

Economic Interdependence and Discord in Post-Normalisation China–US Relations

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Abstract: *While the level of China-US interdependence is at an all-time high, there are increasing signs of an emerging strategic rivalry between the world's largest and second largest economies. These developments seem to counter liberal theories of IR, which claim that interdependence has a pacifying effect on interstate relations, and appear to substantiate the realist position that interdependence, in fact, either fuels the chance of conflict, or has no effect on conflict at all. This paper proposes an alternative approach to explaining the dynamics of interdependence and conflict in China-US relations. It argues that recent developments can be better understood by focusing on the asymmetry of interdependence (the relative level of dependence): as China's relative dependence on the US economy declines, its willingness to engage in conflictual behaviour rises. The paper offers empirical evidence to this end, as well as discussion on the nature of China-US interdependence, their political and strategic relations, and potential future trends in China-US relations.*

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1. Introduction

In recent years, the rise, or more aptly, the re-emergence of China¹ as a great power and, consequently, the shifting dynamics of China–US relations have warranted increased attention and intensified discussion by the media, pundits and scholars alike. This discussion on the ties between the world's largest and second largest economies has raised a number of theoretical issues, as well as widespread speculation about the nature and potential future trajectory of the relationship, and the exact factors influencing it.

To invoke Friedberg's (2005) classification, the main fault line in this debate lies between 'liberal optimists' and 'realist pessimists.' The former group of thinkers emphasise the pacifying power of economic interdependence, international institutions and democratisation, arguing that a combination of these forces will foster common interests instead of rivalry, and stabilise China–US relations in the long run. The latter group of observers, however, point to the fact that China is a rising power both in economic and military terms, and, the argument goes, rising powers are bound to challenge the status quo and expand their sphere of influence to maximise their power and security in an anarchic international system.² According to realist pessimists, the very institutions that liberals believe would dampen Chinese expansionism will be in fact the main targets of China's challenge. Moreover, realists posit, historical examples suggest that strategic considerations and the logic of power maximalisation through expansion supersede the presumed pacifying effects of economic interdependence.

This paper aims to contribute to a subdimension of this discussion, the one concerning the ties between economic interdependence and political discord in China–US relations. Economic interdependence is an especially important factor in the relationship, for it appears to be the strongest among the three causal mechanisms which, according to liberal optimists, are deemed to bring stability to China's potentially disrupting re-emergence. Although Chinese participation in international institutions has certainly expanded in recent years, and there is indeed a wide range of common interests between China and the US in global issues, institutionalised cooperation has been less than intense between them. Moreover, while liberals continue to assume that China's economic development will result

¹ I prefer the term 're-emergence' to rise, for it reflects that China, indeed, had been the pre-eminent power in Asia prior to the 19th Century, as well as by far the largest economy on earth up until the industrial revolution in the West.

² As outlined by Gilpin (1981), one of the main reasons for which emerging states tend to be dissatisfied with, and lay challenge to, the status quo is that the institutions of the international system were set up at a time when their position was much weaker, so the hierarchy of prestige within the system does not reflect their growing power and enhanced position vis-à-vis established powers.

in its democratisation, this has not been the case so far.³ Meanwhile, economic ties continue to deepen between China and the US. On the other hand, there appears to be a discord between the high level of China–US interdependence and their political relations, for their deepening economic linkages failed to mitigate continued tensions arising from an emerging strategic rivalry between them.

The hypothesis of this paper aims to address the aforementioned discord by relying on a combination of realist and liberal assumptions. My main assumption is that the driver of China–US tensions is the changing symmetry of interdependence. In my view, the dynamics of China–US relations can be best explained as a function of shifts in the relative level of China’s economic dependence on the US: as China becomes less reliant on US inputs and the US market for its development, or, in other words, as its relative dependence declines, its willingness to engage in conflictual behaviour rises.

This hypothesis rests on two *a priori* assumptions. First, I accept the realist notion that China and the US pursue conflicting foreign policy goals and interests, and China, as a rising power, is deemed to challenge the international status quo in East Asia and, to a lesser degree, also globally. Second, I also accept the liberal assumption that for both China and the US, economic interdependence is an important factor in strategic calculations, which informs foreign policy decisions to a certain degree. Both states take a strategic view of the management of their interdependent relationship, and take into account the effects economic interdependence has on the trade-off structure of conflict. Thus, the dynamics of the relationship cannot be explained in its entirety by the realist approach which relies solely on changes in relative power, while dismisses the effects of interdependence. It should be emphasised however, that the acceptance of these two assumptions is not without reservations. Unlike liberal optimists, I see interdependence as both a broader strategic stabiliser and an instrument of power politics. And in contrast to realist pessimists, I believe that China’s strategic goals, and its means and options to achieve those, are limited by domestic and structural constraints. Moreover, both China and the US see their own posture as defensive in nature. These theoretical issues will be discussed in detail later on in the paper.

³ A recurring theme of these expectation is that as China’s economy develops, so does a new middle class in China emerge. This new middle class is then expected to claim political rights, for members of it want to have a say in deciding the fate of their country and themselves. However, a recent empirical study by Chen (2013) found that the emerging Chinese middle class is indeed heavily reliant on, and acceptant of, the current political and administrative structure, and has very limited demands for political representation.

To test the hypothesis, I conducted quantitative empirical analysis, charting the trajectory of China–US relative economic dependence and political relations in the years since the normalisation of China–US diplomatic ties (1978), and analysing the relationship between these two variables, as well as both liberal and realist controlling variables. The expectation of the hypothesis is to find a positive relationship between China’s relative dependence and political ties: if China is more dependent on the US, political ties improve, while as it becomes less dependent, relations deteriorate.

The first section of the paper discusses the past dynamics and present status of China–US political relations, and identifies the sources of strategic rivalry between the two countries. The second section details the nature and dynamics of China–US economic interdependence, and explores the role of interdependence in political and strategic affairs. The third section reviews, and comments on, theoretical positions and past research on interdependence and conflict, as well as on the methodological issues of interdependence research. The fourth section outlines the research design of this particular study. Finally, the fifth section of the paper presents the findings of the statistical analysis, and discusses the merits and relevance of those.

2. Sources of conflict and the perception of interdependence in Chinese and US foreign policy

Analytic perspectives on China’s rise, China’s foreign policy motives, the looming power transition between the US and China, and China–US relations in general have varied on a wide spectrum, with most of the arguments lying on either side of said spectrum, and indeed very little room for the middle ground in between. China has been described as the most significant geopolitical challenger to the United States (Mearsheimer 2010; Tellis 2013) with an increasingly assertive foreign policy and expansionistic goals, but also as an inward-looking, defensive-oriented, insecure country wary of the numerous threats it—and its leadership—is facing (Nathan and Scobell 2012; Ratner 2013). Some argue that China is bound to become the dominant international player in the 21st century (Jacques 2009; Subramanian 2011), while others assert that China’s relative power is much more meagre than its reputation would suggest (Babones 2011), and in fact even the ruling elite in Beijing fell victim to the fallacy of overestimating present and potential Chinese capabilities based on linear projections (Nye 2010, 2011a). According to numerous accounts, China is deemed to challenge the present political and economic world order, or is at least beginning to undermine a number of its institutions (Vivoda 2009; Buzan 2010; Chin and Thakur 2010;

Fullilove 2011; Subramanian 2011), and some members of the Chinese leadership and intelligentsia are said to be longing for the reinstatement in some way of pre-colonisation Chinese hegemony in Asia (Zhao 2006; Callahan 2008; Ye 2010; Friedberg 2011; Yan 2011). Others maintain that such a challenge will prove to be futile, and China's options will severely be constrained by a vast web of economic interdependence and institutional interconnectedness, as well as by its common global interests with the US (Rosecrance 2006; Ikenberry 2008). It has also been suggested that China's behaviour is indeed becoming increasingly consistent with global norms (Foot and Walter 2009), that China has become more integrated into and more cooperative within international institutions than ever before (Johnston 2003), that it has a record of at least mixed cooperativeness in the UN Security Council (Wuthnow 2010), and that it can be described, in fact, as a status quo power (Shirk 2007; Johnston 2008; Ren and Tanner 2010; Qin 2010). Chinese elites are labelled as both arrogant and insecure (Friedberg 2012), as conflicted (Shambaugh 2011), but also as at least as cooperative as the average world leader (Feng 2009). And, finally, depending on the observer, China-US relations might be described as chronically instable (Yan 2010) and marred by deep strategic distrust (Lieberthal and Wang 2012), or as enjoying a high degree of strategic stability (Johnston 2011; Fingar and Fan 2013).

