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Chinese Foreign Policy Decision-making
A Neoclassical Realist Approach

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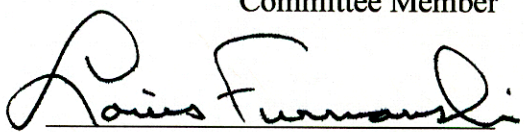

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Abstract

Despite its sudden rise, China has not engaged in balancing US power contrary to the prediction of the balance of power theory. The structure of a unipolar world restricts balancing which is effectively a revisionist act and disturbs the prevailing system whereas balancing is a status-quo behavior in a multipolar world because it has the effect of maintaining the current system. Additionally, the security dilemma generated by the challenger's rise also hinders in balancing. The dominant power is not the only one concerned about its position, but the other great powers are also concerned about the impending change in the system. The challenger's foreign policy is also encumbered by domestic factors like consensus among the elites and regime security. China is constrained by all these factors in both levels. Hence, the relative power of China does not explain all of its foreign policy behaviors.

CHAPTER I

INTRODUCTION

In the last two decades, the field of international relations has been flooded with countless volumes of China study. Every possible theoretical viewpoint has been applied to discern the significance of China's emergence as a great power. Unlike the disintegration of the Soviet Union, China's arrival was long predicted and discussed in the works of international theorists. Nevertheless, the opacity of Chinese decision making process is troubling to western policy makers. China being a state ruled by one dominant political party, it is difficult to identify where the loyalty of the elites rests; in the State or in the Party. For any outside observer, the language is also a big hurdle unless he or she is proficient in Mandarin Chinese, the official government language. All these challenges are further exacerbated by the tight control of the regime on construction, dissemination and transmission of policy objectives. Decision making process is highly centralised in a handful of leaders and their objectives are channelled to the public through state controlled media outlets. It is no wonder that most of the studies are highly theoretical and concern structural parameters of international relations or domestic variables for the explanation of Chinese foreign policy behaviors. In other words, realists tend to look at China's increasing power and its effects on the international balance of power to determine its foreign policy whereas most liberals use variables such as the nature of the regime and interdependence to come up with their conclusions. But, this kind of dichotomy in studying foreign policy is more likely to lead to faulty conclusions about Chinese intentions and conversely elicit mistaken responses from its foreign policy counterparts.

For these reasons, I focus on how Chinese elites formulate their foreign policy. I will look into how structural constraints posed by unipolarity, relative material capabilities and security dilemma affect their decision making. Then, I will cross-reference these structural

factors with two domestic factors—regime security, and elite consensus. My argument is that Chinese foreign policy makers are just as much encumbered by domestic factors as they are by structural factors. The logic behind this approach is that preferences and perceptions of elites matter and the calculation of political risks associated with certain foreign policy choices is significant in ascertaining Chinese behaviors. I also contend that China has not succumbed to a structural pressure to balance against US power. In outlining Chinese foreign policy, I align myself closely with neoclassical realist theory of foreign policy which includes recent works by scholars like Aaron Friedberg, Gideon Rose, Fareed Zakaria, Randall L. Schweller, Thomas J. Christensen and William C. Wohlforth. The next chapter presents a detailed discussion on neoclassical realism and the tools it provides to the students of international relations.

CHAPTER II

LITERATURE REVIEW

In the aftermath of the Cold War, the field of international relations experienced some respite from often dogmatic and tiresome debates among realist, neorealist and neo-liberal camps. The unexpected fall of the Soviet Union and the end of bipolarity as a balancing mechanism in world politics cast serious doubts upon the structural explanations forwarded by neo-realists, and offered every one else an opportunity to reflect on their own approaches, as well. While neo-liberalism made some progress in the study of increasing institutionalization and interdependence, it simply did not present a complete picture of power politics among states and was associated more with an economic realm of the interstate relations—a charge refuted by die-hard institutionalists. Meanwhile, many disillusioned realists returned back to their roots and sought solace in the older texts of classical realism. An attempt was made to rejuvenate the field by revisiting the works of Thucydides, Weber, Carr, Clausewitz, Morgenthau, etc.

This revival was a noble idea in itself but these reformed realists have a big challenge at hand. They could not just abandon the body of scholarship that was created in last thirty years and embrace classical realism wholeheartedly. Granted, classical realism did have some shortcomings and limitations, which led to the development of the neorealist approach in the first place. The structuralist charge that classical realism lacked coherence due to its heavy dependence on human elements and the context of interstate relations was not completely baseless. Meanwhile, moving beyond this debate, there is an increasing number of works being done in the realist vein by scholars who are keenly aware of the shortcomings of both classical and neo variants of realism. This new theoretical strand, which was termed neoclassical realism by Gideon Rose (1998), seeks a synthesis of classical and structural

realisms. It starts with identifying systemic constraints on states' behaviors but also takes into consideration the domestic variables in forging of states' foreign policy behaviors.

The main precept of neoclassical realism is that the relative power of a state drives its foreign policies first and foremost (Rose 1998). But, the theory also contends that the relative power and material capabilities are not totally responsible for a state's foreign policy behavior; the systemic variables instead take a circuitous route interacting with intervening variables at the unit level to come up with results. As an alternative to states' characterization as security seeking units, neoclassical realists believe "that states respond to the uncertainties of international anarchy by seeking to control and shape their external environment" (Rose 1998, 152). States are more likely to want more influence over their external environment. Neoclassical realists accept the definition of power as "the capabilities or resources, mainly military, with which states can influence one another" (Wohlforth 1993, 4). In accordance with such a definition, Zakaria posits that "increased resources give rise to greater ambitions. States are not resource-maximizers but influence-maximizers" (Zakaria 1998, 19). Therefore, neoclassical realism predicts that over the long term relative power of states will shape their ambitions: as their power capabilities increase, it is more likely that states will seek increased influence overseas and with decreasing relative power, the states are likely to curtail their ambitions.

At the second level, neoclassical realists argue that intervening variables such as decision makers' perceptions, elite consensus, regime security and state structure are important for effective translation of systemic factors into states' foreign policy decisions. As such, political elites are constrained by systemic as well as domestic variables. Hence, states are not conditioned by anarchy or systemic pressures only as neorealists would suggest.

Anarchy, as Rose states,

"...is neither Hobbesian nor benign but rather murky and difficult to read. States existing within it have a hard time seeing clearly whether security is plentiful *or* scarce and must grope their way forward in

twilight, interpreting partial and problematic evidence according to subjective rules of thumb” (Rose 1998, 152)

Neoclassical realism assumes the importance of relative power and expects it to affect states’ behavior. But, it refrains from assuming that states are actors conditioned to maintain their relative power in each and every instance. Unlike the premises of neorealism, which warrant a constant mobilization by a state against a rising threat, neoclassical realism provides for various responses ranging from hard balancing to underbalancing, depending upon the domestic political structure of the respective state. It recognizes the fact that foreign policy decisions are made by political leaders and elites with their own perceptions of the relative strengths of their rivals. Even when their prognosis is right about the threat posed by an enemy state, they are not always able to extract or direct enough resources to counter the threat. It is wildly unpopular to transfer a state’s limited resources to military programs unless the threat is clearly visible. Often, a threat is not so apparent. Therefore, states err by failing to respond to a legitimate challenger in a timely manner. Conversely, the threat is sometimes amplified by leaders, who are losing a grip on domestic politics, in order to consolidate power and root out their immediate opponents, leading to unnecessary foreign adventures.

Recognizing all these factors that can influence foreign policy decision making within a state, neoclassical realists have attempted to move beyond exclusive structural explanations of international relations. These realists maintain that scores of different variables and circumstances may affect foreign policy formulation one way or the other. However, they suggest that only the most important variables must be chosen in order to make theorizing foreign policy possible and less complicated. Among the variables most used by neoclassical realists are perception of elites, state-society relations, elite consensus, social cohesion, regime vulnerability and elite cohesion (Schweller 2004).

To all these classical realists, pursuit of power is what drives the locomotive of politics among nations (Morgenthau 1966 [1948]). Conflicts start when there is an imbalance

in power among the states but conflicts also start when there is a breakdown in community whether it's a community of states or a community within a state. Anarchy or the lack of central authority differentiates international politics from domestic politics but "they see more variation in order and stability *within* domestic and international systems than they do between them" (Lebow 2003, 259).

To be sure, classical realists do not downplay the consequences of anarchy in the international order and the amount of constraints it places on politics itself. To them, anarchy is more of a general condition rather than a distinct structure (Waltz 1990, 36). Mearsheimer explains classical realist view as such, "... that structural constraint is treated as a second-order cause of state behavior. The principal driving force in international politics is the will to power inherent in every state in the system, and it pushes them to strive for supremacy" (Mearsheimer 2002). All politics, whether local or international, is a struggle for power and subjected to same human drives, pathologies and hubris regardless of the levels where it is expressed.

Classical realists, therefore, do not make any distinction between domestic and international politics and regard the latter to be an extension of the former and "inseparable from social life itself". Hence, it is no surprise that the pages of Thucydides' account are full of instances where the dysfunction within Athens led to a dysfunctional foreign policy (Thucydides, *Peloponnesian War* 3.36-49.212-23[1972]). Lack of consensus, greed, miscalculation, pride and hubris led Athenian elites to send their troops to wage wars in the distant places leading to a disorder in the ancient city-states system. Thucydides regarded the rise of Athens and the fear among Spartans about this new development as the main cause of the conflict (Thucydides, *Peloponnesian War* 1.21-23.47-9 [1972]). But, he then went on to illustrate how unruly Athenian domestic politics led to the policy of overexpansion and finally the disintegration of the Empire. Athens prospered when it was united behind a

singular leader like Pericles, who defined his domestic and foreign policy objectives in terms of equality, justice and shared norms (Thucydides, *Peloponnesian War* 2.34-46.50-4 [1972]). Athens crumbled when consensus among the elites was broken at home and shared norms and community were destroyed because of its overtly imperial policies.

Balancing of power and the alliance system not only failed to prevent war in the ancient Greece but might have led to the war itself. The scuffle between Corcyra and Corinth, allies of Athens and Sparta respectively, led to the eventual confrontation between these patron states. Instead of acting as deterrence and a preventative structure, the balance of power mechanism proved conducive to the development of a systemic war. Thucydides was not alone in pointing out the ineffectiveness and inadequacy of the balance of power. Morgenthau credited relative stability in Europe during the eighteenth and nineteenth century and the success of balance of power more to the strength of international society than to the distribution of capabilities (Morgenthau 1966 [1948]). The European community broke down only after Poland was partitioned for the first time through Napoleonic Wars which led to a failure of the balance of power system, not the other way around, i.e., the breakdown of balance of power leading to the systemic wars.

Unlike classical realism where human nature is the fundamental cause of wars, the root of international conflict in neorealism lies in the structure of the international system which is inherently anarchic. In the absence of a leviathan, states in an anarchic world are always in a constant struggle for power as a means for survival. While power becomes an end to the classical realists, to the structural realists, power is a means to achieve the ultimate motive of the state which is a maximum security. According to Waltz, states “cannot let power, a possibly useful means, become the end they pursue. The goal the system encourages them to seek is security” (Waltz 1979, 126). All states are rational actors that are functionally similar and the factor that can explain change in the system is the distribution of power

among the interacting units. Waltz described power in this manner: “Power in neorealist theory is simply the combined capability of state. Its distribution across states, and changes in that distribution, help to define structures and changes in them” (Waltz 1990, 36). States are always wary of the distribution of power in the system and if one state possesses disproportionate amount of power, then balancing tends to occur. Hence, the balance of power lies at the heart of neo-realism.

In making a contrast between Morgenthau and himself, Waltz stated that “for Morgenthau, balances are intended and must be sought by the statesman who produced them. For me, balances are produced whether or not intended” (Waltz 1997, 914). Balancing in neorealist understanding is a system induced behavior and a failure to do so against a challenger state would lead eventually to war and breakdown of international order. Waltz recently explained balancing behaviors of states as such: “As nature abhors a vacuum, so international politics abhors an unbalanced power” (Waltz 2000, 28) In similar vein, Mearsheimer contended that in an anarchic system where there is no central authority, status quo powers are rare and there is always an incentive for states to gain material advantage over its competitors (Mearsheimer, 2001, 21). Hence, states are constantly upgrading their material capabilities either to get material advantage or to balance against those who upgrade. In a self-help world, where states are motivated to tilt relative power in their favor, states failing to respond to a revisionist actor will be punished, lose influence, and may eventually succumb or degenerate. Therefore, for the maintenance of peace and stability, it is absolutely necessary for the balance of power to function in the neorealist conception of international politics.

