



## Engaging China: The Political Economy and Geopolitical Approaches of the United States, Japan and the European Union

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Abstract

*This paper examines US, Japanese and European political economy approaches to China and their effect on US-Japan and US-European Union (EU) relationships. Great powers with a greater security concern in dealing with another major country care more about power while those with less concern are preoccupied with calculations of wealth. China's rise and its actions have posed a far greater security challenge to the United States and Japan than to the EU and are driving the two countries closer together. The political economy game involving China reveals a dominant welfare motive among the advanced market economies. The ambition to transform China politically has diminished. China's integration into the global market makes a relative gains approach difficult to implement. Globalization simply limits the ability of a state to follow a politics-in-command approach in the absence of actual military conflict, which explains why the political economy approaches of the United States, Europe and Japan are not that different. China's own grand strategy to reach out to the world and outflank the US-Japan alliance has also contributed to a divergent European policy toward China, although there are severe limitations to Beijing's ability to drive a wedge between the United States and Europe.*

Introduction

This paper examines US, Japanese and European Union (EU) political economy approaches to China, and their effect on US-Japan and US-EU political economy relationships. The China factor is important for comparing US-Japan and US-EU relations. China is a major security challenge for the advanced democracies because of the potentially explosive Taiwan issue and because of its non-democratic political regime. With a low-cost production base, a growing market, and an enlarging pool of capital and skilled labor, China offers both opportunities and challenges for the advanced market economies.

Any paper that covers the United States, Europe, Japan and China essentially talks about a great power game in the contemporary world. These four players are first-rate world powers. Great power relationships necessarily have a significant security dimension to them. In addition, when comparing US relationships with Japan and Europe, we are comparing two alliances (recognizing that the European Union does not overlap exactly with the North Atlantic Treaty Organization (NATO)), which are primarily about security needs rather than economic ones. Thus, although the paper focuses on political economy approaches, it integrates security discussion. Equally important, this great power game should be set in the context of globalization and regionalization. Regional developments, particularly regional integration, factor heavily in the strategic dynamic among the great powers of our time.

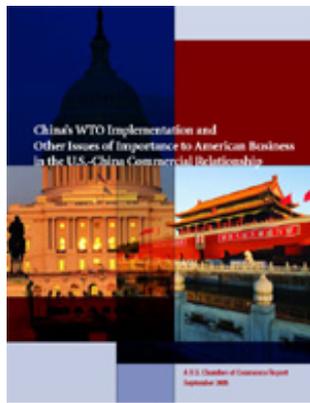
The theoretical issue that the paper deals with is fundamentally a collective action problem among major market democracies, that is, how they coordinate their strategies toward China. It is thus necessary to examine what motivates American, Japanese, and European approaches to China, specifically how important welfare gains, relative gains, and transformative concerns are in guiding economic transactions with China.

My analysis follows a loose game approach that focuses on interest-based goals pursued by the advanced market economies toward China. At the same time, who the Americans, Europeans, Japanese and Chinese think they are and who they think the others are have helped to shape the very game they have been playing. Their identities have also been shaped by the past and present interactions with each other.

In their economic transactions with each other, countries seek welfare gains, that is, opportunities to raise the living standards of their citizens and the wealth of their nations. It follows, then, that the United States, Japan and the European Union should not diverge in their desire for profits and differ only in performance.

**Negotiating China's accession to the World Trade Organization**

The most important test case for understanding US, Japan and EU economic policy toward China was China's accession to the World Trade Organization (WTO), which attracted sustained attention at the highest level for all four players involved. The advanced market economies shared common interests in integrating China into the global economy, gaining reciprocal access to the Chinese market, and providing the strongest possible cushion for their declining industries. China's fifteen-year effort to join the General Agreement on Tariffs and Trade (GATT)/WTO, resulting in a detailed 1,000-page final document, was a testament to the extent of Western concerns as well as those of other member countries. But the US, European and Japanese approaches were different and largely uncoordinated.