This brief—and admittedly incomplete—snapshot of the discourse on China-US relations shows that consensus has proven to be elusive on this subject among scholars of international relations, reflecting the enormous complexity of the relationship and the abundance of factors to be considered. But although the aforementioned positions might seem to be contradictory and mutually exclusive, in my opinion, this is far from the case. Taking a more nuanced view of the present status of China-US relations, one can conclude that both states can pursue a predominantly defensive foreign policy agenda, while being potential foes to one another. China can be insecure domestically but an expansionistic challenger to US interests internationally at the same time (Christensen 2011). China can be increasingly engaged in international institutions while undermining their (Western-oriented) goals in the pursuit of its self-interests.⁴ China's power and influence, as well as the pace of its economic growth have certainly outgrown even the expectations of its own leaders in recent years (Wang 2011: 68), yet China is, and in the decades to come will

⁴ It is a noteworthy contradiction that Western commentators often deride China for not engaging in international institutions, but when it actually does, they again deride it for pursuing its own interests, which are of course often contrary to Western ones. In a sense, the West often expects China to behave in a way which would be irrational.

remain, comparatively underdeveloped in economic terms, as well as in institutional power and military capabilities relative to the US (Subramanian 2011). Suffice it to say that the main differences in opinions regarding the present status and future trajectory of China–US relations stem from the fact that individual researchers emphasise the importance of different causal mechanism within the relationship (Friedberg 2005). It would be beyond the scope—and the intended aim—of this paper to engage in discussion on all of the numerous factors and potential contradictions of China’s re-emergence. For the purposes of this paper, what matters is whether there is strategic rivalry, or at least a marked difference in interests between China and the US. I will now turn to discuss this particular aspect of the relationship.

2.1. Conflicting goals and interests

Despite all the aforementioned differences in opinions, there emerged a rather broad consensus among American observers of Chinese politics that the global financial crisis of 2008–2009 marked an important—and quite visible—change in course in China’s foreign policy, as Beijing has become increasingly assertive in protecting and promoting its interests abroad. A common narrative of this phenomenon is that China’s newfound assertiveness is predominantly a result of its perception that the US (and the whole of the Western world) is in steep decline.⁵ In other words, China perceives that its relative power is on the rise and its relative dependence is on the decline. These shifts spurred Chinese leaders to assert their interests more forcefully in the international arena since the outbreak of the crisis (Economy 2010; Johnston 2010; Swaine 2010; Friedberg 2013). This perceptual change regarding the distribution of power in the international system has been evident in Chinese statements and policy documents as well. Yang Jiechi, then Chinese Minister of Foreign Affairs and current State Councillor, wrote in an article dealing with the post-crisis international order that the relative power of the West is rapidly declining, while China faces ‘historic opportunities.’ Moreover, Yang’s (2011) position reflects on an even more fundamental shift in perception by labelling the 2008-2009 crisis as not only an economic and financial one, but also “a crisis of systems, institutions and ideas,” and asserting that “the deficiencies of the capitalist development model in the US and Europe have prompted deep rethinking on capitalism, and the development models and approaches

⁵ Other factors cited in the discourse include rising Chinese nationalism, the leadership transition in 2012/2013, and the increasingly independent role of the People’s Liberation Army in Chinese foreign policy (see Johnston 2010: 34–45).

of China and other emerging economies, which fared better in responding to the crisis than that of the Western countries, attracted wide attention.” In sum, China believes that the US and the West has not only lost ground in terms of hard and soft power, but also in terms of international legitimacy as a result of the crisis.

What the aforementioned Chinese views reflect is that, in Buzan’s (2010: 30–32) words, China is a ‘reformist revisionist’ member of the international society: one that accepts some institutions of the international society for a mixture of calculated and instrumental reasons, while resists and wants to reform others, and also possibly wants to change its status within the international society. Additionally, Shambaugh (2011) found that since 2008 the discourse on foreign policy in China has been dominated by realists with a strong pull from adherents to the so-called nativist school of thought. The latter is a group consisting of a collection of populist, xenophobic nationalists and Marxists, who distrust the outside world and seek total national autonomy. The former strand of thought, branded ‘realism with Chinese characteristics,’ takes the nation-state as the core unit of its analysis, upholds the principle of state sovereignty above all else, and rejects arguments that transnational issues penetrate across borders. Thus, according to Shambaugh (2011: 24), “what the world has seen from China since 2009 is an increasingly realist, narrowly self-interested nation, seeking to maximize its own comprehensive power.”

Whether behind this perceived turn to realist assertiveness lies a ‘grand strategy’ remains an issue of debate and speculation even among Chinese scholars who are thought to be close to the leadership (Economy 2010; Ye 2010; Wang 2011; Yan 2011). But while the broader motives of China remain in doubt, Beijing has at least defined its ‘core national interests,’ issues on which it is not ready to make compromises, rather clearly. These were first outlined in 2009 during the US–China Strategic Dialogue, and were defined by State Councillor Dai Bingguo as (1) safeguarding the basic system and national security, that is, the stability of the leadership of the Chinese Communist Party (CCP) and that of the socialist system; (2) national sovereignty, territorial integrity, and national unification (the unification of Taiwan and Mainland China); and (3) sustained and stable economic and social development (Swaine 2011; Wang 2011). Moreover, there is intense speculation that the safeguarding of territorial integrity includes the protection of Chinese territorial claims on the South China Sea and East China Sea, which have sparked tensions in the region recently.

However, as Johnston (2010) highlighted, China’s foreign policy goals and its main interests have indeed not changed during the last two decades, and Beijing has been

remarkably consistent—and at times, even more assertive than today—in safeguarding those interests. In this sense, the announcement of the aforementioned core interests is merely an official recognition of a foreign policy practice which has been persistent since long before. Moreover, a recurring theme of the current discourse on this perceived shift in China's foreign policy behaviour has been to describe it as a deviation from former leader Deng Xiaoping's strategy, who famously described his vision for China's international involvement with twelve characters, literally meaning 'hiding one's capacity while biding one's time,' and developed the idea of 'not seeking to lead' (Nye 2011b; Zhou 2013). Yet, as Zheng and Tok (2007) noted, China's growing power, its deepening interdependence within the world economy, along with the changing nature of its internal and external challenges, have prompted gradual shifts in China's foreign policy behaviour well before the global economic crisis of 2008, and the passivity in world affairs envisioned by Deng had already been challenged even by his successor, Jiang Zemin during the 1990s. Although subtly, China reinforced its territorial claims Deng agreed to shelve with the passing of the Law on the Territorial Sea and the Contiguous Zone in 1992. In 1995–1996 China conducted a number of missile test in reaction to the looming elections in Taiwan, spurring US interference. In 1999, the Chinese leadership allowed protesters to throw rocks and bottles at the US embassy in violation of international law in Beijing after the presumably accidental bombing of the Chinese embassy in Belgrade during the Kosovo crisis. And in 2001, Chinese authorities held hostage the crew of a US reconnaissance plane after it accidentally collided with a patrolling Chinese fighter jet, and demanded an apology from the US.⁶ Beijing has never ceased to oppose vehemently foreign dignitaries meeting the Dalai Llama, whom the Chinese describe as a secessionist. China also pursues a universal recognition for its 'one-China policy,' often by both political and economic means, and has never refrained from heavily protesting US arms sales to Taiwan. Moreover, up until very recently, China has been generally supportive of the North Korean regime, and turned a blind eye on Pyongyang's nuclear program. Again, these examples show that China's interests have been consistent for at least two decades, and Beijing has been vigorous in protecting those interests even in times when its relative capabilities were much more meagre than today.