No concept is as unclear as balancing in international relations study. It has been defined in numerous ways and lacks any concrete measure. Morgenthau had this to say about the concept: “the aspiration for power on the part of several nations, each trying either to

maintain or overthrow the status quo, leads of necessity to a configuration that is called the balance of power and to policies that aim at preserving it” (Morgenthau 1966, 163). Waltz only requires an anarchic international system and states’ will to survive for a balancing mechanism to appear. The imagery evoked by this definition is such that the balance of power mechanism resembles some gigantic clockwork—an inevitable natural process that keeps any unbalanced power in check by default. But, anomalies are too many in world politics to take the balance of power theorists at their words. The unwillingness among the other great powers to balance American hegemony is a current case where the balance of power theory proves weak. Going back to the earlier decades of the last century, Britain stood by while the United States surpassed it in combined capability. Recently, in a testing conducted by Wohlforth et al. (2007), the evidence contradicted the core balance of power hypothesis that balancing behavior prevents systemic hegemony. Surveying over 2000 years of international politics in the Middle East, the Mediterranean region, South and East Asia, and Central and South America, they found out that “sustained hegemonies routinely form, and balancing is relatively insignificant in explaining the emergence of nonhegemonic outcomes” (Wohlforth et al. 2007, 156). Similarly, in a study of early modern Europe, Victoria Tin-bor Hui found that the European balance of power was not a result of states’ penchant to balance against each other but was a result of relative weakness of state institutions, due to policies such as the sale of administrative offices and the dependence on loans for military expansion (Hui 2005). Therefore, no hegemon emerged with enough resources to disturb the balance of power.

It is unclear from Waltz’s works to determine the strength of his balance of power theory. At times, he suggests a strong balancing mechanism at work. Commenting on current international order, he contends that a movement from unipolarity to multipolarity is all but inevitable (Waltz 2000, 32). In another instance, he somewhat backtracks: “balancing among

states is not inevitable. As in Europe, a hegemonic power may suppress it” (Waltz 2000, 26). These statements give an appearance that Waltz’s balance of power theory as having mixed effects on the system, dependent upon the power distribution and the polarity of the system. It can be perceived as a continuum in which the left end is occupied by traditional hard balancing approach and the other end is occupied by bandwagoning approach (Waltz 1979, 125-126).

The literature of international relations is filled with a litany of terms describing behaviors at odds with the claims of the traditional balance of power theory. Buck-passing, hedging, distancing, asymmetric balancing, omni-balancing, soft balancing, off-shore balancing, under-balancing and non-balancing are some of the tactics appraised in these works. For the sake of clarity and brevity, I will not evaluate each of those claims. However, it will be helpful to categorize some of the tactics so as to reveal the weakness of the balance of power in its neorealist version. Schweller has just done that for our convenience.

In an essay examining the phenomenon of under-balancing by states, Schweller (2004) explicates four distinct categories of state behaviors. The first, which he calls appropriate balancing, occurs against a revisionist state which cannot and should not be appeased. Next, overbalancing or inappropriate balancing takes place when a defensive minded power is misperceived as an aggressor resulting in needless and costly arms race spiral. The third category, which he calls nonbalancing, consists of a range of tactics including buck-passing, bandwagoning, appeasement, engagement, distancing, or hiding. Lastly, so called underbalancing occurs due to the unwillingness of states to balance or to do so efficiently against a dangerous and unappeasable state. This categorization extends both sides of Waltz’s continuum previously discussed. At the left end, the strategy of overbalancing stretches the continuum, whereas at the right end, the strategy of underbalancing stretches the continuum further right. Waltz only restricts states between traditional balancing and bandwagoning and

whatever comes in between. Schweller's continuum provides for a variety of states' strategies and a better overall depiction of states' behavior.

For the purpose of this thesis, I adapt Schweller's definition of balancing. Schweller defines balancing as such,

“Balancing means the creation or aggregation of military power through internal mobilization or the forging of alliances to prevent or deter the territorial occupation or political and military domination of the state by a foreign power or coalition. Balancing exists only when the stakes concern some form of political subjugation or, more directly, the seizure of territory, either one's homeland or vital interests abroad (e.g., sea-lanes, allies, colonies, etc.). Thus, balancing requires that states target their military hardware at each other in preparation for a potential war. If two states are merely building arms for the purpose of independent action against third parties, they are not balancing” (Schweller 2004, 166).

This definition of balancing has two components, i.e. internal balancing via an increase in a state's material capabilities by internal development, and an external component which takes places by forming an alliance with like-minded states against a dominating power. Both of these actions increase a state's relative capability compared to that of a hegemon.

Concerning China's reaction to US unipolarity and hegemony, the appraisals among scholars are varied. Most liberals see China as being pulled closer to mainstream of international politics via interdependence, institutionalization and an increasing level of democratization internally. This group of scholars argues that the liberal politics of US led international order will accommodate China's rise successfully. Given that China is benefiting from stability and security provided under US hegemony, China will remain a satisfied power with little qualms about prevailing international arrangements. Besides, China has significant domestic challenges which will keep it away from foreign adventures. Taylor M. Fravel (2008) suggests that the main issues of concern for Chinese elites are internal stability and regime security. He further maintains that China does have limited territorial aims in Taiwan and the South China Sea; however, these aims are not necessarily

expansionist from the Chinese perspective. Unless Taiwan unexpectedly declares independence, China will not diverge from its current policy of gradual reconciliation.

Conversely, other scholars, mostly realists, assume that a rising China will eventually seek a status reflecting its material capabilities. China has not completely succumbed to the structural pressure to balance the US. The reasons behind this approach according to Yong Deng are the prevalence of bandwagoning by other powers, domestic insecurity, and “perceived high costs of open confrontation with the United States combine to explain Beijing’s hesitancy” (Deng 2001, 344). But, it should not surprise any one if China changes its attitude drastically as it approaches power-parity. Given its increasing economic and military strength, Mearsheimer believes that, “China, like all previous potential hegemons, [will] be strongly inclined to become a real hegemon” (Mearsheimer 2001, 400). Thomas J. Christensen (2001) sees a real potential of Sino-American conflict over Taiwan given the saliency of the matter in Chinese domestic politics and China’s overestimation of its asymmetric warfare capabilities and its underestimation of American resolve on that particular issue. As does Fravel, Christensen sees a possibility of Taiwan issue creating legitimacy problem at home for the Chinese Communist Party (CCP) regime and it may lead a weaker China to attack Taiwan and its protector, the United States. Christopher Layne, on the other hand, holds that the days of the American unipolar moment are numbered and suggests that China has already started to balance against US hegemony (Layne 2006, 36-37). But, Layne also acknowledges the difficulty of balancing in a unipolar world and holds that the Waltzian prediction on balancing has yet to come to fruition—an argument similar to one made by Pu and Schweller (2011).

While most realist observers of international relations recognize that China’s foreign policy will be influenced by its growing relative power and that it will seek some revision in the system, there are increasing numbers of scholars who think that China’s rise will not

bring conflicts and a complete change in the system (Goldstein 2001; Shambaugh 2004). Instead of seeking revision substantially, China is more likely to be a conservative power with limited ambitions rather than a revolutionary state (Johnston 2003).

On the other hand, scholars of Chinese political psychology and nationalism consider the approach of devising a state's foreign policy from the vantage of relative power a mistaken one. Hence, Peter Hays Gries writes, "Intentions should not be inferred from power alone, whether relative or asymmetric. The actions of other states and a variety of emotions (pride, anger, etc.) also influence decisionmakers" (Gries 2001, 155).

METHODOLOGY

Given the theoretical stance of neoclassical realism that relative power does not directly and efficiently translate into a state's foreign policy behavior, it is inadvisable to expect clear cut models out of neoclassical realists' works. At the same time, these theorists also tend to avoid "thick description" of a state's domestic politics to avoid pitfalls associated with countless variables. Their works are more likely to be case studies and theoretically informed narratives. Despite the movement towards formal and universalistic approaches in political science, neoclassical realists are still in favor of area studies since the explanation of unit level variables' effects on foreign policy requires significant knowledge of domestic political structures. Therefore, a neoclassical realist analysis starts with the descriptions of systemic pressures and the role of relative power in states' behaviors. Then, such an analysis will look for any domestic constraints that might impede effective translation of a state's relative power into its foreign policy. The analyst may come up with a range of actions or hypotheses as to how the state is likely to behave.

Accordingly, I will first look into the structural and systemic constraints imposed on Chinese foreign policy making, especially the effects of US unipolarity and the security dilemma caused by China's increasing power. In the second level of analysis, I will examine

which domestic variables contribute to China's decision making process. Finally, I will conduct a case study of Chinese currency policy to see how these international and domestic factors affect the decision making process.

CHAPTER III

UNIPOLARITY AND SECURITY DILEMMA

The structure of world politics in the post Cold War period is defined by unipolarity. Due to its vast superiority in military capabilities and its status as the biggest economy, the US occupies a hegemonic position. Never before in history has any one state been so dominant in world affairs. America's military virtually dominates every ocean and controls every corner of the globe. It can stage intervention in any locale around the globe within a reasonable timeframe. The US military alone spends about 43% of the world's total military expenditure (Stockholm International Peace Research Institute 2011; hereafter SIPRI).

Given this concentration of power in one actor, the traditional balance of power theory which predicts a balancing coalition of weaker states against the most dominant one seemingly falters. Such balancing behavior is a more viable option in bi-polar and multi-polar worlds where the prospect of being singled out and punished by the dominant power is less than in a unipolar world. The act of balancing is a status quo policy in a multi-polar world because it intends to maintain the power distribution in the system, whereas in a unipolar world, balancing is effectively a revisionist policy because it has an effect of changing the power distribution (Schweller 2008; Pu and Schweller 2011). Moreover, the hegemon is likely to react harshly to such revisionist acts. Therefore, Layne suggests that "in a unipolar world, states must adapt to U.S. hegemony by finding balancing strategies that avoid direct military confrontation with the hegemon" (Layne 2006, 29). Hence, a challenger state has to be surreptitious in its response to hegemony; hide its intentions, downplay its rising strength, ignore and often bandwagon with the dominant power contrary to the prediction of the balance of power theory. Even when the challenger has sufficient resources to balance against the leading state, it is not automatic that the challenger will expend its resources on waging war to end the streak of dominance.

In the post Cold War era, Chinese leaders envisioned a multi-polar world (Zemin 2010, 270). They assumed that the US would remain the most powerful among great powers but they also believed multilateralism would be the next trend in world politics. It didn't take too long for them to realize that their prognostication was inaccurate. As interdependence was increasing with newer trade relations and institutionalization, the structure of international system indisputably favored American power and its continuation. Most international organizations and multilateral venues like the United Nations (UN) and the Bretton Woods System were effectively controlled by the US and its allies. The US-backed North Atlantic Treaty Organization survived the end of Soviet Union and has remained as the strongest alliance in the post Cold War era. The liberal wave of democratization and globalization that has swept the third World has further enhanced American power (Nye 1990).

Under these circumstances, China's choices were constricted. Though it had split from the Communist bloc earlier and became an avowed member of the non-aligned movement, it was now dangerous to stand alone while most of the great powers were reluctant to confront the United States. Given that China had just come out battered and bruised by the domestic upheaval highlighted by the Tiananmen Square Massacre, it was risky to confront a hegemon equipped with superior power and a strong alliance. So, it was only consequential that China opted to form a limited partnership with the reigning hegemon until it developed sufficient power capabilities to deter attacks against it. Jiang Zemin, thus recognized the importance of the relationship with the US in a 1993 speech to Chinese diplomatic envoys,

“It is still the leader of the Western World, and Japan and Western Europe are still not its equal. Whether we can maintain stable relations with the United States has far reaching implications. The United States is still our primary export market and important source of capital, technology and advanced managerial expertise. Preserving and developing our relations with the United States is therefore strategically important for China” (Zemin 2010, 302).

