bad, and there are obviously numerous assets to support it and put it on the road to a faster recovery, even though
some political changes are likely to be accepted in order to face the challenges of the new world economy. The political conditions in China as always have a great impact on the economic situation as well. In the view of the expected economic slowdown in PRC, which is caused by such factors as low consumption and aggravated by social problems, the decisions taken by Chinese leaders will also to a large extent determine the development of events. In this respect, the interdependence of the US and PRC's economies appears even more crucial. The currency issue, though, is likely to be alleviated, as Beijing should continue the appreciation of yuan at least to fight inflation (The Economist 2011b; The Economist 2011b; The Economist 2011a).

One of the problems that China is also likely to face, according to some experts, is a debt problem. The risk that China might not be able to pay the bills is increasing, and the reason is the rapid pace of development, when, for example, some huge construction projects are implemented in the short term and the revenues might turn out not to be enough to cover the costs. The local government debts present a problem as well. However, the fact is that the main reason for these concerns is the economic growth; thus it can be safely stated that the reduction of it by a couple of percents will most likely help cope with the debt problem. Another factor that suggests China can be optimistic lies in its political regime. As the financial system is oppressed by the government, the Chinese debts are also concentrated in the possession of Beijing, and foreign organizations have to face considerable obstacles on the way to their purchase. Moreover, the government has the leverage to manage these issues, including the possibility to easily reduce the debt —
especially when inflation is high – and basically to use the population's savings to improve the situation (The Economist 2011a).

Such problems, thus, become part of the important discussion on PRC’s political system, its future, and its influence on US-Chinese relations. While not a democracy, China differs from other autocracies as well. Even though power is exercised by a single party that obviously does not have any competition, the transition of leadership between generations has been created and works, so some sort of inner democracy is present in the party structure. The question is whether China is approaching real democracy in the future, or if it will continue its own way of development (The Economist 2011a). The latter option sets another question, which is whether democracy is necessary for a highly-developed society, and particularly for a nation of China's size. Although PRC still has a long way to go to reach the level of development of such countries as the US, exploration of the questions above would be helpful in terms of determining further policies towards China, and for better understanding of the economic issues in particular.

Overall, although economic interdependence might have contributed to the development of some economic rivalry between the US and China, and caused outbreaks of a number of conflicts, this interconnection that has formed between the two countries on the basis of economic relations has taken on a great importance and now requires each county to consider how their actions in either the economic or security sphere could poison the overall relationship. As the US continues to be dependent on China, China is also still highly dependent on the US. America provides China with markets to sell their goods, as well as China remains an important export market for the US. Joint venture
networks link both states in a such way that it would be near impossible to curtail cooperation.

The solution to many of the domestic problems experienced by the two countries is also dependent on the successful development of economic relations. The much debated problem of Chinese currency is tightly linked to the issues of American spendings and Chinese savings, along with the Chinese inflation level affecting domestic prices. The linkage between the yuan and dollar also contributes to the situation of mutual dependence since Beijing will accumulate American debts in dollars even if the overflow of dollars starts to cause larger concerns within the global community. This developed interdependence therefore only becomes stronger, and with time any attempts of China to reverse the process could do increasing harm to the PRC's economy. The economic linkages are so dense it sets up the conditions for complex interdependence and alters the behavior of each actor.
CHAPTER 8: SECURITY IN US-CHINESE RELATIONS AND ANALYSIS

The special sphere of the US-China relations is the problematique of national security and its influence on the foreign policy-making process and development of economic relations between the US and China. The problem of national security has been central for both nations, even though their understanding of the related concepts might significantly differ. Although they are major trade partners, the two countries stay rivals in the security sphere, which creates an unusual situation for the United States and thus requires unusual approaches to this topical issue. This question is of great interest — not only for the world's politicians, economists, and political scientists, but also for the global community in general – because it touches upon the future implications of communication between two of the most important political actors in the world arena. In order to fully evaluate the role national security issues play in the economic policy-making process, it is useful to review security-related concepts offered by realists, as well as to examine the recent history of development of the concept of security in both countries, especially China.