⁶ The accident was, according to American commentators, a result of the recklessness of the Chinese pilot. Moreover, it was reported that China indeed disassembled the American aircraft and reverse-engineered parts of it.

However, the most important point is that China perceives the US to be impairing these interests. First, America's democracy promotion agenda is understood in China as designed to sabotage the CCP's leadership, and is perceived as an effort to divide and weaken China (Lieberthal and Wang 2012: viii). Second, the US openly opposes the 'unilateral reunification' of Mainland China and Taiwan, and supplies arms to the government in Taipei.⁷ Moreover, Washington maintains ties with the Dalai Llama, and continues to regard the Uighur community in China's Xinjiang province as an oppressed minority, instead of a group of secessionist terrorists, as Beijing prefers to refer to them. Most importantly from the perspective of international security, Washington also openly—and actively—challenges China's territorial claims in East Asia.

As for the dispute over the Senkaku/Daioyu islands on the East China Sea, although the US maintains that it does not take a position on the issue of sovereignty, it nevertheless recognises Japan's administrative control over the islands. It has also indicated that it regards the territory to be covered by the US–Japan security alliance, which means that US forces would be obligated to defend the islands in case China sought to seize it.⁸ Enraged by the 'nationalisation' of the islands by the government of Japan in 2012, China recently declared a broad Air Defence Identification Zone over the East China Sea incorporating the islands, which the US refused to recognise. Moreover, the Japanese Self-Defence Forces and the US military held a number of drills to prepare for the retaking of offshore islands seized by a third party, what constitutes a direct warning to China. In the case of the South China Sea disputes, China has been increasingly assertive in protecting its self-perceived territories, harassing, and even firing on, foreign ships in the area, and in 2012 the leadership in Beijing created an administrative area covering most of the disputed islets. In general, China has been pursuing a strategy which centres on delaying the resolution of the disputes, as Beijing strives to consolidate its claims vis-à-vis weaker states, and deter those states from strengthening their own claims at China's expense (Fravel 2011: 292). However, the US not only opposes these moves, but, unlike in the Senkaku/Diaoyu case, also questions the legitimacy of the Chinese claims. Reportedly, an American diplomat went so far as to assert that "there is no such thing as a nine-dash line" recently⁹ (Fonbuena 2014).

⁷ However, mostly to lessen the tensions such moves cause in China–US relations, Washington has been more reserved in this aspect lately.

⁸ It might be noted that the concept of an actual invasion on a handful of small uninhabited—and uninhabitable—rocks measuring no more than seven square kilometres is a quite interesting puzzle from the perspective of military strategy.

⁹ The nine-dash line refers to China's self-proclaimed boundary on the South China Sea, which basically incorporates the whole sea.

Commentators have also noted that as China becomes more assertive in pursuing these territorial claims, so does the resolve of the US to counter those claims (Keck 2014). Additionally, Chinese analysts contend that US support for countries which are involved in territorial disputes with China might embolden those states to be more aggressive in their conduct. And although most observers agree that a full-blown war is unlikely over these territories, a widespread fear is that the tensions raise the risk of miscalculation and accidents (Smith 2013).

It should be noted however, that while China is widely regarded as the challenger and the US as the status quo power in the relationship, as the aforementioned examples attest to, the US challenges direct Chinese national interests, while China cannot be regarded as threatening the US directly. However, the US view is that China's advances threaten the freedom of navigation, access and action in international waters where such freedom is deemed vital to meet American commitments and interests. The US is also worried that the Chinese side thinks in terms of a long-term zero-sum game in strategic issues, and this requires that America prepare to defend its interests against potential Chinese efforts to undermine them as China grows stronger (Lieberthal and Wang 2012: ix). Moreover, as noted earlier, the US perceives Beijing's territorial claims as a challenge to the territorial status quo in East Asia by a rising China. What is important to highlight is that even though the US is not involved directly in these territorial disputes, it is the main countering force to China, for the states directly involved—and enjoying US backing—are much less powerful than either of these two parties.

Against this backdrop, the US announced its 'pivot,' or 'rebalancing' strategy to East Asia in 2011, which would involve the stationing of sixty per cent of its naval capabilities in the region. According to then Secretary of State Hillary Clinton (2011), this move reflects the recognition in Washington that the Asia-Pacific will be the most important region in the world in the 21st century, and therefore the US should increase its diplomatic, strategic and economic investment there instead of fighting wars in Iraq and Afghanistan. However, Chinese commentators see the pivot as a new chapter in America's continued 'containment' and 'encirclement' of China, and a renewed effort to hinder its re-emergence (Zhou 2013). In fact, while successive US administrations are said to have dealt with China on a liberal basis, and have emphasised engagement with Beijing over balancing (Friedberg 2012), Chinese leaders have long assumed that the Washington is indeed trying to contain China. This narrative rests on the fact that the US maintains a number of strategic alliances and a large military presence in the region, and, as noted earlier, is perceived as encroaching

on China's national interest (Nathan and Scobell 2012). This assumption of containment has also played a definitive role in shaping China's military policies. The People's Liberation Army (PLA) Navy is enhancing its power-projection capabilities rapidly to be able to operate on high seas, while developing sophisticated anti-access/area-denial (A2AD) capabilities to keep American forces as far away from China's littorals as possible¹⁰ (see Fravel and Liebman 2011). Moreover, it has been argued that the pivot will, contrary to its goals, destabilise the East Asian region by offering misleading reassurance to US partners and creating a 'side-taking dilemma' for some states in the region, which are heavily reliant on China (Ling 2013), even though they might not accept China's potential regional leadership.

In summary, it can be concluded from this discussion that China and the US pursues conflicting foreign policy goals and interests indeed. The US maintains a military presence in East Asia which is unnerving to China. It also opposes territorial claims which China perceives to be an infringement on its territorial integrity. From a US perspective, China challenges the territorial status quo in the region, and thus threatens the stability of the Asia-Pacific, a region deemed to be the most important in the world by Washington.

2.2. The role of economic interdependence

The importance of economic interdependence in China-US relations can be analysed across four different spectrums: (1) their dependence on foreign trade and investment in general; (2) their reliance on bilateral trade and capital flows in particular; (3) the costs and benefits they derive from, and the positive and negative externalities they generate as participants of, the US-led liberal international economic order; and (4) the interactive effects stemming from their concurrent operations in overseas markets. Although the empirical part of this paper deals exclusively with the second aspect, the other three spectrums will be briefly discussed here as well.

It is a widely held notion by students of IR, international political economy and international economics that China's economic development is based predominantly on foreign trade and inward direct investment, and the Chinese economy continues to rely heavily on foreign inputs and technology transfers, as well as access to foreign markets (see Lardy 2011; Lin 2011; World Bank 2013). As noted above, one of China's core national

¹⁰ As noted earlier, another factor to consider is the PLA's growing role in Chinese foreign policy formation, and the apparent gaps in this sense between the civil and the military leadership. These are important for the Chinese military usually pursues a much more 'hawkish' line than the civil leadership (Scobell 2009).

interests is to sustain stable economic growth. Moreover, this aim is fundamentally tied to the first and foremost interest of the Chinese regime, namely the stability of the CCP leadership and the current political system, for in the absence of an elected mandate, economic development and rising levels of welfare has been the most important source of legitimacy for the CCP.¹¹ Consequently, stable access to foreign markets and inputs is vital for the Chinese leadership. Moreover, as China is deeply embedded in international supply chains, it is also heavily invested in preventing any disruption to these. While the US economy is generally less reliant on trade and investment than the Chinese, Washington has been the architect and the champion, and consequently also one of the biggest beneficiaries of the current international economic order, and while its grip on the system is diminishing, it still retains a dominant position within it. China has also profited heavily from these arrangements. In Tellis' (2013: 109–110) words, China's re-emergence "has been engendered in great measure by the permissive benefits of ... [t]he U.S.-backed guarantee of open global commons, ... the creation of stable multilateral exchange arrangements, and the maintenance of the dollar as an international reserve currency."