This was the logic behind China's pursuit of 'most favored nation' (MFN) status and its close partnership with the United States in the early 1990s. A stable relationship with the US not only had security implications but also economic consequences vital for China's development. On the other hand, the US had its own reasons for conferring such status on China. It hoped to benefit by opening the huge Chinese market to its multinational corporations while also pulling China away from its autocratic rule into the mainstream of the world politics.

In sum, the main goal of Chinese foreign policy after the Cold War was to promote an external environment conducive to its internal economic growth that was necessary for it to rise to great power status. Jiang made this clear to his diplomats in the same speech, when he stated,

“The fundamental objective of our diplomatic work is to further consolidate and develop a peaceful international environment – especially a neighboring environment – beneficial to China in order to serve its reform, opening up and economic development, as well as the great cause of reunifying the motherland” (Zemin 2010, 305).

Fully aware that its rise was dependent upon peace and stability in the international world, China set out to establish diplomatic linkages with other nations. At the same time, it also had to make sure that no other nations, especially the United States, formed an alliance against it. As the Chinese economy posted strong growth rates in the early 1990s and internal strife subsided, the party leaders grew more confident in their efforts to modernize China, even as China's sudden rise was also arousing suspicion among its neighbors and the United States. China's assertive and forceful stances against Taiwan during the Strait Crisis and in the South China Sea territorial disputes only reinforced its image as an unsatisfied power seeking to change the status quo (Goldstein 1997, 69). Chinese leaders became increasingly worried about the growing perception of the “China threat” among foreigners while also being circled by states suspicious of its intentions and rising power (Gertz 2000). For instance, in a *Foreign Affairs* article, Richard Bernstein and Ross Munro cautioned that “driven by

nationalist sentiment, a yearning to redeem the humiliations of the past, and the simple urge for international power, China is seeking to replace the United States as the dominant power in Asia” (Bernstein and Munro 1997, 19). Therefore, Chinese leaders had to come up with some ways to check the perception of threat emanating from China’s newfound capabilities.

The New Security Concept—A Grand Strategy?

The Party leaders came out with the New Security Concept (NSC) in 1996. It called for a solution of regional problems according to principles of mutual trust, mutual benefit, equality and coordination (Ministry of Foreign Affairs 2001a; hereafter MFA). It was not much different from “Five Principles of Peaceful Coexistence” which China presented as its foreign policy doctrine in 1954. This new code of conduct reiterated China’s commitment to its long held beliefs of equality in negotiations, non-intervention in internal affairs and peaceful solutions to international problems. The concept sought to curb security concerns among states through diplomatic means and by increasing economic interdependence. Diplomacy and cooperation could take a variety of forms under such a concept, from strong and binding multi-lateral security mechanism to “a forum-like multi-lateral security dialogue” (MFA 2001a). Additionally, states could engage in “confidence-building bilateral security dialogue” (MFA 2001a) or engage in unofficial dialogues of academic nature.

The framework of the NSC provided China with flexible means to promote its security concerns in the region. First and foremost, by promoting a policy of non-intervention in internal affairs, China could ask other nations to stay out of issues like Taiwan and Tibet. As far as China is concerned, these issues are essentially Chinese domestic issues and the solutions to these problems should be addressed not in international forums but by the Chinese themselves. Second, by advocating equality in negotiations and forums, China could project a fair and a less threatening picture of its foreign policy and effectively negate the increasing security dilemma in the region (Shambaugh 2004). Third, the framework of the

concept also provided bilateral confidence building measures allowing China to resolve issues in bilateral settings where China could extract concessions from the other party (Kuik 2005). Fourth, by taking initiatives to incorporate regional issues in forums like the Association of Southeast Asian Nations (ASEAN), the East Asia Summit (EAS), and the Shanghai Cooperation Organization (SCO), China mitigated the possibility of unilateral actions by a single influential actor, including the United States (Foley 2005, 2). Fifth, the unofficial channels of dialogue provided China with a medium to exchange foreign policy concerns with others without subjecting it to any binding mechanism or expectations borne out of official diplomacy (Odgaard 2003, 22-23).

Multilateralism to Check Security Dilemma and Security Concerns

Even though China had envisioned a multipolar world with increased institutionalization, China primarily shunned multilateral diplomacy in favor of bilateral ties in its foreign policy endeavours in the early part of the decade (Kuik 2005). It preferred the less constraining effects of bilateral diplomacy to the complications of multilateralism, especially when it could pressure less powerful states in extracting more favorable foreign policy outcomes. But, its experience in the South China Sea offered a different conclusion. It found that states in South East Asia united when addressing the prospects of coexistence (Odgaard 2003, 11). For instance, in 1993 ASEAN recommended the presence of US forces in the region to potentially keep Chinese aggression in check (Odgaard 2003, 20). The rise of China and its activities in the South China Sea had indeed threatened these ASEAN members.

Hence, China decided to implement multilateralism in its foreign policy in a pragmatic way. It sought to shape the architecture of these regional forums by participating in them. A 1995 report by the Chinese Academy of Social Sciences' Institute of Asia Pacific Studies recommended that “China should proactively shape the development of the

mechanism from within, in order to ensure a favourable position in a fluid and complex security environment” (Kuik 2005, 106).

China also found out that it could change its threat-perception and quell suspicions about its rising power by actively participating in regional forums and promoting cooperation and a common approach. This development was observed by David Shambaugh in an *International Security* essay,

“As a result, most nations in the region now see China as a good neighbor, a constructive partner, a careful listener, and a non threatening regional power. This regional perspective is striking, given that just a few years ago, many of China’s neighbors voiced growing concerns about the possibility of China becoming a domineering regional hegemon and powerful military threat. Today these views are muted” (Shambaugh 2004, 64).

Furthermore, China’s participation in multilateral institutions also provided forums from where it could speak against unabated unilateralism and hegemony. Multilateralism, as such, provided China with an effective means to suppress the security dilemma created by its emergence, as well as a hedge against continued US dominance in the region. By incorporating multilateralism in its foreign policy, China did not abandon bilateralism, however. In fact, between 1999 and 2000, it signed bilateral political agreements with all ASEAN states (Kuik 2005, 114). Thus, both of these diplomatic tracts became complementary elements of Chinese foreign policy.

ASEAN IS NO ALLIANCE FOR CHINA

China has been very active in the South East Asia to promote its foreign policy objectives since the evolution of the New Security Concept. China did maintain a dialogue with ASEAN before it became in 1997 an official member of ASEAN Plus Three (APT), which is basically a grouping of ASEAN along with China, Japan and South Korea. China attended the opening session of the 24th ASEAN Ministerial Meeting (AMM) in July 1991 held in Kuala Lumpur as a guest of Malaysia. It was extended full Dialogue Partner status at the 29th AMM held in Indonesia on July 1996. ASEAN and APT, as regional forums are mainly concerned with issues such as trade, development, technology, agriculture, culture,

environment, terrorism and trans-national crimes. ASEAN does have a dialogue and consultation mechanism for common political and security matters in the ASEAN Regional Forum (ARF) in which China has participated since its founding in 1994. However, even ARF is toothless as compared to NATO and mainly serves as a forum for confidence-building and preventative diplomacy. Recently, APT has extended coordination to another pan-Asian forum, the East Asia Summit (EAS) which includes APT members, Australia, India, New Zealand, Russia and the United States.

Despite China's involvement in the APT and ARF processes, the Sino-ASEAN relationship is mostly an economic one. The prospect of a strong security alliance is very remote. Many ASEAN members have conflicting maritime claims with China in the South China Sea. Brunei, the Philippines, Malaysia and Vietnam all have maritime disputes with China over the Spratlys, whereas Vietnam and China both claim the jurisdiction over the Parcel Islands and even engaged in a conflict in 1974. China, the Philippines and Vietnam also claim the rights over the Mischief Reef, where China has been building structures since 1994 on the features once controlled by the Philippines. China and ASEAN members signed the Declaration on the Conduct of Parties in the South China Sea in 2002 which provides for peaceful solution of the disputes. However, the disputes are far from being resolved and the concerns among ASEAN members are growing because of China's growing economic and military clout. The Chinese government changed its tone in 2010 when it declared the South China Sea a "core national interest"—a characterization previously associated with Tibet and Taiwan issues, where China has stated that it is willing to use military force (Weitz 2011, 8).

Therefore, to hedge against a Chinese military build-up in the South China Sea, ASEAN countries have significantly increased their arm-imports. According to a SIPRI Report 2010, arm imports to South East Asia nearly doubled in 2005–2009 period compared to 2000–2004. Malaysia, Singapore and Indonesia reported growth in arm imports of 722 %, 21

146% and 84% in 2005–2009 compared to 2000–2004, respectively (SIPRI 2010a). Additionally, the countries in the region have sought to develop security relations with the US. For instance, Vietnam, which has historical animosities with China in both land and sea, is on the lookout for a better relationship with the US. In March 2010, it signed a memorandum of understanding with the US to participate and cooperate in peaceful development of nuclear technology to serve its growing energy demand. In October 2010, Vietnam invited the US to use the naval base at Cam Ranh Bay for peaceful purpose (Weitz 2011, 12). The Philippines and Singapore also allow the US to use its naval bases and confer visiting rights for its aircraft carriers as agreed upon in the US-Philippines Visiting Forces Agreement of 1999 and the Addendum to the 1990 US-Singaporean Memorandum of Understanding respectively (Tow 2004, 440-444).

As evident, there is a huge amount of distrust among ASEAN nations and China despite the deepening of economic interdependence. In fact, ASEAN nations seem to be hedging China and the US against each other. This allows them to keep both powers in check, and minimize their influence in regional matters.

The Shanghai Cooperation Organization-A New NATO?

In line with the NSC, China played an instrumental role in the creation of the SCO in 2001 with the Central Asian states of Tajikistan, Kyrgyzstan, Kazakhstan, Uzbekistan and Russia. The process started with the original “Shanghai Five” in 1996, which included all the states of the SCO except Uzbekistan, which formally joined the organization in 2001. The charter goal of the organization is to combat terrorism, separatism and extremism in Central Asia. The SCO has signed four major agreements since its founding: the Agreement on Confidence Building Measures in Military Field along the Border Areas, the Agreement on Mutual Reduction of Military Forces along the Border Areas, the Shanghai Convention on Combating Terrorism, Separatism and Extremism and the Agreement on Regional Counter-

terrorism Agency. The SCO and its regimes have proved beneficial in coordinating actions against terrorists and separatists in the Far West where China has seen a rise in separatist sentiments in recent years. By engendering cooperation and relations with these resource-rich Central Asian nations, China is in essence trying to secure its future energy needs. Also, the agreement to reduce the military presence along mutual borders also is significant because decreased military presence will allay security concerns and the prospects of conflicts between the participants. It will also allow the People's Liberation Army (PLA) to move its ground forces toward more populous parts of the country in the East and the South.

Despite the increasing cooperation in the SCO, there is no evidence that the organization is moving towards a defence organization similar to NATO. There are a number of issues that hinder an alliance formation between China, Russia, and the four Central Asian states. First, the four Central Asian states are more troubled by Chinese and Russian influence than by any Western powers (Horta 2008). The suspicion of Russia is easily understood due to the imperial history of the Soviet Union in the region. While China is seen in a positive light because it never occupied the region, its increasing economic influence in Central Asia is leading to fears that China prefers to restore the Sino-centric tributary system (Horta 2008, 32). This fear is reinforced by the fact that China claimed historical rights over one third of Tajik territories up until 2002. Additionally, these Central Asian states are mostly dependent on foreign aid, especially from the European Union and the United States. Investments from American energy companies, which are seen as more reliable, are also welcomed by the leaders in these nations.

Second, Russia is increasingly uneasy about the increased Chinese presence in Central Asia. At the moment, a short term strategy may favor partnership with China to limit American influence in the region. However, China may present a bigger challenge in the long run in the region which Russia considers within its sphere of influence (Horta 2008, 30). This

mutual suspicion among China and Russia will hinder in the transformation of the SCO into an organization similar to NATO. It is likely to remain an organization focused on preventing terrorism and separatism as well as fostering economic exchanges. The fact that the SCO refused to endorse Moscow's actions in Georgia in 2008 and that it still does not recognize the Russian backed territories of Abkhazia and South Ossetia confirms the non-military nature of the SCO (Blank 2008, 39).

Sino-Russian Relation-What Hinders an Alliance?