A realist Randall Schweller in his work "Neorealism's Status-Quo Bias: What Security Dilemma" dating back to 1996, discusses the development of status quo and revisionist states notions in Realism in the second half of the 20th century. Schweller points out that status quo powers are states that value their existing position in the world, seek to preserve the situation, and therefore are unlikely to use military means to extend influence. Revisionist states, on the contrary, are more interested in increasing their territory and influence, their current position and advantages are not enough to prevent
them from using military power to make an endeavor of conquest. These revisionist countries become the source of competition, aggression, and violence. The whole international situation therefore is dependent on the balance between the two groups of states. In case when status quo supporters accumulate the most power, the world system remains stable.

From the neorealistic perspective, relative gains play a crucial role in the balance mentioned above. More advantage gained by others might prevent states from cooperating, however on the other hand, achievement of security becomes the priority, and since security is hard to achieve unilaterally for most of countries, these countries are inclined to cooperate. Therefore, while states might have to cooperate, they stay concerned about deceitful behavior of their partners, as well as the possibility that these partners may gain relatively more and become either a domineering friends or more powerful foes. In conclusion, Schweller asserts that the current world order is determined by satisfied status quo states as they possess most power. At the same time the developing states are unlikely to go to war because costs significantly outweigh benefits, while the states are focused on their own development (Schweller 1996, 90-121).

In his more recent work, "After Unipolarity: China's Visions of International Order in an Era U.S. Decline," Schweller addresses the issue of anarchy in the world relations more specifically, that is by discussing the situation that has developed during the next twenty years after the breakup of the USSR. Schweller states that even though traditional realism would suggest that strengthening of the developing states, which should result in multipolarity, creates a basis for a new, fierce struggle for power between
countries, in fact, this situation only means that the international balance will somewhat change when other important players join the US on the top. Further development will be dependent on the intentions of each participant of the process. Schweller proposes three ways in which those states, particularly the most likely US challenger China, might decide to behave. The options include the role of a supporter, when it contributes to maintaining the existing situation, a spoiler, when it takes efforts to change it, and a shirker, when it enjoys the advantages of a higher position but escapes the responsibilities attached.

As Realism suggests though, when a hegemon's competitors gain certain strength, they tend to become aggressive and would like to display their dissatisfaction and their ambitions for a greater role in the world affairs. Nevertheless, the Chinese approach to this situation, according to Schweller, does not imply an open confrontation with the US, but is rather comprised of a set of measures taken to undermine American leadership. These measures include voting against the US in international organizations, promotion of multilateralism, and employing soft power. The reasons why Beijing would choose this path consist in China's understanding of its own backwardness in comparison to the US, the general willingness of the US to cooperate, and the necessity to maintain stable relations with the US to continue successful development (Schweller and Pu 2011, 41).

In any case, the position of China in the world arena is quite ambiguous. On the one hand, China is highly involved in international interactions and has demonstrated its willingness to collaborate with other countries. On the other hand, Chinese politics is still
under a veil of mystery for many global actors. This can be explained by the fact that as an Asian country with eastern social and political traditions, China adopts a policy which might be not fully comprehensible for western countries. At the same time, China’s power is growing, and foreign experts find it necessary to hypothesize on the further pace of developments. What to expect from PRC in the coming years?

China is still a developing state, and due to a lower degree of responsibility it used to take little part in global affairs; with its growth, however, China is becoming much more involved. Thus, the question of Chinese compliance with the international norms of security, free trade, proliferation and arms control, national self-determination, and human rights becomes more urgent. More or less, violations of these rules by China could be observed in all of their aspects. However, the highest concern is caused over the situation with self-determination (Chinese policy towards autonomous regions in western China and Taiwan), and human rights.

Although China stands for multipolarity, at this point of its history it cannot afford to oppose the US leadership due to its growing interdependence, as well as other factors in Sino-American relations and global issues. Thus, there is strong evidence of the Chinese commitment to the status quo. Nevertheless, there are some causes for concern. They consist of the change of regional perceptions of Chinese political goals, which has been expressed by more frequent assumptions of Chinese political ambitions; Sino-US economic relations also might be represented as a threat to American power; Chinese reluctance to recognize the independence of Taiwan and arms buildup in the region
clearly undermines the incontestability of the American military’s dominance in the region (Johnston 2004).