So, both states attribute high importance to economic interdependence in their respective foreign policies, and the maintenance of free flows of trade and investment remains a major common interest for them. In addition, access to one another's market and capital should also be considered a high priority for both. The rapidly growing Chinese market is becoming an increasingly important source of revenue for US firms in light of the struggling domestic economy, while China is the largest foreign creditor of the US government.

Nevertheless, both sides have important concerns vis-à-vis one another both on the systemic and bilateral level. The US is dismayed at what it sees as mercantilist policies and a free-rider attitude on the part of China in international economic affairs. China, on the other hand, assumes that the US is taking advantage of the US dollar's status as the world's main reserve currency, and accuses the US of protectionist policies as well (Lieberthal and Wang 2012). In addition, while Chinese policy-makers and analysts assume that the relative

¹¹ It is a widely held notion that the second most important source of legitimacy for the CCP is nationalism. The conventional wisdom about Chinese nationalism is that it is a tool for the CCP to strengthen its popular legitimacy by forging a common belief in the uniqueness of China, and by (partly) diverting popular dissatisfaction and anger towards outside actors. Yet, the nationalistic sentiment seems to have grown deep roots even among the middle class, and has complicated China's diplomatic relations with neighbouring countries. In short, the CCP exploited nationalism for domestic political reasons, but this has the possibility of overshadowing China's status in the international society, and deeply damaging its ties with other countries (see Lam 2010).

decline of the US presents strategic opportunities for China, quite ironically they also regard the problems of the US economy and the apparent deadlocks in US domestic politics as a potential threat to the economic development of China. Recently, Chinese officials have voiced their discontent with US economic policies, and asserted that China, as the largest creditor of the US, wants the safety of its investment be assured (Chu 2013). Further bilateral disputes have arisen over the Chinese currency regime, for the US maintains that the yuan renminbi is severely undervalued to give an advantage to China's exporters on the global market. For the US, China's large trade surplus vis-à-vis the US has also been a contentious issue, and American commentators and public opinion reflects an increasing uneasiness with US outsourcing to China amidst economic hardship at home. An additional recent trend has been uneasiness in the US about the potential national security threats some Chinese state owned enterprises would pose if those entered the American market.¹² Moreover, accusations of industrial cyberespionage have been traded between China and the US, and Washington has been complaining long ago over alleged intellectual property rights (IPR) violations and the lack of legal safeguards for IPR protection in China (see Morrison 2014). It is safe to conclude that both countries try to take advantage of the supposed freedom of economic exchange to promote and safeguard their national economies.

Moreover, both China and the US have a history of using interdependence as a strategic instrument of foreign policy. The US, for its part, has been active in utilising economic sanctions to promote its interests abroad, and it has also been contended that the whole US-led international order is, in fact, a scheme for Washington to maintain and further its political and economic goals globally (Strange 1987; Arrighi 1999). While China has only recently discovered punitive economic measures as a foreign policy tool, it has reportedly halted vital rare earths exports to Japan amidst political tensions in the two countries' island dispute, and slashed non-tariff barriers on traders from the Philippines as retaliation in connection with another territorial issue.

China has also been seeking to decrease its economic reliance on Western markets and technology in the wake of the global crisis. This stems from both domestic and international factors.¹³ The crisis resulted in a dramatic decline in demand in developed

¹² Recent such cases include Chinese state-owned telecommunications corporations ZTE and Huawei, which have faced obstacles in entering the US market for fears of their potential threat to US national security due to their ties to the Chinese state.

¹³ For a detailed discussion on China's handling of the economic crisis, and the potential challenges of sustaining its economic development, see Lardy (2011).

countries, which are traditionally the main destinations of products manufactured in China. To offset the results of the crisis, China launched a huge stimulus effort in 2008–2009 worth four trillion yuans (thirteen per cent of China's GDP in 2008), which in turn reinforced the already glaring imbalances in the Chinese economy. The core of the problem is that China's development in recent years have been fuelled disproportionately by investment (reaching 49 per cent of GDP), while household consumption have declined to chronically low levels (as low as 36 per cent of GDP). The main premise of China's Twelfth Five-Year Plan launched in 2011 is to raise the level of consumption to create a more sustainable economic model and enrich the population for political gains on one hand, and to lessen China's dependence on the struggling Western markets on the other. Moreover, China also seeks to transform its economy from one centred on low-value-added manufacturing to one based on indigenous innovation, and has mobilised impressive resources, both financial and administrative, to this end. Apart from decreasing China's reliance on foreign technology, this initiative also aims to lessen the detrimental effects caused by the deterioration of the price competitiveness of the Chinese economy stemming from the shrinkage of the workforce.

It is a natural progression for a developing economy to advance through the ranks in the international division of labour, and this process has been observed in many East Asian countries. However, China's economic transformation, if successful, would result in a dramatic change in the patterns of China–US interdependence. China's reliance on the US market would decline, while the development of the Chinese consumer market would open up even larger opportunities for US firms. On the other hand, it would strengthen the position of China, and the leadership in Beijing, which has a track record of protectionism, might be inclined to continue to limit access of US firms to its consumers. Another longer-term aim of China is the liberalisation of capital accounts and the internationalisation of the yuan renminbi. This process has been slow and constrained due to domestic factors, but should it continue, it would definitely lessen the importance of the US dollar as a reserve currency, and thus would further undermine US preponderance in the world economy.

At the same time, the US is pursuing an ambitious free-trade agreement in the region called the Trans-Pacific Partnership, which in turn does not include China. This initiative seems to allude to what some American analysts suggest, namely that instead of containing or confronting China, Washington should instead help China's potential regional balancers to get stronger economically.

Finally, regarding the potential interactive effects stemming from concurrent economic operations by China and the US in overseas markets, it has been suggested that as China's economic engagement with the rest of the world deepens, it might find itself in a competition with the US over access to commodities in third-party markets. While this remains a possibility, empirical evidence is lacking to back up this claim (Marton and Matura 2011).

In summary, it was established that both China and the US place a high value on international economic exchange, and the maintenance of interdependence is a priority for both states. However, they have also shown a tendency to regard interdependence as a strategic instrument in pursuit of both their economic and foreign policy agendas.

3. Interdependence and interstate conflict: A brief overview

3.1. Theories of interdependence and conflict

As identified by Barbieri (1996), there have been at least four propositions put forward by scholars of IR on the connection between economic interdependence and interstate conflict: (1) interdependence promotes peace; (2) interdependence increases the potential likelihood of conflict; (3) symmetrical interdependence may promote peace, while asymmetrical interdependence may lead to conflict; and (4) interdependence is irrelevant to conflict.

The fourth theory asserts that trade—and thus interdependence—is in the domain of 'low politics,' and as such does not play a role in leaders' calculations relating to war (Buzan 1984; Levy and Thompson 2010). While the discord between the levels of high and low politics has been accepted to some degree even by some liberals (Keohane and Nye 1977), it has been previously established that international economic exchange and interdependence does play a significant role in calculations vis-à-vis one another for China and the US. Nevertheless, this proposition is not without its merits, although I would take a different spin on it. To translate this idea into contemporary China–US relations, it can be argued that China's core national interests, first and foremost its territorial claims, represent a de facto level of high politics, which supersedes other considerations in the conflict–cooperation trade-off structure. However, it has also been established above that the very nature of interdependence makes it a vital component of two of China's three core national interests. In this sense—far from the realist assumption—the main factor is the subjective value of each core interest and the trade-off matrix between these interests for the Chinese leadership. This idea will be expanded upon later on. A similar claim related to this fourth

assumption is that all other factors in international affairs are subordinate to the changes in relative power among nations, which is the main driving force of conflict. It has been noted in the introduction that the importance of relative power is accepted in my hypothesis. But, again, I still contend that interdependence does play a vital role as well.