The alliance that makes the most sense if it were to form against the US is a Sino-Russian alliance. Despite the common interest in diminishing US dominance, these two countries have not made a decision to foster a serious partnership. Both China and Russia attempted to normalize their relations in the wake of the disintegration of the Soviet Union. This started with an official visit by Russian President Boris Yeltsin in December, 1992, when he and the Chinese President Yang Shang Kun signed a Joint Statement on the Foundation of Mutual Relations. They pledged to “establish good-neighbourly, friendly and mutually beneficial relations” and Chinese and Russian officials signed “24 other statements, documents and memoranda of understanding on cooperation on a range of issues, including border demarcation and reductions in armed forces” (Kile 1999, 500). Soon afterwards, in a reciprocal visit by the Chinese President Jiang Zemin to Moscow in September 1994, a joint statement released with Yeltsin defined Sino-Russian relationship as a “constructive partnership.” The visit also resulted in both countries pledging not to initiate the use of nuclear weapons and target their missiles across their borders.

The Sino-Russian union was strengthened further by the *Treaty of Good-Neighborliness and Friendly Cooperation*, a twenty-year strategic, economic, and geopolitical treaty, signed in 2001 by Jiang Zemin and Vladimir Putin. Article IX of the treaty is particularly controversial because some analysts regard it as a defence pact (Cohen

2001; Menges 2001). The article stated that “When a situation arises in which one of the contracting parties deems that peace is being threatened and undermined or its security interests are involved or when it is confronted with the threat of aggression, the contracting parties shall immediately hold contacts and consultations in order to eliminate such threats” (MFA 2001b). It is not clear yet if China and Russia are in fact moving towards an old-fashioned alliance. This alliance would provide huge benefits to both parties. For China, Russia is a great source of arms, weapons and technology, and for Russia, China provides a huge market for its natural resources. The potential for energy exports to China is real with some Chinese experts predicting that Russia will be able to provide 25 -30 billion cubic meters of natural gas, 15-18 billion kilowatts of electricity from Siberia and 25-30 million tons of oil from the Kovykta oil field in Eastern Siberia (Menges 2001).

Recently, in November of 2010, China and Russia signed an agreement to allow for the use of their own currencies in trades between them, instead of the dollar. This move, probably a move to improve bilateral trade also undermines the dollar’s position as a de facto currency in international transactions. While the prospects for Sino-Russian relationship seem superficially good, there are many reasons that could derail the process. First and foremost, the historical memory of the Sino-Soviet split at the height of the Cold War has not totally been erased. More importantly, China and Russia will themselves vie for influence in Central Asia and Northeast Asia. As China grows stronger and wealthier, Russia is likely to get nervous about its role in Central Asia as well as in the overall Eurasian region. Historically, Russia held the status of the most dominant power in the region—a place China is likely to take away from Russia but which it will prefer to maintain. Also, the fact that China and Russia are geographically conjoined and share thousands of miles of border will play a greater role in heightening rivalry between them. Already, Russia is worried about increasing Chinese influence in the Far East, the evidence of which is recent high profile visits to the

region by Russian leaders (Kaplan 2009). Given these circumstances, the dawning of a strong Sino-Russian alliance is not inevitable. It is unlikely unless the United States chooses to become a belligerent power in the region, leaving them no choice but to embrace each other in opposing US hegemony.

Economic Dependency on Hegemon

Apart from security issues, China is also hugely dependent on the US to maintain its economic growth. Even though it is rapidly developing, it will take few decades before China reaches economic parity with the United States. There are numerous predictions including the US Government's National Intelligence Council projection of impending economic parity between China and the United States. According to a National Intelligence Council (NIC) 2004 report, China will match the US GDP around 2040 (NIC 2004, 32). A 2008 economic paper presented by Goldman Sachs predicts that economic parity is more likely to occur around 2027, revising its previous estimate of 2040 which was adopted by NIC 2004 report (Purushothaman and Wilson 2003; O'Neill and Stupnytska 2009). No matter where the estimates go, it is clear from trends in manufacturing and trade that the Chinese economy occupies a central role in the world economy. China became the lead manufacturing state in 2010 with 19.8 percent of total global output as compared to 19.4 for the United States; effectively ending the US's 110 year run (Marsh 2011). Contrary to China's perception as a low cost manufacturing center of apparel, cheap electronic products and household items, a look at export data shows a different picture. For instance, in 2009, China export figure for high-technology products was \$348 billion compared to \$141.5 billion for the United States (See Table 1).

Despite all these significant economic gains, Chinese leaders are still mindful of China's huge dependency on exports to the United States and on foreign trade overall. Diversification is highly needed if China wants to escape unscathed from global financial

turmoil in the future. Its GDP is very reliant on exports and this fact should be unsettling for Chinese leaders because consumption in Western economies is slowing down due to recent recessionary pressures.

Table 1: High Tech Exports for Selected Countries (1990- 2009), Current US \$.

Country Name	1990	1995	2000	2005	2009
China	N/A	13.1	40.8	214.2	348.2
Germany	39.2	57.1	82.7	142.5	142.4
Japan	65.6	110.1	127.3	122.6	99.2
United Kingdom	34.5	52.1	69.9	82.8	57.1
United States	90.9	128.7	196.6	190.8	141.5

Source: World Bank Database (Accessed on November 5, 2011).

As of 2010, the total trade between these two countries amounted to \$459 billion and the US remains China's biggest trading partner (US Congress 2011b, 1). But, this dependency has also become worrisome to the Chinese leaders lately. Due to the credit crunch experienced after the bursting of the housing bubble in US market and the impending cost cutting in public sectors forced by large budget deficits, it is likely the consumption in the US will stagnate for the foreseeable future. Simultaneously, the voices for actions against an alleged Yuan undervaluation are getting louder in the United States, which might possibly lead to countermeasures including introduction of tariffs against Chinese products. These developments do not bode well for Chinese exports and in the event any one of these scenarios is materialized, the Chinese unemployment level will go up resulting in social unrest.

China has also looked to increase its trade with ASEAN economies. Its trade with ASEAN economies increased from \$39.5 billion in 2000 to \$178.2 billion in 2009 (See Table 3). Similarly, it has pushed for increased trade relations with Australia, Brazil, India and Russia. Most analysts concur that its recent diplomatic and trade promotion in Africa is the result of its policy to diversify its trading partners (African Development Bank 2011).

Resource rich Africa will provide China's industries with raw materials in the future as well as a future market for China's huge manufacturing output.

In a concerted effort to find consumers for its huge industrial outputs, China has also attempted to increase consumption at home. At the moment, China's internal consumption only accounts for 36% of its GDP, which compared to the United States (over 70%) is very low (Woetzel et al., 2009). With increasing wealth, China's middle class is likely to increase its consumption. The main structural impediment to low consumption in China is its lack of social safety nets and welfare programs similar to Western welfare programs. Regardless, internal consumption is only going to move up which should give a boost to China's economy and make it less reliant on foreign trade. The huge economic stimulus the government introduced in 2008 in the wake of the housing crisis had very positive effects on its economy (WB 2009). Sitting atop a cash reserve of \$3 trillion, China could very well use its cash reserve to stimulate its economy in the event of future crisis.

Table 2: China's Top Trade Partners, 2010 (in US \$ billions)

Rank	Country/region	Volume	% change over 2009
1	United States	385.3	29.2
2	Japan	297.8	30.2
3	Hong Kong	230.6	31.8
4	South Korea	207.2	32.6
5	Taiwan	145.4	36.9
6	Germany	142.4	34.8
7	Australia	88.1	46.5
8	Malaysia	74.2	42.8
9	Brazil	62.5	47.5
10	India	61.8	42.4

Source: PRC General Administration of Customs, China's Customs Statistics

Table 3: ASEAN-China Total Trade, 2000-2003 (in US \$ billions)

Year	2000	2009
Total Trade	39.5	178.2

Source: ASEAN Trade Statistics Database

Discussion

All realists agree that relative power is the single most important factor in explaining a state's behavior in the international arena. From there on, there is not much concurrence among realists as to how and when the emergent power will manifest its newly acquired power. The balance of power theory predicts that the rising power will challenge the most dominant power in the international system either by forming a balancing alliance or by acquiring comparable material capabilities (internal vs. external balancing). Neorealists suggest that such policies of states are induced by the structure of an anarchic international system, where states take it upon themselves the task of correcting system-wide imbalance in power in order to ensure their survival. Therefore, China as a rising power is equally concerned by American dominance and seeks to restore the balance of power.

However, Chinese foreign policy behaviors in the post Cold War period do not show any significant evidence of an alliance formation against the United States. In fact, China and its leaders have utilized the relative peace and stability provided by American hegemony to bolster its relative power in order to acquire a greater power status in the international system. This alliance formation has been hindered first because of sheer American dominance in the current world. Second, instead of aligning with other powers to alleviate American dominance as neorealism predicts, ironically China had to work to lessen the security dilemma generated by its own rise among the same nations with which it could possibly form an alliance against the United States. Neorealism does not account for this pattern of interstate relations. It only focuses on power rivalry between the first rate power and whoever the next challenger is. The security dilemma among Northeast Asian actors itself has impeded the creation of traditional alliance directed against the United States. Historical rivalries, memories of subordination and mutual distrust are great barriers to the formation of Sino-Russian or Sino-ASEAN alliances. Even the geography of Northeast Asia is a hindrance to

such alliances. China still has many unresolved territorial and maritime disputes with its possible partners. Even if these claims are settled, nations are still worried about China's increasing influence inside their borders. Russia, for similar reasons, has all of a sudden started to consolidate its power in its Far East region fearful of China's influence due to increased migration in sparsely populated Russian territories. ASEAN nations have similar concerns with China's increasing influence in their respective economies and the security implications.

However, the lack of alliance formation or traditional hard balancing does not mean that China has no aspirations in replacing the position held by the US in the world order. At a minimum, it seeks a multi-polar world. The structural constraints have compelled China to devise other ways. First and foremost, China has focused internally to enhance its relative power and has already succeeded in closing the power gap. Second, China has also undertaken what can be viewed as an undermining of the US's global authority via its newfound partnerships and linkages, and its call for multilateralism and its activism in global forums.

Modelski (1987) predicted that a rising power involved in delegitimation of a hegemon's power will simultaneously build up its arms and will seek allies to eventually fight a hegemonic war for renewal of the system. Similarly, other hegemonic stability theories (Gilpin's (1981) version of hegemonic theory and Organski/Kugler's (1980) Power-Transition theory) predict hegemonic war being fought between the dominant power and the challenger. However, there are some instances where wars can be avoided. As Kugler stated:

“Power transition research supports claims that overtakings are dangerous when policy makers fail to accommodate them. ... Rather, the political negotiations among contenders determine whether potential challengers can be made satisfied with the rules and norms governing world politics. If the declining dominant state is able to engineer a satisfactory compromise....., war is not expected. If the two sides remain intransigent, war is expected” (Kugler 2006, 40).

Nevertheless, hegemonic war is a distinct feature in all of these theories. If fought, it will create a new system of states commensurate with their respective powers. The question

that becomes more salient is whether such system-wide wars are likely in present time, especially when two opposing nations both possess nuclear weapons which can effectively wipe out any gains realized in such wars.

Despite accepting the restraining effects of nuclear weapons in war and politics, political theorists usually downplay their role in theory building. Politicians and policymakers, however, do not discount nuclear weapons or states possessing nuclear weapons in their decision making. Events in recent history provide ample evidence to believe in the significance of nuclear weapons. We do not have to look further than a decision to depose nuke-less Saddam and his rule while Kim Jong-il still defies Western powers. NATO would have been unlikely to bomb Libya if Gaddafi had a functioning nuclear program. Also, the absence of a full-blown war between two nuclear nations should not go unnoticed, even though the span of time in consideration is very short.

If the international system is anarchic, then nuclear weapons have brought some semblance of order into the system. They have reduced the security dilemma among states with second strike capabilities by making nuclear war against them costly. Nuclear deterrence also stops an aggressor from making existential threats or initiating war against other nuclear capable states. Therefore, it is not surprising that the Soviet Union and the United States chose to fight proxy wars in the forests of Southeast Asia and in the mountains of Afghanistan rather than confront each other directly as Hitler and Roosevelt 's armies did. Nuclear weapons seem to have definitely disrupted the cycles of hegemonic war in world politics.