Even though China is representing itself as a peaceful state, there exists certain historical evidence that suggest its inclination for use of force in relations with its neighbors. The example of such a tendency might be found in policies implemented in Mao Zedong's era in the 20th century. Mao's texts illustrate the understanding of China's position in the world by the Chinese elite of that time. For Mao, conflict is a solution to political problems, and therefore is inevitable and desirable. Contradictions between adversaries grow into principal antagonistic ones, and at that point diplomatic means turn out to be inefficient. Violence is strongly acceptable ideologically and pragmatically, and war is considered the highest form of struggle. Security, in his opinion, is also fully dependent on military power. In his works, Mao develops a strategy to defeat an enemy that relies on a set of actions which include finding weak spots of the adversary with the help of intelligence service, deploying the troops in certain ways, and using the adversary’s experience and mistakes against them. For example, in “On the New Stage” (1938) Mao points out that the only way to defeat Japanese imperialism is to use military power.

Generally, in Mao’s grand strategy, military power plays probably the most important role, and the conflicts, which are supposed to be necessary to achieve his political goals, are to be provoked and started by China. This strategy is generally similar to Western Realpolitik. Thus, however the Chinese policies might have changed in the 21st century, strategic culture and ideational roots of Chinese military behavior are very
important in terms of studying Chinese political behavior, because those might be part of the strategy that has led the Chinese to their growth of influence in the international arena nowadays (Johnston 1996).

In any case, what definitely affects the way a country pursues its domestic and, more importantly, foreign policies is the nation's perception of security interests and its accordance with the notion accepted in the world community. The national interests of a country might be characterized with the help of the political statements and documents within the country, as well as through international interactions, including, for instance, the state’s participation in international organizations. The physical embodiment of national security is state boundaries, and the violation of them is the violation of the state’s national security.

China is a special case in the discussion of security interests. It is a large world power that is involved in major international processes, and its opinion should be regarded. At the same time, the Chinese perception of national interests has not, in fact, considerably changed over the centuries, even though the country’s modern view has been formed as a blend of traditional culture, modern political rhetoric, and the result of interactions with the external world — or, in other words, under the pressure of the world community.

Talking about the Chinese attitude to the boundaries problem, it should be mentioned that it was quite disputatious. The examples of the border conflicts that occurred between China and its neighbor states, such as the Soviet Union, Russia, India, and Vietnam, show that China was always inclined to assert claims to the border
territories, mostly arguing that the territories were obtained by the other states as a result of unfair treaties or that the frontiers were not, in fact, properly marked at all. Whether the disputes led to any military actions or not, and whether China achieved any positive results or not, the tendencies to maintain the rights are clear.

It is useful to mention the relations of PRC with its three main disputed territories: Taiwan, Tibet, and Hong Kong. Probably the major attribute of the Chinese attitude to these regions is that China has always considered them its integral parts, and as a result, treated the territorial problems related to them as internal problems. Moreover, the point always highlighted by China is that not only do the territories compose one state, but also that the population of them composes one united nation. The ways China developed relations with these three regions were different, though, which is obvious considering its differing relations with them. Taiwan was separated after the triumph of the communist party over Guomindang. Subsequently, the tactics of the Chinese government dealing with this problem involved constant insistence on Taiwan’s belonging to continental China. That much is also clear in the statements made by the United States about its acceptance of the Chinese view on the issue.

In the case of Tibet, China found it possible to apply force to occupy the territory, after which it established effective sovereignty in the region, and then devoted much effort to develop it in an attempt to close the existing gap in economic progress between Tibet and the Chinese provinces. Hong Kong experiences the most flexible attitude from the Chinese side. Being under British rule, and presenting some kind of a security threat to China, it still did not feel much aggression from the continent. Although Beijing
insisted on the illegitimacy of Britain’s presence in the region, Hong Kong was only probably subjected to economic pressure from the Chinese. It also should be mentioned that, in all the discussed cases, this Chinese flexibility was expressed through the conditions of unification proposed for the regions: the autonomy.