Advocates of the first, liberal assumption argue that trade is a more cost-efficient way to obtain resources and accumulate wealth than costly and potentially destructive territorial conquest (war). As trade and foreign investment increase, there are fewer incentives to ensure a state's security and economic welfare through territorial expansion, especially as returns on manufacturing, services and capital have far exceeded the economic returns on land (Rosecrance 1986, 1999). On the contrary: if conflict leads to a cessation or at least a diminution of trade, then states are deterred from initiating conflict against a trading partner for fear of losing the welfare gains associated with trade. Countries with the greatest gains from trade face the highest costs of potentially lost trade and hence engage in the least conflict and the most cooperation (Polachek 1980; Polachek, Robst and Chang 1999).

The liberal position is supported by a wide body of empirical literature both on the monadic and dyadic level (see, *inter alia*, Polachek 1980; Oneal et al. 1996; Polachek, Robst, and Chang 1999; Oneal and Russett 1999; Gartzke, Li, and Boehmer 2001; Maoz 2009). Even though realists contend that East Asia is 'ripe for rivalry' (Friedberg 1993; Mearsheimer 2010), a recent empirical study concluded that there is indeed a 'liberal peace' based on economic interdependence in Asia (Goldsmith 2007), and it has been argued that commerce and international institutions are taking over the pacifying role of the US hegemony (the *Pax Americana*) in the region (Pempel 2010).

However, despite this large body of rigorous empirical evidence, this particular mechanism seems to provide only a marginal explanation for the dynamics of China-US relations. Although economic ties between the two nations have expanded rapidly over the last three decades, their political relations were never quite harmonious apart from a few short periods. On the other hand, despite the aforementioned sources of strategic rivalry, high-level conflicts have largely eluded the relationship. The two states have been involved only in a meagre number of low-intensity militarised interstate disputes since the normalisation of their diplomatic relations.¹⁴ Although the US slashed a number of sanctions on China, mostly in the 1990s, these failed to deter deepening economic ties. Even

¹⁴ Usually, the Taiwan Strait Crisis, the bombing of the Chinese embassy in Belgrade, and the spy plane incident are described as militarised interstate disputes.

though the post-crisis power shift put a further strain on relations, Cold War-style animosity does not seem like a realistic perspective for the near future, and engagement, communication and dialogue between Chinese and American policy-makers and public intellectuals remain continuous and mostly amicable. Hence, I believe that from a broader perspective economic interdependence does act as a stabiliser in China–US relations. Obviously, it does not serve as a magic wand that makes tensions go away. But it does keep the relationship between certain bounds neither party is daring to cross. Between these bounds, however, relations have been volatile. It is this space in between where the dynamics of relative dependence and relative power might operate. Interestingly, a recent empirical study found that in the case of China and its neighbours, both aforementioned assumptions—that trade promotes cooperation, and that relative power increases raise the likelihood of conflict—are valid (Masterson 2012).

In contrast, the second, realist argument lies on the assumption that as the main goal of a state is to maximize its security in an anarchic international system, states are striving to lessen their dependence on outside forces and reduce their vulnerability to the minimum by exercising control over vital resources (Waltz 1979). Thus, greater dependence will lead to greater competition for these resources and a higher potential for conflict (Mearsheimer 1990). Adherents to this position generally refer to historical cases where expansionistic states striving for control over land and commodities attacked their key trade partners in the process. The most prominent such cases include German conduct in the First World War and the Japanese attack on the US in the Second World War. However, most evidence to this end is merely anecdotal. The only prominent empirical validation for this position is a single paper by Barbieri (1996).¹⁵ Moreover, the main problem with this assertion arises from the fact that even if the statistical relationship is negative between interdependence and conflict, the causal relationship behind this presumed phenomenon has not been adequately explored, and in the specific case of China–US relations, there is indeed very little, if any, evidence that would support the notion that higher interdependence would be a cause for higher possibility of conflict. Theoretically, there can be two channels through which increased interdependence would transmit political animosity between China and the US. First, as noted earlier, with their economic ties deepening, the two countries have been engaged in an increasing number of trade and financial disputes. However, it should be highlighted that none of these disputes has actually resulted in widespread sanctions or other

¹⁵ The methodology of this paper is disputed by liberals. See Oneal and Russett (1999).

severe punitive measures, either political or economic. While some sanctions have been imposed by both sides, the levels of economic exchange continued to expand rapidly in spite of them. Moreover, the US has actually sought legal and institutional resolution to some of these disputes before the World Trade Organisation's dispute settlement body, which is in fact the most amicable way possible to settle such differences.¹⁶ These disputes might fuel frictions in the bilateral relationship, yet the lack of related punitive measures and efforts to settle these issues through consultative and institutional channels is also a testimony to the fact that both countries value bilateral economic ties, and avoid hurting those in the absence of an infringement on their vital interests. Moreover, it has already been noted that empirical evidence is lacking in backing up the second such potential channel, namely competition for commodities in third party markets.

Finally, the third position should be considered, which is, in fact, the direct opposite of my hypothesis. Hirschman (1945) proposed that one state's potential to interrupt trade with its partner, and thus exert economic costs on it, yields bargaining power in the political arena. Consequently, in an asymmetrical relationship the dependent state can be subjected to the manipulation or coercion of the more powerful one if the latter threatens to sever economic ties. This basic premise has been repeated by Keohane and Nye (1977), who argued largely along the same lines by stating that the less dependent state in an asymmetrical relationship may exercise its relative economic power to gain concessions or bring about economic or political change. A different argument as to the negative consequences of asymmetrical interdependence has been made by adherents to dependency theory. According to this line of thought, trade linkages between developed nations producing manufactures goods and less developed nations producing commodities or other less sophisticated products solidify the gap in development between them, because the terms of trade are detrimental to the less developed member of the dyad (Galtung 1971).

As for the latter theory, the case of China clearly does not fit into this narrative. The assumptions of Hirschman (1945), and Keohane and Nye (1977) are certainly plausible. As noted earlier, I do regard economic interdependence to be a potential instrument of power politics. However, China-US relations have taken a different trajectory in terms of the effects of asymmetry. To this day, the US continues to be the more powerful and less dependent one in the relationship, yet it has been rather muted in exercising its leverage. On

¹⁶ It should be also noted that these trade frictions as of today are by no means more severe than the ones between the US and Japan, which states are allies, or the ones between the China and the EU, in which relationship it would be very hard to identify any sort of strategic rivalry.

the other hand, China defended vigorously its interests even in times when it was in a relatively weak position. Up until the announcement of the ‘pivot,’ Washington’s strategy has been reasonable consistent towards China: it sought to achieve political change in Beijing by way of engagement instead of coercion (Friedberg 2012), and hoped that economic development will lead to China’s democratisation and socialisation into the status quo. In a sense, the US has actually helped China to emerge as its main potential foe.

3.2. Methodological issues of interdependence research

Similarly to the presumed political effects of interdependence, both its conceptualisation and operationalisation remains an issue on which scholarly perspectives differ. For Hirschman (1945), the nature of interdependence is captured by the opportunity costs one state can impose on another by severing economic ties. Keohane and Nye (1977) distinguished between sensitivity (the strength of the effects on one state of occurrences in another) and vulnerability (the relative availability and cost of the alternatives). Rosecrance et al. (1977) differentiated between vertical and horizontal interdependence, the former concept—similarly to Keohane and Nye (1977)—measured by the equalisation of factor prices across economies, and the latter signifying the flow of good between economies.