If the destructiveness of nuclear weapons makes hegemonic wars very costly, are there any other ways through which states can surpass the entrenched power? One way is through peaceful transition. We have seen this happen frequently in world politics. The most salient example is the peaceful transition between Great Britain and the United States

beginning in the late nineteenth century. Additionally, we have seen power transitions between second rate powers occur in recent decades without any significant disruption. As China has surpassed every other power but the US in material capabilities, we have yet to see any conflagration between China and the countries it surpassed like Germany and Japan.

Instead of hegemonic wars to renew the system, the dominant power may simply disintegrate or dissolve as happened with the Soviet Union. As Gilpin (1981) points out, the hegemon may simply fall under the burden of its overexpansion and the costs associated with it. Over-consumption at home, declining growth rates and the diffusion of technology may lead to gradual eroding of a hegemon's power. Of course, Gilpin does see an eventual confrontation between the challenger and the hegemon. Whether such confrontation will evolve into a systemic war of elimination is the biggest question of our time.

In this chapter, I discussed China's responses to its increase in relative power. Contrary to the prediction of the balance of power theory, there is little evidence of explicit balancing behavior by China against the reigning hegemon. The structure of unipolarity has its own constraints on the traditional response of alliance formation since such acts are overtly revisionist and would warrant a harsh rebuke from the powerful hegemon. To exacerbate the problem the challenger faces, it is also confronted by a security dilemma generated by its rise—similar to China's East Asian neighbors' concerns about increasingly powerful China. As a result, the challenger has to find other ways of undermining the hegemon, whether it is through internal development, promotion of multilateralism or active diplomacy. Chinese foreign policy seems to include all the features mentioned above.

CHAPTER IV

DOMESTIC CONSTRAINTS ON CHINESE FOREIGN POLICY

In the last chapter, I attempted to link the constraints of the international structure and the role of relative power on Chinese foreign policy. Neoclassical realists assume that states are primarily motivated by these factors. However, they also believe that these factors alone do not entirely explain the process of policy formulation. Foreign policies are made ultimately by policy elites who are themselves mindful of domestic politics as well. The perceptions of these elites, regime security, consensus among them, and the strength of social cohesion are important factors that play intervening roles in foreign policy creation. To neglect these constraints of domestic policy in explanations or interpretations of a state's international behavior will not only result in an incomplete, but a wrong, picture. Fortunately, neoclassical realists take this lesson to heart.

Following the Cold War, the chief assertion among Chinese elites about US foreign policy is that it is mainly concerned with maintaining hegemony and checking the rise of any other nation capable of challenging its unique position. The view that multipolarity would dawn gave way to one which saw enduring US preponderance, as the events of the 1990s unfolded. The intervention in Taiwan and Kosovo solidified Chinese opinions that the US is an unchecked power with “an offensive-oriented, ‘neo-imperialist,’ ‘neo-interventionist’ strategy geared toward expanding, perpetuating, and imposing its worldwide hegemony” (Deng 2001, 350). The foreign policy choices under the George W. Bush administration; the withdrawal from ABM Treaty, rejection of Kyoto Protocol and invasion of Iraq by circumventing the UN Security Council, only solidified such opinions. US sales of weapons to Taiwan were decried by Chinese leaders which saw this US policy as an attempt to prevent the reunification of Taiwan with the mainland. They were troubled particularly by the

American plan to expand the theatre missile defense system in Northeast Asia including Japan and Taiwan.

Chinese elites saw the American policy of continued criticism of Chinese human rights and interference in Taiwan as an affront to China's sovereignty. They were especially wary humanitarian interventions in Kosovo and Somalia based upon the concept of limited sovereignty. To them, such practices only manifested the heavy-handedness of US foreign policy and the imposition of Western values on Easterners. Victories in high-tech and minimum casualty wars in the Gulf and the Balkans altered the psyche of the US, which Chinese describe as a "Gulf War Syndrome"—an essential lowering of the threshold for the use of violence. The 1999 Chinese Embassy bombing in Belgrade and the incident involving a Chinese fighter and a US reconnaissance plane in 2001 only solidified such perceptions among the Chinese public.

While all these events have shaped Chinese perceptions of the US as a belligerent power bent on imposing its will and maintaining its super power status, they have also opened up scrutiny on China's military backwardness. They have also become aware of America's ability to maneuver in international regimes to produce favorable outcomes to promote its agenda. Therefore, the common analysis among China's policy elites is that despite the US's hard-headed approach, China should steer clear of direct confrontation with the US and instead focus on internal development and diplomacy American power.

Regime Security

In a December 1995 speech at a meeting of the Central Military Commission, President Jiang Zemin revisited the importance of PLA's role in maintaining the CCP's power as such, "...the PLA is an armed body that carries out the political tasks of the Party and adopts the purposes and objectives of the Party as its own" (Zemin 2010, 476). In an unofficial but highly circulated transcript of 2004 Christmas Eve speech titled "Historical

Missions of the Armed Forces for the New Stage in the New Century,” Hu Jintao reiterated the consolidation of the ruling status of the Communist Party as one of four major tasks for the PLA (U.S. Congress 2009). The official White Papers on Chinese National Defense of 2008 contains following paragraph:

“The PLA insists on putting ideological and political work first, and pushing forward the innovative development of ideological and political work, to ensure the Party's absolute leadership over the armed forces, the scientific development of the military, the all-round development of the officers and men, the increase of combat capabilities and the effective fulfillment of historical missions” (China Government 2009a).

Though the democratic forces were decisively defeated during the domestic upheavals between 1989 and 1991, the CCP is immensely worried about the security and the legitimacy of its regime. Thus, the emphasis by the party leaders on the political indoctrination of the PLA has been a common theme throughout communist rule. As Deng abandoned the legacy of Marxism and Leninism and instead promoted the socialist market economy, the ideological attraction of communism has been shrinking. The opening of China for foreign capital has brought along Western ideas that are incompatible with the CCP's autocratic regime. Though the party has been able to put a tight leash on political protests and anti-government activities, mass protests do occur. The frequency of such protests has increased as income inequality and corruption have risen in recent years. Mass protests have erupted due to layoffs, unemployment and poor working conditions in factories in urban areas. In rural and suburban areas, farmers and residents are equally being agitated by the local officials seizing their lands and properties in the name of economic development, as well as by environmental degradation brought about by excessive industrialization and haphazard mining operations.

Despite all these problems at hand, the main attraction of the CCP to the Chinese people is its ability to sustain economic growth at home. The Chinese populace has seen its per capita GDP increase fourteen fold since 1990 (World Bank 2010; WB hereafter). Starting from the abject poverty and famine endured during the Cultural Revolution, the Chinese

populace has enjoyed the prosperity brought by market reforms. The challenge to the CCP regime is whether it can maintain the same level of economic growth and channel those economic gains to the marginalized Chinese working class, rural farmers, and the people in the frontiers. Consequently, the Chinese government acted swiftly with its 2008 economic stimulus package in the wake of falling demand and rising unemployment due to the economic crisis in the United States. Many analysts also attribute the unwillingness of Chinese government to adjust its currency exchange rate to the fact that any appreciation in the yuan will make Chinese exports more expensive, which will eventually lead to unemployment.

The CCP also has to deal with a movement towards self-determination among ethnic minorities on its Western frontiers. The province of Xinjiang is the center of a separatist movement of ethnic Uyghurs fighting for their hoped-for state of “East Turkestan”. Tibet has seen its share of flare ups in recent years—the most notable being the protests during the 2008 Summer Olympics in Beijing. Western China, which is made up of nine provinces, three autonomous regions and one central government controlled municipality is home to 70 % of China’s minority population (China Government 2009b). Out of China’s 13,670.17 miles land border, 11,806 miles runs through minority regions (China Government 2009b). Therefore, the regime understands the importance of maintaining minorities’ allegiance towards the state. If the regime fails to protect the territorial integrity whether it’s in the West or in Tibet or in Taiwan, it will no longer be seen as a guardian of the Chinese state and its demise will begin to unfold.

So, it is not surprising that China chose to settle its border disputes with the Central Asian states of Kazakhstan, Kyrgyzstan and Tajikistan as well as Russia and Vietnam, given the priority the regime places on the stability in border regions. In most of these border compromises, China accepted far less than it claimed. For instance, in a compromise with

Kyrgyzstan, China only received 32% of the disputed land whereas in another settlement with Kazakhstan, China only received 22% of the disputed land (Fravel 2005). Fravel suggests that China's penchant for territorial compromise can be explained by the necessity to maintain stability in its frontier regions—the destabilization of which will cause the Chinese people to question the regime's effectiveness. Going further back to 1960s, Fravel points out that China settled its land disputes with both Burma and Nepal next to the border of revolting Tibet. Earlier in 1950s, similar talks were stalled and China showed no willingness to accede to demands made by Burma and Nepal. But, when the situation in Tibet got worse, the settlements were swift and China only received 18% of disputed land from Burma and 6% of contested territory from Nepal and half of Mt. Everest.

China's compromises in these instances are puzzling because China undeniably had the upper hand because of its superior military capabilities. But, the settlements make sense when the domestic constraint imposed by regime security is put in perspective. Fravel claims that "internal conflict often creates conditions for cooperation, producing a "diversionary peace" instead of war" (Fravel 2005, 49). Whether such cooperation can be achieved in a different range of issues is questionable. Nevertheless, it can be said that China made concessions on territorial disputes in order to improve security and maintain stability in its volatile frontier regions.

Elite Consens/Elite Cohesion

Schweller regards elite consensus/disagreement as "the most proximate cause of a state's response or nonresponse to external threats," whereas elite cohesion "concerns the degree to which a central government's political leadership is fragmented by persistent internal divisions" (Schweller, 2004, 170-180). In the neoclassical realist formulation of foreign policy decision making, both of these variables play influential roles. To recognize

them is to accept that governmental leaders make foreign policy decisions ultimately, not the states.

Elite consensus and elite cohesion in China are maintained by the CCP and its structure. The decisions are made by select few elites at top level and disseminated to underlings whose function is to build and find consensus among lower level party officials and the general public, whether through indoctrination or propaganda. Foreign policy decision making is a highly centralized affair and “highly reflective of one individual’s or a certain set of individual’s perceptions, tendencies, and preferences” (Zhao 1996, 79). The process has evolved since the early days of CCP rule when it was totally authoritarian under Mao. Many credit Deng Xiaoping for making half way change—a consultative authoritarian model as Harry Harding (1987) calls it. In the model forwarded, the final decisions on bigger foreign policy issue still funnel through few at the top or the apex but consultations are made with important constituencies in the lower level. David Lampton and Kenneth Libenthal (1992) have put forth a “fragmented authoritarianism model” which posits that the decision making process is concentrated at the top, but fragmented and decentralized in lower levels. In recent years, as China’s contact with the outside world has become more frequent and the decision making portfolio has enlarged, the foreign policy bureaucracy underneath the main leadership level has become more professionalized and is allowed to handle routine foreign policy matters. However, the biggest and most complicated tasks are reserved for the CCP’s Politburo Standing Committee (PSC) comprised of nine members from the CCP’s Politburo. The table below lists current nine members of PSC with their respective state and party portfolios.

Table 4: Members of the CCP’s Politburo Standing Committee and their Portfolios.

Leaders	Party Position	State Position
Hu Jintao	General Secretary of the CCP Central Committee/Chairman of the CCPCMC	President of the PRC/Chairman of the PRCCMC
Wu Bangguo	Party secretary of the Standing Committee of the NPC	Chairman of the Standing Committee of the NPC
Wen Jiabao	Party secretary of the State Council of the PRC	Premier of the State Council of the PRC
Jia Qinglin	Party secretary of the National Committee of the Chinese People's Political Consultative Conference	Chairman of the National Committee of the Chinese People's Political Consultative Conference
Li Changchun	Chairman of the CCP Central Guidance Commission for Building Spiritual Civilization	
Xi Jinping	Top-ranked Secretary of the Central Secretariat of the CCP/Vice Chairman of the CCPCMC /President of the Central Party School of the CCP	Vice President of the PRC/Vice Chairman of the PRCCMC
Li Keqiang	Deputy Party secretary of the State Council of the PRC	Top-ranked Vice Premier of the State Council of the PRC
He Guoqiang	Secretary of the CCP Central Commission for Discipline Inspection	
Zhou Yongkang	Secretary of the CCP Central Political and Legislative Committee	

Source: Compiled from the official websites of Chinese Government and the Communist Party. Accessed at <http://english.cpc.people.com.cn/>; <http://www.gov.cn/english/>

Notes: CCP= Communist Party of China; PRC= People’s Republic of China; CCPCMC= Chinese Communist Party’s Central Military Commission; PRCCMC= People’s Republic of China’s Central Military Commission.