The Chinese understanding of national interests is also clearly expressed in their method of conducting human rights policies. Since the establishment of the People’s Republic of China, the government has been persistently advancing the idea of Chinese independence from the wider world, its right to pursue its own policy, and live according to its own principles. The economic aspect of Chinese sovereignty is, of course, another example. Even though China is significantly involved in international trade, the government of PRC has always reserved the right to control its economy to a large extent.

A certain shift, however, took place in the Chinese attitude toward security-related issues in modern times. The position of the Chinese government toward sovereignty, which was expressed in territorial claims in three major directions on the Chinese borders, shifted from a “loud” to a “silent” one. China still considered the disputed territories its integral parts and hoped to have them back as soon as possible; however, it also became more flexible. Thus, in the relations with India and Vietnam, China did not reduce its claims, but the frictions took a form of negotiations between the governments and were marked by general improvement. Additionally, in those years, the economic component already started to play the leading role in the relations among Asian countries, and China's responsibility to the international community grew (Carlson 2005).
At the same time, it should be mentioned that there is a certain set of methods which has been practiced by China through time. The Chinese concept of security underlies these methods: a major part of the Chinese interpretations of international relations, as well as Chinese foreign policy, are based on the principles of independence, non-interference, and the respect of states’ political, economic and social systems. China also demonstrates much flexibility in terms of relations with its neighbors and partners; disputes are being resolved at the level of bilateral negotiations, and almost no dogmatic statements are being made. Furthermore, China tends to observe the relations, policies, and potentials of other players in the world arena, after which it draws conclusions about the most effective policy to be adopted toward those players.

One more important aspect of the Chinese worldview is that it has always put its internal stability and the territorial integrity ahead of all else because this is the guarantee of peace and stability along its borders and in the region. This means that as long as some of China’s internal questions remain unsolved, the country is not going to initiate steps in world politics that are going to significantly shake the international community. This may be considered one of the major arguments against the claims about the revisionist tendencies of PRC: as long as Taiwan and other territorial questions remain unsettled, China is likely to keep to the status quo. Globalization could be named one of the other arguments: the growing interdependence of the country — and the interdependence of China and the USA in particular — create a situation that makes China carefully consider all the steps taken in global politics (Carlson 2005).
This also brings on the question of Grieco's relative gains. Probably, this problem is not particularly relevant in the US-China case. The interdependence between the two countries affects China's behavior in a way that it makes China less aggressive even though China is gaining relative to the US. China appears to be indirectly heavily dependent on the US to solve its domestic problems such as the population growth and rural-urban migration because it needs US markets for Chinese goods. These problems would not be solved without continuation of an active interaction with the US. Thus, economic interdependence makes Beijing cautious and open for cooperation with Washington.

The war capabilities of China are, though, one of the factors that cause a major concern among Americans. The Pentagon considers China the actor that holds the most potential to compete with America in the military area. Moreover, Beijing has confirmed the gravity of this alarm by its actions. In October 2006 a Chinese submarine managed to remain undiscovered and surfaced in close proximity to the American aircraft carrier "Kitty Hawk". Successful testing of an anti-satellite missile conducted by China in January 2007 demonstrated that American orbital formation can no more be considered invincible and stirred up massive turmoil. The Chinese also conveyed a message to the US that they could no longer have free access to Chinese sea ports by refusing an aircraft carrier formation and two destroyers a port call to Hong Kong in November 2007 (Defense Tech 2006).

The main purpose of this military build on the part of China is to get the advantage in case of an armed conflict in the Taiwan Strait and to prevent American
influence, which might follow if Beijing attempts to solve the Taiwan problem with the use of military force. China is trying to shift the balance in the ratio of military potentials in this area to its favor so that Washington would have to think very carefully before deciding to display actions of force to support Taiwan "separatism."

The situation intensified in October 2008 after the Pentagon announced an agreement of weapons supply with Taiwan in the amount of 6.5 billion dollars. The agreement included the supply of 30 Apache attack helicopters and 330 Patriot missiles. Officially Beijing then condemned the sale of American weapons to Taipei as a flagrant violation of agreements between the US and PRC and intervention into internal affairs of China (The New York Times 2009). The next episode of military contradictions took place in March 2009, when the American government accused China of provoking an American military vessel. The incident took place in neutral waters of the South China Sea (Mcdonald 2009). The Department of Defense then delivered a note to the military attaché of China, which said that Chinese surveillance ship and several other vessels had surrounded the American ship *Impeccable* and attempted to close in on it.