It is this latest conceptualisation that the vast majority of research on interdependence has followed. Generally, students of interdependence have traced the relationship between trade and militarised interstate disputes. Yet, the literature varies heavily in its operationalisation of trade interdependence. Some studies focus on trade share (bilateral trade relative to total trade), others measure economy-trade share (bilateral trade as a component of GDP), and still others focus on either exports or imports exclusively, either as a share of total exports/imports or GDP. Different approaches measure different things, of course, and consensus has proven to be elusive on the right approach to follow. Moreover, most studies have sought to capture the systemic effects of interdependence, and thus have focused on large-N samples on both the dyadic and monadic level. In addition, for the same reasons, relative dependence or the asymmetry of interdependence has mostly been overlooked in these studies. And even if it were taken into account, operationalisation ranged from trade balance to GDP, to imports to GDP, to total trade to GDP.

The aforementioned aspects pose some difficulties for this study in relying extensively on previous scholarship on this phenomenon. First, the research on this issue focused almost exclusively on militarised interstate disputes. My focus here is broader, for militarised disputes are relatively rare in contemporary interstate relations, especially among great

powers. As noted earlier, only a very limited number of such instances can be identified in post-normalisation China–US relations. Second, focusing on trade exclusively fails to capture the very nature of contemporary economic interdependence, while the role of capital movements has not been explored by most past studies. This can be attributed in part to the fact that reliable historical data is scarce in this regard, and direct and portfolio investment has only recently emerged as an important force in the global economy after waves of capital account liberalisation swept through the system. Nevertheless, flows of foreign direct investment and portfolio investment have been increasingly vital components of economic interdependence, especially for developing countries such as China relying on foreign capital and technology for their industrial catch-up. For these reasons, attempts have been made by some to incorporate these into models of interdependence, which efforts will be followed here. Moreover, a number of recent studies analysed the nature and effects of complex international financial linkages, which are undoubtedly a signature feature of the present economic order (see Li, Zhang and Willett 2012). However, these will not be taken into account here, for the chronic lack of reliable historical data.

4. Research design

Taking these observations into account, I employ here a model which is relatively simple, but at the same time takes into account not only trade, but also FDI and portfolio investment. The units of analysis are dyad-years between 1979 and 2012.

4.1. Independent variable

The main independent variable is China's relative economic dependence on the US (RD). The economic dependence of each state on one another is conceptualised here as the sum of the amount of total bilateral trade, and the amount of inward direct and portfolio investment¹⁷ from the other state, relative to GDP. Bilateral trade and investment figures are weighted by total trade and total investment as a proportion of GDP, respectively. Weighting has been done to control for the differences in the relative contribution of trade and investment in the two economies, and to account for the differences in their relative 'exit costs' to some degree. As the Chinese economy is generally much more reliant on trade and investment than the US', its exit costs (the opportunity costs of losing out on trade)

¹⁷ Data for FDI and portfolio investment were scarce up until the last decade, and data was not available for each year surveyed. For those years in which data was not available, the figures for the previous year(s) were kept constant. However, the levels of FDI and portfolio investment were so low in the preceding decade (and even more miniscule in the 1980s), that missing data had no measurable statistical impact on calculations.

would be higher than the costs the US would have to incur in case their economic relations would deteriorate. China's relative dependence on the US is then calculated as the difference between China's dependence on the US, and the US' dependence on China. In summary, the variable is calculated for every dyad-year based on the following formula:¹⁸

$$d^r_{cu,t} = \left(\frac{M_{cu,t} + X_{cu,t}}{GDP_{c,t}} \times \frac{M_{c,t} + X_{c,t}}{GDP_{c,t}} \right) + \left(\frac{I_{uc,t}^d + I_{uc,t}^p}{GDP_{c,t}} \times \frac{I_{c,t}}{GDP_{c,t}} \right) \\ - \left(\frac{M_{uc,t} + X_{uc,t}}{GDP_{u,t}} \times \frac{M_{u,t} + X_{u,t}}{GDP_{u,t}} \right) - \left(\frac{I_{cu,t}^d + I_{cu,t}^p}{GDP_{u,t}} \times \frac{I_{u,t}}{GDP_{u,t}} \right)$$

where M represent imports, X represents exports, I^d represents FDI position, I^p represents portfolio stock for a given dyad-year t , while c stands for China and u for the US.¹⁹

Economic data were gathered from the International Monetary Fund's direction of trade database, the World Bank's economic indicators database, the statistical extracts of the Organisation for Economic Cooperation and Development, the US Treasury, and the US Bureau of Economic Analysis.

4.2. Dependent variable

The dependent variable in the model is the numeric value of bilateral political relations between China and the US for each dyad-year (PR). The numeric values for political relations are calculated using data from the Global Database of Events, Language and Tone (GDELT),²⁰ by averaging the sum of the Goldstein-scale values²¹ of every dyadic event in a given year. Only events where the participants are state-actors were considered. In sum, around 150,000 such events were used for the calculations.

¹⁸ I use GDP instead of total trade—as some of the cited articles do—because in large and relatively closed economies, such as the US and China, the relative importance of trade is significantly lower than in other countries. Thus, GDP is a better measure of the importance of a bilateral relationship on the total economic activity of such a country.

¹⁹ A case could be made for using FDI and portfolio investment flows instead of stocks. However, since this study focuses on the dynamics of China–US economic interdependence, this would make no difference, since the changes in stocks in different dyad years represent the flows in themselves. Moreover, stocks represent not only the financial transactions recorded prior to and during the surveyed year, but also other changes in price, exchange rates, and volume, and therefore give a clearer picture on the actual value of investment at a given time.

²⁰ GDELT is a computer-coded catalogue of international events. Events are coded from a number of international news sources, such as the Associated Press, Agence-France Presse, the BBC, the New York Times, the Washington Post, etc. See Leetaru and Schrodtt (2013).

²¹ The Goldstein-scale operationalises interstate events on a scale ranging from values -10 to +8.3, with -10 being a militarised attack, and +8.3 being the extension of military aid. See Goldstein (1992).

4.3. Controlling variables

Two sets of controlling variables will be introduced to the model: two ‘realist’ and two ‘liberal’ ones. First, the relative size of China’s economy compared to the US’ will be considered (RE). This is to control for the fact that the size of one state’s economy has a deep influence on its policy choices by determining its power in the international arena. For most of the time frame surveyed here, China was significantly weaker than the US in terms of economic power, while its large dependence on the US economy constrained it, and forced it to adopt mostly conciliatory policies towards the US. Although a size of an economy is generally a decent indicator to express its national power, the relative military capabilities of China will also be controlled for (RM) so as to highlight another constraint on its strategic choices. This variable, for the lack of a better indicator, is conceptualised as China’s relative military budget to the US’. Just like in the case of the economy, China has also been weaker in military power and capabilities. For realists, the rise of China’s economic and political power in itself is a source of potential conflict.²²

The first liberal controlling variable is common membership in intergovernmental organisations (IO). According to liberals, this factor should have a positive causal effect on peace. Common IGO-membership will be operationalised as a sum of a number of dummy variables, which take the value of one for a given organisation in a given year if both states were members.²³ Another usual liberal controlling variable in interdependence research is the level of democracy, but given that China is considered to be an autocratic regime, and none of the relevant sources of data on levels of democracy have shown any sort of meaningful change within the Chinese political system over the last two decades, it would be pointless to include this variable.

Instead, a second model will be set up containing another liberal variable, namely the absolute level of economic interdependence (AI). This is to control for, and assess the relevance of, the established scholarly orthodoxy on interdependence in this specific relationship. Total interdependence will be calculated based on the following formula:²⁴

²² Data for these indicators were gathered from the World Bank and the Stockholm International Peace Research Institute.

²³ Data for IGO membership were sourced from the Correlates of War IGO-dataset until 2007. The dataset was completed by the author for 2008–2012.