As the table above shows, the same person holds different positions at the triumvirate of party, state and military. For instance, Hu and Xi are number one and number six in the hierarchy of the CCP. They are also the President and the Vice-President of the State respectively. Lastly, they also serve as chairman and vice chairman of the Party and the State Military Commissions. Experts believe these two members of the PSC are most active in foreign policy matters because Hu and Xi are also Chair and Vice Chair of CCP’s Foreign Affairs Leading Small Group—a body which is believed to “review major foreign policy issues and make recommendations to Politburo Standing Committee for action” (U.S. Senate 2011, 3). The State Council, the official administrative body of PRC headed by Wen Jiabao

represents China in foreign relations, and therefore is influential in foreign policy. The State Councillor, Dai Bingguo, who is simultaneously a member of the Leading Party Members' Group of the State Council, director of the office of the foreign affairs leading group of the CCP Central Committee, director of the office of the national security work leading group of the CCP Central Committee, vice-minister of foreign affairs, and member of the CCP Committee of the Ministry of Foreign Affairs, is regarded as one of the most influential foreign policy actors because of his extensive experience in foreign policy matters (China Government 2008; SIPRI 2010b, 11; U.S. Senate 2011, 3).

The role of the PLA in foreign policy making is real however experts disagree as to how important its role remains due to the push toward professionalization of the Army and the separation of armed forces from civilian decision making (U.S. Congress 2010, 10). As a result, military officials who retired from top positions in the CCP were replaced by civilian officers, and currently there is no representation from the PLA in the PSC. Even then, the role of the PLA remains significant in the matters of defense, arms procurement and sales, and proliferation. It can still voice its opinion through the CMC which is chaired by President Hu Jintao and where nine out of eleven members are represented by the PLA's leaders.

The list of other actors beneath the central leadership that are involved in the creation of foreign policy or that are influential in the process includes the Ministry of Foreign Affairs (MFA), the Ministry of Foreign Trade and Economic Cooperation (MOFTEC), Xinhua News Agency, the CCP Central Committee International Liaison Department, and the PLA General Staff Department. There are also peripheral actors which produce inputs to the process and include government sponsored research institutions, think tanks and local and provincial governments.

Despite the close-knit appearance of the foreign policy apparatus, frictions among various groups have become evident in recent years. The most high profile case that

illustrated foreign policy division occurred during the Copenhagen Climate Summit in 2009, where MFA officials wanted to promote compromises so that China would not be regarded as an agreement-spoiler. However, the National Development and Reform Commission which is responsible for domestic politics on climate change did not budge from its initial position which was to prevent setting fixed targets of carbon emission for both developed and developing countries despite Premier Wen Jiabao's sympathy for MFA's compromising attitude (SIPRI 2010b, 8-9). Another instance that puzzles foreign relations observers is the PLA's reluctance to maintain sustained military to military relationships with its American counterparts even after President Hu's pledges were spelled out in joint agreements signed in 2009 and 2011 with President Barack Obama (U.S. Senate 2011, 4).

The true mettle of Chinese elite consensus and cohesiveness will be tested in the 18th Party Congress in 2012 when the current leadership positions will be vacated by the President, along with other membership positions in PSC. The current Vice-President Xi Jinping and Vice-Premier Li Keqiang are rumored to replace Hu Jintao and Wen Jiabao in the PSC and take Presidency and Premiership (Miller 2008, 7). Aside from these two vacancies, there will be more PSC and Politburo seats up for grabs and those jockeying for positions are Li Yuanchao, Liu Yunshan, Ling Jihua, Wang Huning, Du Qinglin, Yang Jing, Cai Wu, Wang Jiarui, Shen Yueyue and Chongqing Party Secretary Bo Xilai (Li 2011, 15). If the transition goes smoothly, the foreign policy decision making will remain static with the PSC as its nucleus. It will be interesting to see how this new batch of leaders will consolidate power after the transition and if any more decentralization will occur in policy formulation due to infightings among various groups for more influence.

Discussion

In this chapter, I discussed how domestic constraints affect the Chinese decision making process. The United States is perceived as a hegemonic power bent on maintaining its

leading position but Chinese leaders do not want a direct confrontation because it will derail China off its developmental track. Given the perception of the US as an aggressive and an interventionist country with a lower threshold for using its military power, Chinese leaders are wary of US involvement in Taiwan, especially. Therefore, the PLA's Navy has seen huge upgrades in its defensive and offensive capabilities in recent years. China has also been the first to decry any foreign interventions anywhere in the World, and has refused to levy hard sanctions against nations like Iran. This comes as no surprise since China has a number of minority groups with aspirations for self-determination. It has also sought good relations and has settled border disputes with countries bordering Tibet and the Xinjiang Autonomous Region in order to stabilize its frontiers. The creation of SCO was a way to solve its domestic problem through regional cooperation in issues like terrorism and separatism. Thus, China's policies of regional cooperation and non-confrontation with the US are shaped by its domestic situations.

Additionally, the perceptions and preferences of the elites matter hugely in foreign policy decision making because the process is still limited to a select few even when the number of power centers is multiplying. Despite having a strong consensus among the elites, the current leadership is not as powerful as Mao or even Deng to make a radical change in policy all by itself. It has to make decisions based upon bargaining and consultation leading to delayed response in a crisis situation. This diffusion of power may lead to a policy stalemate and lack of coordination among foreign policy carriers. For instance, the security bloc may promote a policy of confrontation with the United States contrary to a policy of engagement favored by the economic bloc. This sort of infighting will hinder any coherent and effective policy response in an era speeded by globalization and where challenges to security are enormous due to nuclear proliferation and terrorism. Not helpful in the process is the rise of firebrand nationalism of Chinese netizens and their ability to steer national

discourse. The elites will have to be increasingly mindful of what their citizens are posting on the message-boards when they make decisions concerning China's role in international politics.

CHAPTER V

CASE STUDY: CHINESE CURRENCY POLICY

One of the most contentious points of disagreement in Sino-American relationship is the persistence of a huge trade deficit with China. The vocal critics include lawmakers from the political parties, manufacturers and trade unions. There are calls being made to toughen the stance with China regarding trade policies and resolve an array of grievances that include illegal subsidies, uneven labor standards, intellectual property theft, and currency undervaluation. As unemployment in the US is hovering above 8 %, the demand for actions is getting louder, especially on the currency exchange rate. Nobel laureate Paul Krugman estimated that at current level of exchange rate, 1.4 million US jobs will be lost in a couple of years to Chinese manufacturers (Krugman 2009). Fred C. Bergsten of the Peterson Institute of International Economics recently testified that the yuan is undervalued by about 15 % on trade-weighted basis and about 25 % against the dollar (U.S. House 2010). The US Department of Treasury Report (USDT) to Congress on International Economic and Exchange Rate Policies of July 2010 came just short of labelling China as a currency manipulator by concluding that the yuan is substantially undervalued (USDT 2010). The International Monetary Fund (IMF) 2010 Article IV Staff Report for China maintained that the yuan is substantially below the level that is consistent with medium-term fundamentals (IMF 2010). The report pointed out three abnormalities that would suggest currency undervaluation: (1) the rapid pace of accumulation of foreign currency reserves held by the Central Bank that reached \$2.4 trillion at the end of the first quarter of 2010; (2) the sizeable current account surplus of \$297.1 billion in 2009 even though it spent hundred of billions on economic stimulus; and (3) the current level of the real exchange rate that is close to the level it was at in the late 1990s despite gaining huge productivity gains (IMF 2010, 19).

China exercises a strict control over its exchange rate unlike most advanced economies where market based floating exchange rates are maintained. Between 1994 and July 2005, the yuan was pegged to the US dollar at about 8.28 yuan to the dollar. In July 2005, the yuan was appreciated against the dollar by 2.1% and moved to a managed float, based on a basket of major foreign currencies, including the US dollar. From July 2005 to July 2009, the yuan appreciated by 21 % and the dollar-yuan exchange rate went from 8.27 to 6.83 yuan per dollar (U.S. Congress 2011a, 1). However, the Chinese government has halted the appreciation of the yuan in the wake of the recent financial crisis and the yuan/dollar exchange rate has been kept relatively constant since July 2009 through June 2010 at 6.83. On June 19 2010, China returned to an exchange rate regime that would be more flexible and more market based, with the yuan allowed to trade within a band of plus/minus 0.5 % against the dollar on a daily basis. On June 21, the first trading day following China's announcement, the yuan appreciated 0.43 %, the largest single day appreciation against the dollar since China's initial 2.1 % revaluation on July 21, 2005 (USDT 2010, 18).

The huge foreign reserve accumulated in China has caused the yuan to lose its value, distorting market based prices. A cheaper yuan has an effect of making Chinese exports to the United States relatively inexpensive. It will also render US exports to China relatively expensive. Hence, US exports to China decrease and those American goods and service industries that compete with China have to face huge pricing pressures from cheap Chinese exports. This has resulted in the shutting down of many US factories and the widening of the trade deficit, leading some analysts to find a direct correlation between the American trade deficit and American job losses, especially in the manufacturing sector. For instance, a study by the Economic Policy Institute shows that the US trade deficit with China through July 2010 has increased by 18% over the same period last year. The overall deficit with China in 2010 will lead to a loss of between 512,000 to 566,000 jobs (Scott 2010, 1). Moreover, an

undervalued yuan has forced other East Asian economies to intervene in currency markets to keep their currencies weak against the dollar in order to compete with Chinese goods. This has prevented in a real depreciation of the dollar to other Asian currencies, rendering US exports expensive throughout Asia.

There are three questions that are raised regarding Chinese currency policy. First, how did China manage to consistently undervalue its currency without any significant repercussions? Second, what are the domestic and international determinations of Chinese currency policy? And, what does the future hold for the yuan?

In the May 1992 report to the Congress, the Treasury named China as a currency manipulator for the first time since the Omnibus Trade and Competitiveness Act of 1988 required it to monitor and report semi-annually on currency regimes and trade practices of trading partners. China remained on the list until December 1994. The Treasury determined that China highly regulated its foreign currency allocation to importers and controlled imports by necessitating permits and requiring official letters to buy dollars. China also maintained a dual exchange rate system, one the official rate and another the market rate determined in its swap centers which were responsible for trading foreign exchanges at official auction rates. Hence, the Treasury welcomed China's move to combine its dual exchange rate regimes on January 1, 1994 by pegging the yuan at 8.7 to the dollar, which was the prevalent market based rate. The new rate amounted to 33% overnight depreciation from official rate of 5.8. Nevertheless, China vowed to move to a market based socialist economy and reform its foreign exchange system. Consequently, the December 1994 Treasury report removed China from the list of currency manipulators.

There are number of reasons for the US's deficient handling of the issue. First, the Clinton Administration's engagement policy with China put the issue on the back burner. The significance of overall relation with China was far greater than the issue of currency

undervaluation. The Administration hoped to bring China into the mainstream of international politics and establish a strategic relationship in the post Cold War world by easing the relationship that had been strained since the Tiananmen Square Crisis. As a result, the US also stopped linking renewal of China's MFN status to its human rights situation in 1994—a reversal of a policy set by Clinton himself a year earlier. Second, the US took a soft approach because its multinationals were clamoring for access to Chinese markets. US exports to China was steadily rising since the early years of the decade and the Treasury's reports in the subsequent years touted growing exports to China. For instance, the August 1995 report credited recent yuan appreciation in real terms and growing economic activity in China for the surge in American exports (USDT 1995, 19). A year later, the August 1996 report claimed that exports to China increased by 26.5% in 1995. Further, it also claimed that China was moving towards reduction of tariffs on some 4,000 items as a step to liberalize its economy in order to enter the World Trade Organization (WTO) (USDT 1996, 12-13).