The Pentagon annual report of 2009, however, was somehow ambiguous, confirming the peaceful rise of China but also declaring the uncertainty of the situation with the potential use of military power. It was reported that compared to the year 1999, China’s military budget doubled in size and, according to the official data, comprised about 60 billion dollars. The Pentagon also criticized China for weapons trade with such countries as Iran, Sudan, Zimbabwe, because part of these supplies had gone to the hands
of terrorists acting on the territories of Iraq and Afghanistan (Office of the Secretary of Defense 2009; Mount 2009).

The question that remains is whether China is a status quo power or a revisionist state. In part, the problem lies in the vagueness of these concepts. Nevertheless, it might be useful to look at some indicators of China's position in the world and sum up the results. One of the aspects to consider would be China's involvement in international affairs. The examination of PRC's membership in international organizations show that while the Asian state was not an active participant in global life before, already in the 1990's it became more active than it would be expected for a country at that level of development (Johnston 2003, 5-56). Is China trying to change the rules of the game? In terms of its participation in economic organizations, China was not noticed attempting to propose cardinal changes. For international security institutions, China's intentions are harder to measure since it participated in founding a number of those. It should also be mentioned that the processes of rule changing in international organizations are designed in a way to prevent participants from easily promoting self-interests.

China's activities within the organizations include struggle for sovereignty for itself and other developing states, support of free trade – because Chinese leaders see further successful economic growth of the country as a result of cooperation and integration into the global capitalist system, and somewhat vague and controversial positions on such issues as proliferation and human rights. Economic interdependence seems to be the major factor affecting the decisions of the PRC's government to basically not challenge the US global leadership position: the costs of the necessary economic
transformation and social militarization would be too high so it would impede the country's growth significantly (Johnston 2003, 5-56).

Therefore, the case of relations between the US and China, one of which is the current world political and economic leader while the other is the rising global power, potential rival and therefore a threat to the first one, represents an interesting area to study regarding the connections and conflicts between security rivalry, economic cooperation and interdependence. There are reasons to claim that this situation might not lead to an intense security rivalry, as the traditional approach would suggest. For realists, the hierarchy of a state's problems is based on the presumption that due to anarchy in the international system, the only way for a state to ensure its own security is to increase its military capability. Therefore, any other issues, including economic ones, are pushed to the sidelines (Paul and Ripsman 2010). Kissinger in his recent book *On China* claims that the 2008 Olympic Games in Beijing were a symbolic declaration of the returned great power of the Chinese nation, and an additional reminder that China was coming out as the victor of the economic crisis, unlike other nations (Kissinger 2011). He also asserts that the debates on proper foreign politics are still ongoing in PRC's governmental institutions, and the declared "peaceful rise" of China will have to face a number of realistic obstacles (Kissinger 2011).

Nevertheless, assuming that the development of events is not interrupted by totally unexpected changes, I would argue that both sides will make efforts to prevent any existing areas of tensions from affecting their relationship in general. In other words, there are grounds to believe that both countries will prefer to preserve the current state of
affairs and the rules of the game, which constitute the overall predominance of economic issues over security in their bilateral relations. Meanwhile, each of the states has its own unique combination of circumstances that explains such tendencies.

As it was already discussed above, there are different approaches to the problem depending on whether China should be considered an aggressive state. Although the Chinese army was rarely seen in the ancient wars of conquest, and basically all the aliens who would come to China following the Portuguese in the 16th century for the purpose of trade, exploration, or colonization were absorbed into the Chinese population, some historical documents since ancient times up until the epoch of Mao indicate that China's military strategies were quite well-developed, and always considered a force when national security appeared in danger. Nevertheless, evidence show that the Chinese Communist leadership decided to embark upon the road of reconciliation, which can be proved by the maximum effort taken by PRC in elimination of territorial disputes with its neighboring countries in the second half of the 20th century. There may be some more recent exceptions, such as the disputes of the seas near China, but the overall trend holds. Starting with the first reforms of the new China, the country’s government has been proposing decisions aimed at taking any possibility to move forward with limited conflict, raise the economy, and take the nation to a new level of development. The conditions that are necessary to achieve these goals formulated by the Chinese could also be used as evidence of China's present commitment to the security status quo.