**China and the WTO**

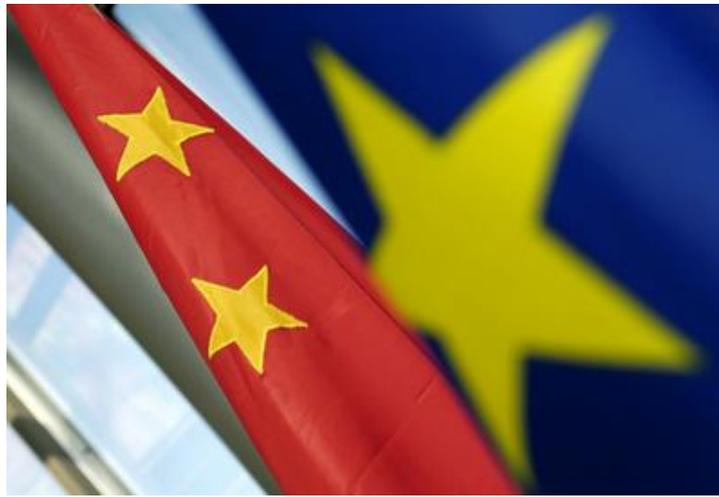
The United States took the lead in negotiating the terms of China's entry into the global trade organization. Washington essentially wanted China to join as a developed nation, a status with greater obligations from Beijing. This was not simply because the United States wanted to act as a hegemon to provide public goods for the international community. Domestic politics was a principal determinant of the American negotiating position. China was already a large trading nation with a rapidly enlarging trade surplus with the United States, from \$53.0 billion in 1997 to \$73.5 billion in 1999 according to US statistics. US deficits with China hurt, particularly given US overall trade deficits of \$211 billion in 1997 and \$357 billion in 1999 (IMF 2004: 511-12).



**China's exports**

Strong opposition to China's accession came from across the political spectrum, including labor unions, human rights activists, religious conservatives and defense hawks. Opposition to China's accession in the US Congress explained why the Clinton administration decided not to accept China's much improved offer during Premier Zhu Rongji's April 1999 visit to the United States. The two governments finally reached an agreement in December 1999. President Clinton had to engage in intensive lobbying to win Congressional approval (May 2000 for the House and September for the Senate) for granting China a permanent normal trading status. Even without the annual review of China's MFN status, Congress has ready tools to deal with China, including annual evaluation, Congressional hearings, anti-dumping, countervailing and import surge safeguards (Tiefer 2001).

The Europeans shared with the Americans the need to set standards for China's accession, but they believed that some flexibility was warranted because of the difficult reform process in China (Algieri 2002; Shambaugh 1996: 23). European Commission Vice President Leon Brittan openly criticized the United States for what he termed excessive pressure on China to join the WTO as a developed nation. He wanted China to join as part developed and part developing (Studwell 1996). The more moderate EU position resulted partly from its trade performance. The European Union also had a sizable trade deficit with China, totaling \$21.4 billion in 1997 and \$28.0 billion in 1999. But unlike the United States, the European Union enjoyed an overall trade surplus of \$119.7 billion in 1997 and \$61.9 billion in 1999 (IMF 2004: 34-35).



Nevertheless, after the US-China deal was struck, the European Union engaged in tough negotiations with China, particularly over insurance, and concluded an agreement on 18 May 2000. The EU negotiators received concessions beyond the American deal in more than 150 industrial and agricultural products. The European Union won important concessions in the insurance industry; foreign firms now may choose their own partners when entering the China market. Progress was also made in the telecommunications industry, another major European concern (Laprès 2000, 2001). The US factor benefited the European Union in that China could not exert too much pressure on the EU when the US Congress was debating China's permanent normal trading status (Algieri 2002: 75).

Japan was not nearly as visible as the United States and the European Union in the WTO accession game. Unlike Sino-US relations, WTO accession was not a prominent issue in Sino-Japanese relations. Unlike the United States and Europe, Japan had more or less balanced trade with China if one includes its trade with Hong Kong, which was mostly transshipment to China. In fact, Japan enjoyed trade surpluses of \$4.9 billion in 1997 and \$3.8 billion in 1998. Besides, Japan had maintained a large trade surplus with the world for years, amounting to \$107.1 billion in 1998 (IMF 2004: 272-3). Japan struck deals with China earlier than the United States and the European Union (Sugihara et al. 2002: 44-51). Japan and China reached a bilateral agreement on goods in September 1997 during Prime Minister Hashimoto Ryutaro's visit to China. The Japanese government had a strong stake in China's accession. Japan could trade even more with a growing trading partner in a multilateral trading regime. Japanese also saw trade as part of the overall relationship and felt that some issues could be left until after China joined the WTO. The Chinese and Japanese governments reached an agreement on services during Prime Minister Obuchi Keizo's visit to Beijing in September 1999 (Wan 2006: 59).