Third, the trade deficit with China, although growing large, was not the largest one on a bilateral basis. In 1993, the trade deficit with China was only \$22.8 billion, one third of deficit with Japan, which amounted to \$60.5 billion (USDT 1994, 16). Besides, the US also had trade deficits with Korea and Taiwan which had been named currency manipulators numerous times (USDT 1994, 20-21). China was not the exclusive focus of the US regulators. Fourth, the US's policy preference under Treasury Secretary Robert Rubin had been to maintain a strong dollar in international market throughout 1990s. This paragraph in 1996 Treasury Report illustrates the acceptance of strong dollar policy;

“Throughout the period, US Treasury Secretary Rubin reiterated that “a strong dollar is in the interest of the United States.” A strong dollar improves confidence in US assets and thus contributes to lower interest rates and reduced capital costs to US business, expanding investment in the US economy. A strong dollar contributes to sustaining the economic expansion by holding down inflation and to raising real wages and living standards of Americans” (USDT 1996, 6).

Fifth, the United States maintained very impressive growth and surprisingly low unemployment throughout the 1990s, allowing it to overlook trade deficits with China. The unemployment rate fell down under 5 percent in 1997 and by 2000 it hovered around 4 percent (See Table 5). The rate of GDP growth in the latter half of the decade was impressive too. From the first quarter of 1996 to the last quarter of 1999, the GDP grew on an average quarterly rate of 4.65 percent, a very high rate for a mature economy (See Table 6).

Table 5: Quarterly Unemployment Rate for the US (1996-1999), 16 Years and Over.

Year	Jan	Feb	Mar	Apr	May	Jun	Jul	Aug	Sep	Oct	Nov	Dec
1996	5.6	5.5	5.5	5.6	5.6	5.3	5.5	5.1	5.2	5.2	5.4	5.4
1997	5.3	5.2	5.2	5.1	4.9	5.0	4.9	4.8	4.9	4.7	4.6	4.7
1998	4.6	4.6	4.7	4.3	4.4	4.5	4.5	4.5	4.6	4.5	4.4	4.4
1999	4.3	4.4	4.2	4.3	4.2	4.3	4.3	4.2	4.2	4.1	4.1	4.0

Source: Bureau of Labor Statistics, 2011.

Table 6: Gross Domestic Product, Percentage Change from Preceding Period (1996-1999).

Year	1996				1997				1998				1999			
	I	II	III	IV	I	II	III	IV	I	II	III	IV	I	II	III	IV
GDP	2.8	7.1	3.5	4.4	3.1	6.1	5.1	3.1	3.8	3.6	5.4	7.1	3.6	3.2	5.2	7.4

Source: Bureau of Economic Analysis, 2011.

Finally, China did not devalue its currency during the Asian Financial Crisis contrary to the expectations of many experts including the Treasury. The crisis started when Thailand was unable to defend the Baht and had to float it, leading to its devaluation as well as the devaluations of other East Asian currencies. The yuan which was also pegged to the dollar lost its competitive advantage due to its appreciation. Like China, many of these nations were export-based economies competing in same product segments. An expensive yuan would render higher prices for Chinese exports in the international market. It was a foregone conclusion among experts that Beijing would devalue the yuan sooner or later. However, Beijing did the unexpected and chose not to devalue its currency, earning much goodwill among its East Asian neighbors. Instead of a currency manipulator, China was heralded as a good savior credited with saving East Asian economies by taking financial blows itself.

However, there are few advantages to an undervalued yuan. The US producers who import capital equipment and parts made in China benefit due to lower costs which result in the final US product being cheaper and competitive in the world market. Likewise, many imports from China are produced by US-invested enterprises which benefit from an undervalued exchange rate. On the other hand, focus on trade-deficit leads to underestimation of the fact that millions of US consumers benefit from cheap and affordable Chinese products, ranging from garments to electronics. Also, trade statistics should be taken with a grain of salt. The way that country of origin is designated in international trade is arcane and dubious in that it fails to capture the reality of global production networks. In many instances, China serves just as a final assembly point of a product whose parts are produced all over the world, but China is accounted with the full cost of the product instead of some value in labor that is added in the final assembly. A very recent paper from the Asian Development Bank looks at the production cycle of a very popular Apple product, the I-Phone (Asian Development Bank 2010; hereafter ADB). In 2009, I-Phones contributed \$1.9 billion to the trade deficit with China if the traditional method is applied. However, the production of I-Phones is highly globalized, with research taking place in the US and major components made in Japan, Germany, South Korea and Taiwan. I-phones are produced in Shenzhen, China by Foxconn, a Taiwanese contractor. Applying value added approach, China's share was just mere 3.6% to the total final production cost of \$178.96 for an I-phone which amounts to \$6.5 per unit. The trade deficit on this product alone will come down to \$73.45 million from \$1.9 billion using the value added approach (ADB 2010, 5).

The job losses in the US in 2000s are real and significant, but there is no clear indication whether there is a link with Chinese imports. First, not all US manufacturers export to China or compete with Chinese imports. Second, the economic recession in the early 2000s increased unemployment across the entire economy and the jobs lost were not fully

recovered even after the recovery (Bernanke 2003). Finally, there is a long-run trend shift away from manufacturing toward the service sector. According to a Congressional report, employment in the manufacturing sector “as a share of total non-agricultural employment has fallen from 31.8% in 1960 to 22.4% in 1980, to 10.7% in 2005, to 10.5% in 2006” (U.S. Congress 2008, 30). This trend is much larger than the Chinese currency issue, and is caused by changing technology, productivity gains and shifts in comparative advantage. The issue of Chinese currency rate has really been become salient in economic conversation in the domestic front only in the last few years.

Under all these circumstances, US regulators were very slow and unwilling to respond to the perceived currency undervaluation by China. Despite China’s huge current account balance against the US and its increasing foreign reserves, there was no willingness to confront China since the Administration forged the policy of engagement. Increasing exports to China which also relaxed its tariff structure as a step towards WTO membership also sent mixed signals to the US regulators. The policy of maintaining a strong dollar and an impressive economic growth at home discouraged American actions during 1990s.

The Bush Administration came with a resolve to settle economic issues with China and was heading towards confrontation when the events of September 11, 2001 completely shifted its priorities. Congress occasionally raised the issue but did not enact any significant legislation. The issue got bigger in the 109th Congress when Senator Charles Schumer (Democrat, New York) and Senator Lindsey Graham (Republican, South Carolina), introduced the China Currency Bill (S 295) calling for 27.5% tariffs on all Chinese imports if China did not appreciate its currency by 27.5%. The bill got significant traction in the Senate despite an attempt to kill it by a pro-free trade group of lawmakers. Senator Schumer eventually agreed to pull it back in exchange for a full Senate Committee hearing. But, the message was sent to the Chinese, especially when the Currency Bill attracted a broad

bipartisan support. On July 21st 2005, few months after the introduction of bill on February, China removed the yuan from a decade-old peg against the dollar and implemented a managed float against a basket of currencies. The yuan was re-valued effectively by 2.1% to 8.11 against the dollar and it could float in a tight band of 0.3% on daily basis.

While international pressure seemed to have influenced the Chinese decision to revalue the yuan, there were some domestic reasons behind such a move. Inflation has been particularly a big headache for the Chinese authorities. The increasing supply of money due to a positive account balance and a huge trade surplus has led to an upward price movement in food prices and the property market. Although inflation had not been as acute as in the mid 1990s when it was upwards of 10% on annual basis, there was a steady rise of inflation in the middle years of 2000s. In 2004, the rate of inflation was 3.9% and while it crept downwards to manageable 1.8% and 1.46% in the next two years respectively, it again climbed back to 4.7% in 2007. The fact that increasing food prices hurt the Chinese working class is not lost on the leaders of the CCP. In a report presented to the National People's Congress in 2008, Wen stated that the "price hikes and increasing inflationary pressures are the biggest concern of the people" (Jiabao 2008). In order to check food prices he also promised to "implement the system of provincial governors assuming responsibility for the 'rice bag' (grain supply) program and city mayors for the 'vegetable basket' (non-staple food supply) program" (Jiabao 2008).

Besides putting inflationary pressure on Chinese citizens via an influx of foreign money due to increased exports, a cheaper yuan also means less consumer purchasing power and thus less domestic consumption. This is worrisome because low purchasing power hold back the living standard of ordinary Chinese citizens. Second, it also keeps China reliant on exports for domestic growth rather than on domestic consumption. Therefore, it is in China's own interest to appreciate the yuan and the leaders are fully aware of it. For instance, the

Report on the Work of the Government presented by Wen to the State Council on March 5th, 2004 includes the following statements:

“We should make full use of the role of monetary policy, appropriately control the size of credit and optimize the credit structure to support economic growth while fending off inflation and financial risks. We will work to basically balance international payments and keep the exchange rate for the Renminbi basically stable at a proper and balanced level” (Jiabao 2004).

A similar report in 2008 by Wen contained the following paragraph:

“The decision to follow a tight monetary policy was based on the following considerations: the strong possibility of resurgence in fixed asset investment, continued excessive supplies of money and credit, the still-unsolved problem of excess liquidity, and considerable inflationary pressure. For these reasons, we must improve financial regulation to control the excessively rapid growth in the supplies of money and credit” (Jiabao 2008).

It is evident that the Chinese leaders are worried about the domestic implications of an undervalued yuan as much as they are influenced by the international pressure. In fact, a case can be made that the Chinese leaders give more weight to the domestic considerations on this matter. In a luncheon with a visiting US Chamber of Commerce delegation in March of 2005, Wen cautioned that “reform of the yuan's exchange rate is a matter of China's own sovereignty. Any pressure or media play-up, or politicising an economic matter, will not help solve problems” (Jiabao 2005) It is increasingly important for China’s leaders to maintain an appearance of independence in its monetary policy in front of a nationalistic domestic crowd. Even if nationalism is not high on the list, there are other domestic considerations which shape their decision making on exchange rate regime. As the Governor Zhou Xiaochuan of People’s Bank of China (PBC) reiterated in a 2006 speech, “China as a large developing economy with heavy employment pressures and a still fragile financial system, could only adopt a gradualist approach to adjust its economy in a controllable manner”(Xiaochuan 2006). Therefore, it is not surprising that China has maintained a slow and a guided appreciation of the yuan against the dollar despite the calls for swift action.

There are two major constituencies within China which are influential in the currency regime. First, the exporters guided by NDRC, which is charged with coordinating national economic and industrial policies, support a depreciated yuan. Second, the reformists in the

PBOC, who are charged with implementing sound monetary policy and checking inflation, prefer a more flexible currency. While the course of actions China has led towards a float based regime supported by the reformers, it is hard to say when and if the yuan will truly be exchangeable and free in the currency market. The view in the United States that only market based currency rate is fair is not necessarily shared by the Chinese officials. In the same speech in which he called for some forbearance on the yuan appreciation, Governor Zhou protested:

“According to the Articles of Agreement of the IMF, “member countries shall have the right to choose exchange rate regime, either free floating, managed floating or fixed exchange rate, at their own discretion”. In this sense, there exists no such an exchange rate regime that can be labelled as “manipulating exchange rate”. China’s gradual shift from a relatively fixed arrangement to an exchange rate regime with greater flexibility in line with the needs of economic reform and opening up has won extensive support from the world community, and those criticisms wrongly accused this action as “manipulating exchange rate” will not be widely accepted” (Xiaochuan 2006).

Therefore, it should not come as a surprise when China intervenes in its currency market if it finds intervention necessary. However, the act of balancing both domestic and international pressures on its currency regime has increasingly turned difficult. For instance, in the heat of global financial crisis in 2008, China pegged the yuan back against the dollar at 6.83. While it seemed to be an emergency measure directed at maintaining stability in a volatile global market, leaving the yuan as it was would have surely depreciated its value because the majority of currencies in the basket against which the yuan was floating since 2005 were losing their values. Given that the rates of annual growth of exports were just 8 % in 2008 and a negative 10 % in 2009, depreciation would have been good for Chinese exports and would have reduced unemployment pressure at home (See Table 7). But, the Chinese officials did not let the yuan depreciate and kept the exchange rate fixed similar to its actions during the Asian Financial Crisis a decade ago. One explanation for such move would be that China did not want to see the US’s trade deficit worsen even more. As its major trading partner, it is necessarily not in the interest of China to see an economically challenged United

States. Nevertheless, as China intends to move towards more market based currency regime, it will gradually lose its absolute control over the yuan.