The major conditions for successful international performance are considered by the Chinese leaders to be domestic peace, stability, and prosperity. These include
economic development and the achievement of the territorial integrity of the state. For the first condition, the Chinese leaders elaborated a program which allowed the country to become the world's fastest developing economy, reaching today's position in the international community within the shortest possible period of time. Taking into account the orientation on exports since the early stage of the reform, the development of good relations with the world's largest economy, the US, was necessary for successful economic growth. This means certain concessions were made to the US despite any possible political contradictions, and accelerated trade led to the situation of economic interdependence which can be observed today.

After regaining authority over Hong Kong and Macao, on the issue of territorial integrity China is only left with the unresolved Taiwan problem and control of the seas near China. As China has declared the island of Taiwan its inseparable part, the government's policy is to not take major game-changing actions in the world arena until it is returned to the fold. At the same time, considering the extremely low probability of this happening due to multiple factors, including the attitude of the local population to the issue, the island's government, and the support from the US, China risks staying in the "domestic problems" stage for a long time. On the other hand, the rapprochement between the island and the continent seems to be inevitable, at the very least due to economic reasons, and in a globalizing world with the borders blurring this result probably might satisfy PRC. Still, Taiwan is a prominent problem in US-Chinese relations. While the US maintains support for the island, including military support, China will not be able to solve this issue by force. The Chinese military capability still
stays far behind that of the Americans, and will remain thus in the foreseeable future. In order to achieve their goal by peaceful means, China definitely needs to gain American support.

An integral part of reaching superpower status for China would be taking responsibility for the world's problems and international security. Since the establishment of PRC and up until now, even though China is a member of a number of international organizations, its government stresses the inability of China to join the club of major decision-makers due to an insufficient level of development and the necessity of coping with domestic problems. The responsibility that would be imposed on China implies not only a bigger role in world affairs, but also possibly a more negative reaction from the global community, similar to that which is currently being experienced by the US. China cannot afford to disrupt relations with any countries, including those considered rogue states by the US, because a lack of energy resources and raw material compels the Chinese government to search for and develop every possible option.

China is and has been trying to gain influence in weaker states in Africa, including hotspots like Sudan, but this is directed at gaining access to raw materials and not to enhance China’s influence on the international system. While this has created some tensions with the US, they are minor issues (Wines 2007). Other relatively small problems affecting the US-China relationship include unresolved territorial disputes between China and Southeast Asian states over islands in the South China Sea. The battle over shelf oil has been a disturbing aspect of relations among the Asian countries; however, China is not interested in being excessively aggressive towards her neighbors,
as well as in poisoning its relationship with the US because of this. Thus, there are multiple chances to settle these issues peacefully.

The potential US-China rivalry is different from the Soviet-American confrontation in the past. While the latter took place definitively on the global scale, the present condition of PRC's military forces will not allow it to oppose the US on a similar level. The position which seems to be achievable for China in the future is that of regional hegemon. In order to attain a certain status in the security system of East Asia, China needs to keep normal relations with the current world leader, the US, because it would be more efficient to peacefully develop the country’s national army and seek to obtain better control over sea routes in the region than to bear losses in a conflict with the US, whose military superiority is still unquestionable (Guo and Guo 2010).

Peaceful development of the relationship with the United States is one of the major points of international policy for the Chinese ruling elite, and has been stressed by the country’s leaders multiple times. In particular, it has often been stated that the successful growth of PRC is impossible without stable and amiable relations with the world's greatest power, China's major product market, and an invaluable source of advanced technologies. Besides, due to America's leading position in the world's affairs, its relationship with China affects PRC's relations with other countries, such as Japan and the European states (Guo and Guo 2010).