²⁴ This formula is a modification of the one used by Masterson (2012). Here, the sum of FDI and portfolio investment includes US stocks in China plus Chinese stocks in the US. In other words, $\sum I_{cu,t}^d = \sum I_{uc,t}^d = I_{uc,t}^d + I_{cu,t}^d$

$$I_{cu,t} = \frac{\frac{(M_{cu,t} + X_{cu,t}) + \sum I_{cu,t}^d + \sum I_{cu,t}^p}{GDP_{c,t}} + \frac{(M_{uc,t} + X_{uc,t}) + \sum I_{uc,t}^d + \sum I_{uc,t}^p}{GDP_{u,t}}}{1 + \left| \frac{(M_{cu,t} + X_{cu,t}) + \sum I_{cu,t}^d + \sum I_{cu,t}^p}{GDP_{c,t}} - \frac{(M_{uc,t} + X_{uc,t}) + \sum I_{uc,t}^d + \sum I_{uc,t}^p}{GDP_{u,t}} \right|}$$

4.4. Time-frames considered

The analysis was carried out across three different time-frames. The first, and broadest, includes dyad-years between 1979 and 2012. The former date marks the first year after the normalisation of diplomatic relations between the People's Republic of China and the US; while the latter is the last year for which adequate data were available. The second time-frame is 1992–2012, representing the post-Cold War period. 1992 is used instead of an earlier date between 1989 and 1991 because that year marked the end of the upheaval in Chinese domestic politics after the Tiananmen Square events, and also the resumption of economic reforms marked by leader Deng Xiaoping's symbolic tour of Southern China. The third period is 2001–2012. 2001 was chosen for it marked a point after which relations improved after the bilateral tensions arising from the bombing of the Chinese embassy in Belgrade and the spy plane incident started to wane. Moreover, 2001 also marks the beginning of the war on terror, which improved cooperation between China and the US.

4.5. The models

The relationship between the sets of data was computed by multilinear regression. Model 1 includes variable RD, RE, IO and RM. Model 2 includes RD, AI, RE, IO, and RM. The independent variables had to be transformed to improve linearity and normality, and reduce skewness and kurtosis. The cube root method was used for the transformations.²⁵ Data for China's military budget were not available prior to 1989, so the RM variable will only be included in calculations for the post-Cold War years. Normal distribution proved impossible to achieve for the AI variable for the period between 1992 and 2012, so the results of this period are not included for Model 2.

²⁵ To ensure normality and linearity, a number of models were considered, and numerous avenues to correct the data were entertained. Needless to say, given the small sample size and the volatility of the indicators measured here, options were limited, and compromises had to be made. Normality was tested for with the Shapiro-Wilk test, and Q-Q plots were examined as well. The AI indicator was especially problematic for the time frames after 1992, and only partial normality was achieved.

4.6. Potential deficiencies and bias

Finally, the potential deficiencies and shortcomings of the model outlined here should be addressed. First, the model used herein fails to account for either the benefits or the costs of the ‘structural power’ of the US derived from its preponderant, if no longer hegemonic, position in the world economy (Strange 1987). While US economic dominance has certainly waned in recent years, the events of the latest global crisis have shown once again that the US is still able to exert both negative and positive externalities on other economies,²⁶ either willingly or unwillingly, through official channels or market mechanisms.²⁷ Additionally, the US dollar remains the main reserve currency in the world, and the decisions of the Federal Reserve have widespread impact in emerging economies—and especially in the case of China, which holds around US\$1.5 trillion in US securities. On the other hand, China is capable itself of exercising facets of structural power, albeit on a much smaller scale. One compelling argument to this end is that China’s rise contributed to the global crisis by flooding the world economy with cheap credit, driving down interest rates, and thus fuelling the reckless lending in the US (Mees 2012). Nevertheless, while certainly of paramount importance, structural power is a concept which would be extremely problematic to operationalise—highlighted by the fact that no-one has ever even attempted to do so. Second, the aforementioned model is far too simplistic to capture aspects of US–China interdependence stemming from the differences in relative development levels between the two economies. One such aspect is that *prima facie* trade figures in this relationship can be misleading as a result of the differences in the unit values of finished manufactured goods entering the US market from China and the amount of Chinese value added over the manufacturing process of these goods. Generally, China is at the lower end of the international value chain (Lin 2011), thus export figures overstate the real income the Chinese economy derives from manufacturing. Data, however, is extremely scarce in this regard, and evidence to this end is based largely on rough guesses and a small number of case studies.²⁸ Third, the model does not take fully into account the potential differences in

²⁶ An example for the former is the crisis itself, which started in the US financial system. As for the latter, the monetary easing policy of the Federal Reserve created a world-wide credit and investment boom.

²⁷ An example for the former is, again, the Federal Reserve, while the latter can be US investment banks, among others.

²⁸ One particularly interesting case is that of the Apple iPhone and iPad devices. While each of these devices—assembled in China by a Taiwanese company, Foxconn—adds upwards of US\$200 to China–US trade, only around US\$10 of that ends up in the Chinese economy in the form of labour compensation. Most of the value added comes from outside China, and virtually all of the profit ends up in the hands of non-Chinese firms as well. So while China exported more than US\$2 billion worth of iPhones to the US in 2009, its value-added trade surplus was only around US\$70 million (Xing and Detert 2010; Kraemer, Linden and Dedrick 2011).

welfare costs which the two economies would incur upon the decline in interdependence. It is reasonable to assume that US bond yields would rise in case China would stop shoring up trillions of dollars worth of US securities. The Chinese economy would also suffer high costs if it would lose access to the US market, FDI and technology. However, it is also reasonable to assume that the potential rise in interest rates in the US would be less costly than the decline in Chinese economic activity in case Chinese firms would lose out on US exports and investment. As in the previous cases, operationalising this potential phenomenon in itself would warrant a whole different type of research altogether.

All things considered, this model does not capture China–US interdependence in its entirety, and most probably understates China’s relative dependence on the US. It does, however, reflect accurately the key dynamics of China–US economic relations, and thus should be considered sufficient for the purposes of this paper.

5. Findings and discussion

5.1. Results of the regression analysis

<i>Independent variables</i>	Time frames		
	1979-2012	1992-2012	2001-2012
<i>Relative dependence</i>	0.562 (0.016)	0.706 (0.014)	1.61 (0.074)
Relative size of the economy	0.435 (0.435)	2.35 (0.396)	-2.81 (0.645)
Common IGO-membership	-1.288 (0.001)	1.71 (0.402)	16.6 (0.375)
Relative military budget	n.a.	-7.71 (0.165)	-1.9 (0.776)
Adjusted R ²	0.36	0.314	0.659
N	34	21	12

Results of the regression analysis for Model 1 are presented in Table 1.²⁹ Data shows strong support for the hypothesis with a very high level of significance across all of the dyad years surveyed (1979-2012), as well as for the post-Cold War period (1992-2012). For the third period surveyed (2001-2012), the effect of relative dependence is very strong on political relations, the significance of the finding, however, is beyond the threshold of what can be

²⁹ The values of the statistical relevance (p) of the findings are in parentheses.

considered strong. Nevertheless, it is still in the range ($0.05 < p < 0.1$) where it shows some, albeit weaker, support for the hypothesis.

What is also clear is that apart from relative dependence, only one other variable had a meaningful effect of any sort of significance on political relations. This variable, surprisingly, is common IGO-membership, which has a considerable negative effect with very strong significance. It can be inferred thus that China's increased institutional participation failed to result in a common ground with the US. The results for the relative military budget of China, which has a very strong negative effect on relations, are somewhat beyond the threshold of statistical significance, and thus cannot be considered valid. In another model, it might confirm the realist notion that relative power shifts increase the chance of conflict, but from this present finding, this cannot be safely concluded.