Table 7: Chinese Exports (2005-2010)

Series Name	2005	2006	2007	2008	2009	2010
Exports of goods and services (constant 2000 \$, billions)	791.8	980.9	1175.5	1247.4	1142.1	1422.8
Exports of goods and services of GDP)	37	39	38	35	27	29
Exports of goods and services (annual % growth)	24	24	20	8	-10	25

Source: IMF Database, Accessed at www.imf.org, on November 20, 2011.

The Future of the Yuan

Besides being the richest nation and the largest economy in the world, there are three other reasons that have helped the United States become the most influential player in the global financial market. First, the role of the dollar as the world's main reserve currency enables the United States to finance its huge current account deficit. Second, there is a huge appetite for the dollar denominated bonds in the global financial market because of the certainty and the stability associated with the US financial system. Third, the US dominates the global institutions of finance like the IMF and the World Bank through which it promotes policies that serve its best interests. These three factors aid the US in maintaining its position as a lead nation in the global financial system.

These facts are not lost on the Chinese leaders. If China is to be a true rival to the US, then it is one of the requirements that the yuan challenge the hegemony of the dollar as well. Looking at the Chinese government's policies in the last two decades, there are some signs that can be interpreted as a move towards enhancing the yuan as a competitor currency to the dollar. But, these are just some baby steps and a resolute determination cannot be made from such moves. It is hard to assess China's policies with any certainty because of their gradual and incremental approach and the lack of a distinct policy signal. Nevertheless, it suits our purpose to study them even though some of them are in infancy.

In a much circulated essay by the Governor Zhou of PBC released on March 23, 2009, he called for an international reserve currency that is decoupled from any individual national currency (Xiaochuan 2009). Without directly naming the US, he cautioned clearly about the negative impact of the deteriorating US economy on the global financial system due to the dollar's status as the main reserve currency. According to Zhou, "the crisis again calls for creative reform of the existing international monetary system towards an international reserve currency with a stable value, rule-based issuance and manageable supply, so as to achieve the objective of safeguarding global economic and financial stability" (Xiaochuan, 2009). From Chinese perspective, everything Zhou said made sense because the global financial system was suffering due to the domestic housing crisis and profligate US spending. The essay appeared just a little more than a week after a similar proposal was made by Russia which stated that "the obsolescent unipolar world economic order should be replaced by a system based on the interaction of several major centers" (Russia Government 2009). Together, these releases made headlines around the world. Coming out just a week before the 2009 G-20 Summit in London, these statements reflected Chinese frustration at its dependence on the US dollar for its financial health since most of its savings are held in dollar assets. It can also be seen as a pushback by China against the United States and the EU who made Chinese currency issue headlines during the past summits.

China has also started allowing the issuance of the yuan denominated bonds by foreign financial and non-financial firms to raise capital as a part of the internationalization of the yuan. In August 2010, McDonald's issued yuan denominated bonds in Hong Kong, becoming the first foreign non-financial firm to do so (See Table 8). Caterpillar Inc. immediately followed suit (See Table 8). Similarly, Guggenheim Investments and Invesco rolled out yuan denominated bonds on the New York Stock Exchange for the first time in September 2011 (See Table 8). Investor demand for these yuan denominated international

bonds have been very positive and as the Chinese Central Bank relaxes control over capital flows, there will be more offerings in the bond market.

All these developments do not bode well for the status of the dollar as the global reserve currency. While the position of the dollar is unchallenged at the moment, the future is uncertain because of rising budget deficits and GDP/debt ratio. Meanwhile, China continues to impress with spectacular growth rates and current account surpluses. As China's financial market liberalizes along with a healthy economy, investors will be attracted more to yuan denominated bonds instead of US financial products. Additionally, as China allows for the settlement of trades in the yuan with its trading partners, the use of dollar will likely diminish. Recently, in November of 2010, China and Russia signed an agreement to allow for the use of their own currencies in their interstate trades, instead of the dollar. In July 2009, China launched a trial program which allowed firms in select cities to settle transactions in its own currency. It also named Hong Kong as the international center for the yuan settlement. About 7% of China's foreign trade is settled in yuan in the first quarter of 2011, most of it with Hong Kong (See Table 8). By the end of April 2011, yuan deposits in Hong Kong climbed to 511 billion yuan (\$79 billion), or 8.4% of total deposits (See Table 8).

Aside from the promotion of its usage and the creation of the international bond market for the yuan, China's involvement in the Chiang Mai Initiative (CMI) also reduces US influence in the global financial market. Originally founded as a multilateral currency swap agreement between APT members in 2000, the initiative also launched a reserve fund amounting to \$120 billion in 2010 in order to intervene in liquidity crisis similar to the AFC of 1996. China and Japan are the biggest contributors to the fund with \$38 billion shares each. With the proper functioning of such a regime and gradual increase of the reserve amount, Northeast Asian states will have a better option in the CMI than the IMF in the future if a liquidity crisis reoccurs. The US has been able to exercise significant influence around the

globe through the Bretton Woods institutions-the importance of which will be diminished if the CMI truly becomes an alternative to the IMF.

Looking at Chinese currency and monetary policies provide a hint as to how overall Chinese foreign policy works. Its exchange rate policy is mainly a function of its domestic politics and economic necessities. China has resisted international calls for a quick appreciation of the yuan in order to manage a smooth transition of the yuan into a market based regime. While it has responded to international pressures in some instances, those actions came only when the calls for the change became very intense. Even then, Chinese leaders made sure to tell others that China would not buckle under any outside pressures and that its currency policy was solely a domestic matter. Within China, the decision regarding the currency policy is made at the top but there is significant divergence in policy preference under the apex of decision making. The NDRC along with the exporters prefer a cheaper yuan while the PBOC is worried more about the inflation that comes with a depreciated yuan.

The internationalization aspect of the yuan is troubling to US policy makers. While it might be long before the yuan poses a serious risk to the status of the dollar, the Chinese are incrementally building a framework to promote the yuan as an alternative in trade and in financial instruments. By creating regional financial institution in the CMI, China seeks to reduce influence from the outside actors in Northeast Asia. Being the region's largest economy, as well as, one of the two biggest contributors to the CMI fund, China will be able to forward its agenda in the arrangement. Any success in fending off the involvement of the IMF and the US in a future financial crisis will be a huge foreign policy victory for China. This will only cast into doubt the notion that US leadership is indispensable in solving international crisis thereby delegitimizing the undue influence of the United States. This approach is not of a direct confrontation and like the overall nature of Chinese foreign policy seeks a way to increase China's own influence.

Table 8: Timeline of Chinese Currency Policy (1994-2011).

Date	Actions
Jan. 1, 1994	China combines its dual exchange-rate system by adopting the market rate of 8.7 which is a depreciation of 33% overnight of the official rate of 5.8. The move is heralded as a step towards establishing a socialist market economy.
Dec. 1, 1996	Yuan is made fully convertible into foreign currencies for trade purposes but severe limitations are imposed on trading foreign currencies to make loans and investments.
1997-99	China wins praise for its commitment to not devalue the yuan during the Asian financial crisis. The yuan is pegged at 8.28 through frequent interventions.
2001-05	China eases its capital controls after joining the WTO, but international pressures mount to quickly adjust the exchange rate.
Feb 2004	Hong Kong banks can now offer limited retail yuan banking services.
July 21, 2005	A peg against the dollar is rescinded and a managed float based on a basket of currencies is implemented. The yuan is revalued by 2.1% overnight to 8.11.
July 2007	The first yuan-denominated bonds are sold in Hong Kong.
Jul 08-Jun10	China moves yuan back to dollar peg at 6.83 amidst global financial crisis.
July 2009	A trial program to allow companies in select cities to settle trades in yuan. Hong Kong is named a pilot city to receive settlements.
June 19, 2010	China moves back to managed float after two-year hiatus.
July 19, 2010	Yuan clearing in Hong Kong is expanded, and offshore yuan trading begins
Aug. 20, 2010	McDonald's becomes the first non-financial foreign company to issue yuan bonds in Hong Kong, followed by Caterpillar Inc.
Nov. 2010	China and Russia signed an agreement to allow for the use of their own currencies in their interstate trades, instead of the dollar.
Oct 1, 2010	China allows select exporters to keep some of their foreign-currency earnings offshore in a trial program.
Jan, 2011	The World Bank issued its first bond denominated in Chinese yuan in Hong Kong.
Jan. 12, 2011	Bank of China opens yuan trading for US customers at its branches.
Jan. 13, 2011	China launches a pilot program to let domestic companies use yuan for investments outside China.
Feb. 4, 2011	US Treasury says China's exchange rate is "substantially undervalued" but declines to name China a currency manipulator
March-April	About 7% of China's foreign trade is settled in the yuan in the first quarter,

2011	most of it with Hong Kong. By the end of April, yuan deposits in Hong Kong climb to 511 billion yuan (\$79 billion), or 8.4% of total deposits.
April 28, 2011	Li Ka-shing's Hui Xian Real Estate Investment Trust becomes the first yuan-denominated initial public offering outside of China but falls sharply on its debut on the Hong Kong exchange.
September, 2011	Guggenheim Investments and Invesco rolled out the yuan denominated bonds on the New York Stock Exchange.

Source: Compiled from Wall Street Journal, Financial Times and REUTERS.

CONCLUSION

In this study of Chinese foreign policy decision making, I have looked at both structural and domestic factors that affect the process. First, I looked into the constraints posed by the structure of the international system on decision making process. Despite China's growing power and the prediction of neorealism that states tend to balance against the hegemon, China has refrained from employing balancing tactics. This is not only due to the fact that the US can punish such a move but also because so many powers have chosen to bandwagon with the United States. Meanwhile, China has hugely benefited from the peace and stability that unipolarity has brought and its material capability has been enhanced greatly in a very short time. A neorealist would expect that China will begin to balance as soon as it reaches power parity with the United States. Here again, the balance of power thesis faces significant problem. The same security dilemma that is supposed to bring the contending states closer to a conflict hinders the challenging state in its quest for dominance. This is evident in Northeast Asia. As Chinese might has grown, so have the concerns among its neighbors in ASEAN and Russia. Instead of focusing its efforts in devising ways to challenge the dominant power, China has to spend time allaying fears among its neighbors by embracing multilateralism and effective diplomacy. The close proximity, historical grievances and animosity among the actors in the region only enhances the security dilemma. This fact of interstate politics has been very much neglected by international relation theorists. Constrained by the security dilemma generated by its rise and due to the overabundance of

power in the hegemon, China as the challenger state does not always balance or form an alliance.

Aside from structural constraints that hinder the challenger from confronting the hegemon, the challenger is also impeded by the factors within its borders. The concerns of regime security and the lack of cohesion and consensus among the elites also stop states from focusing on its foreign endeavors. China is a prime case. Despite having a tight consensus and cohesion among the elites, the regime has never felt secure on its feet. A vast territory with diverse ethnic populations coupled with the fading saliency of the Communist doctrine, Chinese leaders are always under huge pressure to maintain the integrity, territory and the solidarity of the state. Therefore, it signed many border treaties providing concessions to the aggrieved states even though it was powerful enough to extract more in the settlements. But, China preferred the stability of its frontier regions over the lost territories. Even then, the Chinese regime can only provide so much concession in the future. Issues like Tibet and Taiwan are of paramount interest to the Chinese people and if the regime were to somehow lose its grip on these matters, the Chinese people will definitely hold the leaders accountable. So, the leaders have to maintain a balance between its domestic and foreign agendas in order to safe-guard their rule.

This study used only a few variables that are put forth in neoclassical realist literature. Because of tight control on the decision making process by a small number of elites, the variables such as cohesion and consensus among the elites were not discussed that much. But, this might be the next big factor. As Chinese people and the elites interact more with the outside world, they are more likely to aspire for democratic values and freedom of expression. While Chinese leaders themselves might be aware of the inevitability of the need for democratic reforms, they only seem to be taking measured steps at the moment and real reforms are nowhere close. How wealthy and educated Chinese citizens are going to react to

the continuation of the politically oppressive regime is a question that should interest scholars in the future. Also, interested scholars may take a look into how Chinese domestic political system is oriented and how it is evolving. As Chinese citizens and groups with varied interests get wealthier and more resourceful, are they more likely to unite into opposing factions to promote their respective economic interests and values? Will this lead to a competitive environment within? These queries are indeed interesting and will surely impact China's foreign policy behaviors in the decades to come.

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