America’s attitude toward China is driven by factors entirely different than what drives China’s attitude toward the US. In the American government, the attitude towards China differs depending on party affiliation and even among members of the same party.
Among Republicans, business conservatives advocate pro-Chinese policies, because liberalization in trade would lead to mutual benefits. Military hawks and Christian conservatives demand harsher policies against China because of its growing military power, lack of human rights and religions oppressions. Democrats generally tend to express more a positive attitude towards Beijing. As it was often reflected in official speeches by President Obama or the former Secretary of State Hillary Clinton, US-China relations are usually seen as mutually beneficial (Xinhua News Agency 2012; Halper 2013); Chinese efforts to promote democratization are recognized; and further cooperation is declared as a future aim.

The anti-China partisans from both parties are alarmed by PRC's increased military budget (by almost 13% from 1996 to 2008), and by the fact that its military capacities are focused on countering the US forces (Perlez 2012). The US budget has been in decline, and even though its military spending exceeds that of all other nations combined, the US has commitments and responsibilities in different regions of the world while China is mostly engaged in defending its regional interests. China has also modernized its nuclear weapons. There is a fear that China will become inclined to use military power in its border disputes (conflicts with Vietnam, the Philippines, and Japan). China manipulates its currency, imposes trade barriers, and pursues the goal to become a less export-oriented country. China benefits from its large population. Additionally, it obtains Western technologies illegally. In terms of ideology, as a successful authoritarian capitalism country, China may set an example for other developing countries, leading them astray from the democracy path.
Pro-China advocates argue that China will have to cut its military spending soon, because the country’s growing domestic problems (social, ethnic, and environmental) will require more money. Chinese technological progress is not sufficient yet to confront American power, they add, noting that the US defense budget increased by 68% since 2001. The US also has many allies in the region (Japan, Singapore, Malaysia, Indonesia, the Philippines, South Korea, Thailand, Australia, and Taiwan), and China hardly has any. Thankfully China recognizes this and most of territorial disputes are settled by China diplomatically. Pro-China US advocates also point out that even though China holds a major part of the American debt, it does not use this against the US (for example, China did not cut its dollar holdings in 2008 and 2009; that would have hurt the US), as doing so would have hurt China as well. The pro-China advocates further claim that Chinese authoritarian ideas could not be "exported" to other countries due to the specific characteristics of the Chinese nation (Etzioni 2011, 647-666).

The views on US-China relations among American politicians may vary, but most of them would agree that it is in America's interests to contribute to the consolidation of the current positions taken by each country. The major argument on the American side in favor of a smooth relationship with China is due to economic dependence on the Asian state. China is not only the US’s largest importer and second largest export market, but also a major US creditor and manufacturing base. The aggravation of relations with China would make it necessary for America to significantly reconsider its system of production chains and bring financial difficulties.
Despite the US willingness to share the responsibility for global affairs with another country, it remains important for the US to maintain its indisputable leadership among the states. At the same time, the US needs Chinese support on a number of issues. One of them is North Korea, in a variety of negotiations wherein China plays an important role. The same goes for other problem regions such as Africa and the Middle East. After the events of September 11, 2001, international terrorism became an issue at the forefront of the American political agenda. These circumstances also placed China and the US in the same camp against a common threat. A strategic partnership with China would allow the US to count on its support in the decision-making processes related to certain prominent problems, as well as on China's vote in international organizations.

The US, along with China, is likely to favor the differentiation between economics and politics. The fact that China represents a non-democratic state with a number of issues that are considered unacceptable by the US exposes the US to certain difficulties. However, the latter country’s economic dependence on China and the need for Chinese support on crucial political issues lead America toward the necessity of smoothing these contradictions, as it happened after the Tiananmen incident in 1989. Taiwan, and, for example, the corresponding human rights dispute are the leverage America can use in its relations with China to exert pressure in exchange for help.

There is also the phenomenon of globalization to consider; a crucial feature of the modern age as opposed to the past. A globalized world implies not only blurred boundaries in terms of trade and economics, but also the existence of a number of common threats, such as international terrorism, drug trafficking, and environment
pollution – problems that touch upon many nations and can only be struggled with cooperatively if there is to be any hope of success (Paul and Ripsman 2010). In this light, surprisingly China and the US might find themselves as less implacable opponents, but rather potential partners. Moreover, Confucianism, which underlies the Chinese national character, is much closer to Western democratic values than, for example, Islam. This means that the US is more likely to find help from China when there is a transnational problem.