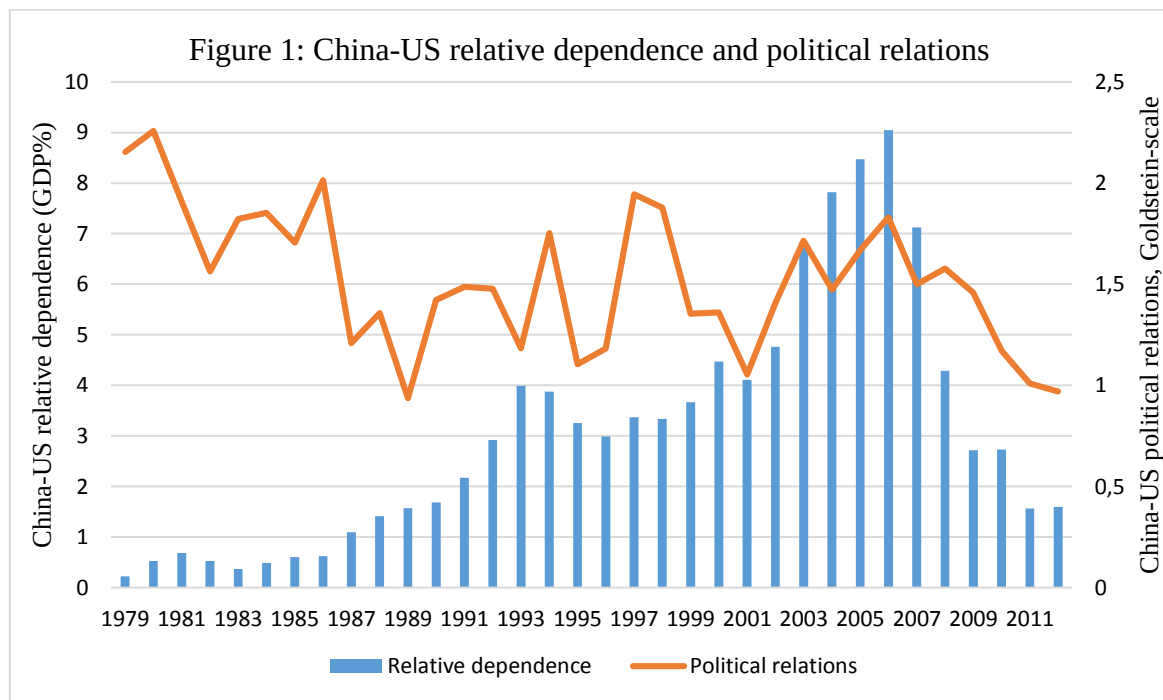
Table 2 shows the results for Model 2. As noted earlier, the period between 1992 and 2012 was not analysed due to issues with the distribution of the data. Similarly to the previous model, relative dependence is the variable with the generally strongest effect on political relations across the board. As in the previous model, it shows higher significance in the whole period surveyed, but it borders on the threshold of what can be considered statistically acceptable between 2001 and 2012. IGO membership again has a strong

<i>Independent variables</i>	Time frames		
	1979-2012	1992-2012	2001-2012
<i>Relative dependence</i>	1.012 (0.016)	<i>n.a.</i>	0.713 (0.093)
Absolute interdependence	-2.54 (0.184)	n.a.	0.06 (0.931)
Relative size of the economy	2.82 (0.135)	n.a.	-1.48 (0.627)
Common IGO-membership	-1.221 (0.001)	n.a.	7.99 (0.361)
Relative military budget		n.a.	-0.91 (0.772)
Adjusted R ²	0.378	n.a.	0.619
N	34	21	12

negative pull on relations for the whole period surveyed (1979-2012). All other variables were beyond the threshold of acceptability. The R-squared values of findings shows that the models can describe a relatively decent amount of variance in political relations, although their explanatory value is weaker across the whole period than after 2001.

5.2. Interpretation of the findings

Figure 1 charts the dynamics of China–US relative dependence and political relations. These values in themselves warrant some attention. First, the volatility between major post-normalisation disputes and reconciliation is very clearly pronounced. Apart from the post-2006 deterioration, the low points in political relations are all tied to a specific event. Namely, the Tiananmen Square protests of 1989; the North Korean nuclear crisis of 1993; the third Taiwan Strait crisis of 1995–1996; the bombing of the Chinese embassy in Belgrade in 1999; and the spy plane incident in 2001. In contrast, the continuous deterioration in relations after 2005 cannot be tied to a single event, although the decline is markedly steeper after the outbreak of the financial crisis in 2008. As visualised by the graph, there appears to be a very strong relationship between China’s relative dependence and political relations between 2001 and 2012 ($r = 0.82$, $Cov = 0.66$). In any case, this strongly suggests that the current deterioration in relations is a product of structural forces. It is noteworthy that according to this data, China–US relations are at their lowest point since the Tiananmen Square events presently. This seems to confirm those accounts which predict a strategic rivalry between the two nations.



However, it should also be noted that political relations between China and the US, while certainly volatile, moved within a rather narrow positive range between 2.25 and 0.88 as measured on the Goldstein-scale. This signifies that the relationship is very tightly managed, and both sides are wary of the other, which has both positive and negative effects.

6. Conclusion

The hypothesis of this study asserted that the dynamics of China–US relations can be best explained as a function of shifts in the relative level of China’s economic dependence on the US. Specifically, I have argued that as China becomes less reliant on the US, bilateral relations deteriorate, for Beijing becomes more willing to pursue its interests. As China’s interest are contrary to those of the US, this results in the deterioration of bilateral relations. The hypothesis was tested with quantitative analysis, and the results supported the hypothesis.

Having established that the level of China’s relative dependence on the US has a meaningful effect on political relations, one question is left to answer: based on this observation, in which direction China–US ties might potentially be heading? Of course, as in most cases, no definitive answer could be given to this question. However, the findings of this study at least give a helping hand in identifying the main factors and charting the processes and mechanisms to be paid attention to in the near future. For one, the composition of China’s dependence on foreign inputs and markets will continue to change, and Beijing’s power and leverage in international affairs will continue to grow. Meanwhile, the sources of strategic rivalry between China and the US will persist, and the potential for China’s socialisation into the status quo will remain very limited. From this, it might seem that the dangers and ills that realists associate with great power rivalry may become more pronounced in the coming years, and China–US relations will deteriorate ever further. Additionally, Copeland’s theory of trade expectations can be useful to supplement this survey. Copeland (1996) argues that instead of the static considerations of interdependence at a given time, levels of interdependence and future trade should be considered simultaneously when determining the peace/conflict inducing effects of economic linkages. Applied to this study, it can be inferred from this that China’s behaviour is not only affected by its currently diminishing levels of dependence on the US, but also by the fact that this trend is widely expected to continue into the future.

This is only one side of the full picture, however, and even the aforementioned factors are likely to have a much more muted effect on China–US rivalry at large than realists would expect. First, even though its reliance on the Western world might decline, and the West’s dependence on China might rise, China is, and will remain, much more open in economic terms than previous established great powers (Subramanian 2011). This puts a vital constraint on the potential appetite for expansionistic and destabilising moves of the leaders in Beijing, especially as sustainable economic growth remains the main source of

their legitimacy and also the predominant reason for the acceptance of the current Chinese political structures by the society. Second, to sustain its economic growth and deter the structural problems facing its economy, China will have to face yet another wave, or potentially even several new waves, of liberalisation (Lardy 2011), which will in turn stabilise China's deep embeddedness in the world economy. Third, China will have to play a role in protecting its access to foreign inputs, above all raw materials, and protecting the international value chains, on which much of its economic activity depends. While this does not mean that China will not try to alter the status quo to some degree, it should also be noted that its capabilities to do so are very limited.

Both Chinese and American leaders seem to accept the reality that while they pursue different interests, they nevertheless need each other to some degree. Xi Jinping, having taken the presidential post of China a year ago, called for 'a new type of major power relationship' between the US and China. As Lampton (2013: 52) put it, "[t]he core premises of such a relationship are that major conflict between the U.S. and China is not inevitable, that it would be catastrophic for each country and for the world should it occur, and that the opportunity costs of simple non-cooperation on key issues are enormous." Nevertheless, as the findings of this study attest to, the scope of cooperation envisioned by Xi will be constrained by a number of factors, and the downward direction of China-US relations will most probably not change. Their rivalry is very tightly managed on both sides, and discord might become muted when the urgent need for cooperation arises between Beijing and Washington. But as the findings of this paper indicate, as China grows stronger and becomes less reliant on the US, the differences in interest between the world's largest and second largest economies will broaden.

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