Generally, the case with China and the US suggests that the realist approach and concept of the threat of a rising power might not be as relevant today as it was back in the Cold War. The 20th century marked an incredible leap forward in science, both in terms of the military and social spheres. Many autocratic regimes are now gone, and the world remains on the path to democratization. By now, the international community has accumulated the experience of two world wars and the Cold War, times when the future of global society was in the balance not even once. Today, arms buildup is no longer such an efficient means of pressure on a state's adversaries.

The realists, of course, would not agree with this more optimistic scenario, and would see many more causes for concern that are offered in this paper. From the realist points of view, the rise of China is bound to bring about significant problems for the American leadership status, and probably the end of America's – and in general, the West’s, – dominance in world affairs. The current stage of China's development still might be considered a preparatory period before the state's transition to another position. China's economy has not become the biggest in the world yet, and it yields to America's
economy in technological respects as well. China's military forces have not gained momentum either, and Beijing is perfectly understanding of that. Therefore, PRC generally remains modest in its actions and statements.

However, the situation might change already in the coming decade. The Chinese economy is set to overtake the US economy, and will improve qualitatively. The lack of technologies will be filled in with the help of America and other countries, via both legal and illegal means. Financially, the US might soon find itself fully dependent on China because the latter has accumulated a significant portion of American foreign debt. The gap between the Chinese and US military will decrease, since China continues to demonstrate a considerable increase in its capabilities while the US has cut its military budget. Additionally, China's cultivation of ties with other developing countries helps the Asian state create a new respectable image and reputation in the international community.

Thus, once China is closer to the implementation of its primary plans, it might become more aggressive and demand the right of the deciding vote. The country’s continuing manipulation of its currency will be an extra source of leverage for Beijing in its game with the US. At some point, the US might turn out not to be powerful enough to oppose China and dictate its will. From the realist perspective, such a situation should lead to a conflict between the two states, with one of them laying a claim to world dominance and the other defending its failing positions.

In response to this critique it should be stated that China is not and for a long time is not going to be interested in a conflict with the US. Despite the dependence on China that has been developed by the US in the course of recent years, PRC's well-being
is also still highly dependent on the US. It is in the interests of the Chinese economy that American consumers remain capable of processing the large incoming flow of Chinese goods. China's government understands that a serious conflict with a country as powerful as the US will slow down the desirable economic development of PRC, will generally weaken it, and thus will put it to a disadvantage.

This situation clearly shows that the realist approach should not be considered relevant for the US-China case, as well as for modern international relations in general. The development of communication has promoted globalization and other forces, such as economy, that has started to dominate international relations in place of this outdated approach. The relationship between the US and China opens a new era in understanding and interpreting a multifaceted bilateral relationship. Modern relations between states could be characterized with the help of three major aspects of complex interdependence (Keohane and Nye 2001). The first of these is the variety of communication channels, implying connections on both formal and informal levels that bring more personal interactions instead of blind governmental level exchange. The second is the absence of hierarchy among issues and interlinking of domestic and foreign problems, which to a certain extent prevents state from treating international problems in isolation and facilitates a negotiation process under any predicaments. The third is the exclusion of military actions for any situation that involves economic interdependence, which limits the probability to a minimum.

A rising power can no longer become the source of an inevitable security conflict between states, as it used to be in the last century. The term "security" is more
often related to economic security, and economic leverage has become more effective than military measures while counterbalancing existing powers. International relations is no more a zero-sum game, and the actors gain and lose from both the strengthening and weakening of other economies. Cooperation, therefore, is the way that allows countries to make most gains, regardless of the hierarchy in interstate relations.

A phenomenon so complex as interdependence is a new trend, but it does not seem to be reversible. The growing ties between economies lead to a kind of mutual dependence in which conflict has to be minimized for the common and individual good. Security problems are now topical because the world is undergoing a transformation to a new form. The concept of security itself is exposed to new interpretations, but economic issues dominate increasingly. Security rivalry might take place, but it will more often occur under the conditions of economic interdependence, and this factor will eventually facilitate the relaxation of any tensions. Instead of building up arms, the sides involved are more likely to make efforts to improve economic indicators and thus be able to compete on a desirable level.
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