**Japanese towers rise in Shanghai**

The Japanese government publicly characterized its agreement with Beijing as facilitating US-China relations. Obuchi told journalists that the conclusion of the Japan-China WTO negotiation would help improve Sino-US relations in the aftermath of the accidental NATO bombing of the Chinese embassy in Belgrade. But a more important motivation was actually using China's accession as a diplomatic deliverable for a successful prime ministerial visit during which Obuchi had to explain the new defense guidelines with the United States. Like the Europeans, Japanese officials felt that the United States was too harsh on a transitional country like China. The Japanese were well aware of American displeasure but concluded that they could proceed without damaging their relations with the United States or affecting US negotiations with China: 'Americans will do what they want.'<sup>[1]</sup>

The rule of the WTO accession game is that any of the 100 plus members may seek bilateral negotiations with China and that the concessions one country receives will be applicable to other members. China engaged in bilateral talks with the United States, the European Union, Japan and thirty-four other countries. It would be difficult to coordinate a common strategy among all thirty-seven parties. But the United States, the European Union and Japan (plus Canada) were the largest trading powers and had controlled the agenda of the global trading regime until the Doha Round. It was thus not inconceivable for the three to coordinate. The three major trading powers certainly would all benefit from any concessions that others would acquire from China. But they did not actively coordinate a common strategy for China's accession to the WTO. On the contrary, there were mutual suspicions and criticisms. As mentioned above, the Japanese and Europeans were critical of America's tough negotiation position. Americans saw the Europeans as having less incentive to open China's market for industrial products since American and Japanese firms were

more competitive (Stokes 1999: 180). The Americans criticized the Japan-China agreement on goods in 1997 as setting the bar too low and moving too fast. They were basically concerned that the Japanese and European flexibility would simply result in more Chinese goods channeled to the American market, since Japan and the European Union had entrenched practices to keep foreign goods out, while the US market was more open.

As one would expect, free riding was an obstacle to trilateral coordination. Moreover, growing trade tension between the United States and the other two gave them grounds to be suspicious of each other's motives. The United States and Japan had largely been competitors in the Chinese and Asian markets since the late 1970s. The United States was particularly suspicious of Japan's official development assistance and massive direct investment after the mid-1980s. Japan was viewed widely in the American policy community as expanding its influence in East Asia at the expense of the United States. The Clinton administration was highly critical of Japan's trading practices in the early 1990s and adopted tough, results-oriented negotiating tactics. America's view of Japan as a free-rider had been well established by the time the Sino-Japanese WTO accession agreements were reached. Trade tension between the United States and Europe also grew. There was no close cooperation between the United States and the European Union on China. In fact, the two did not have a closely coordinated trade policy to Asia in general (Steinberg and Stokes 1999). Americans were also smarting from a previous incident in which Brittan went to China to strike an intellectual property agreement right after the Americans had won their first such agreement with the Chinese, even though the Europeans had rejected the American invitation to participate in the negotiations (Stokes 1999: 180). In response, Tokyo and Brussels viewed Washington as having an arrogant unilateralist trade policy and adopted tough positions vis-à-vis the United States.

The fact that bilateral concessions are often tailored to the specific concerns of the country involved means that the fear of being taken advantage of by free-riders is also reduced to some extent. The European Union could not fully utilize the US-China deal since it did not cover some areas important for Europeans. EU Trade Commissioner Pascal Lamy said prior to the EU-China negotiation that Europe was 80 percent satisfied with the US-China deal (Laprès 2000: 8). Therefore, the European Union still had to negotiate with China. The logic applies to other countries as well. Mexico was the last country to sign an agreement with China because its specific concerns had not been addressed by the previous thirty-six agreements.

The United States, Europe, and Japan achieved part of their objectives in negotiations with China because China wanted to join the WTO and made compromises accordingly. China wanted GATT/WTO membership to enhance its modernization, to improve its position in the international system and to help shape the world trade regime. From a political perspective, China's pursuit of WTO membership could be seen as the reformers' attempt to lock in market reform policy (Woo 2001). Since China is not a democratic country, the central government had some ability to avoid capture by protectionist special interests. But even in China domestic politics mattered a great deal. There were winners and losers in China as well, not only in economic terms but also in ideological terms. Also, bureaucratic politics explains much of China's WTO negotiating position (Wang 1999). Zhu's failure to secure an agreement with the United States during his trip to the United States in April 1999 weakened his position in Chinese domestic politics (Fewsmith 1999). That awareness also put some pressure on the Clinton administration.

The Americans, Europeans and Japanese continue to monitor China's compliance with accession commitments, often with score cards. In full agreement, they have paid particular attention to the intellectual property protection issue, viewing it as at the core of the knowledge economy central to the long-term competitiveness and welfare of their countries in the face of pressure from cheaper but skilled labor forces in large emerging countries like China and India.

### **Trade disputes with China**

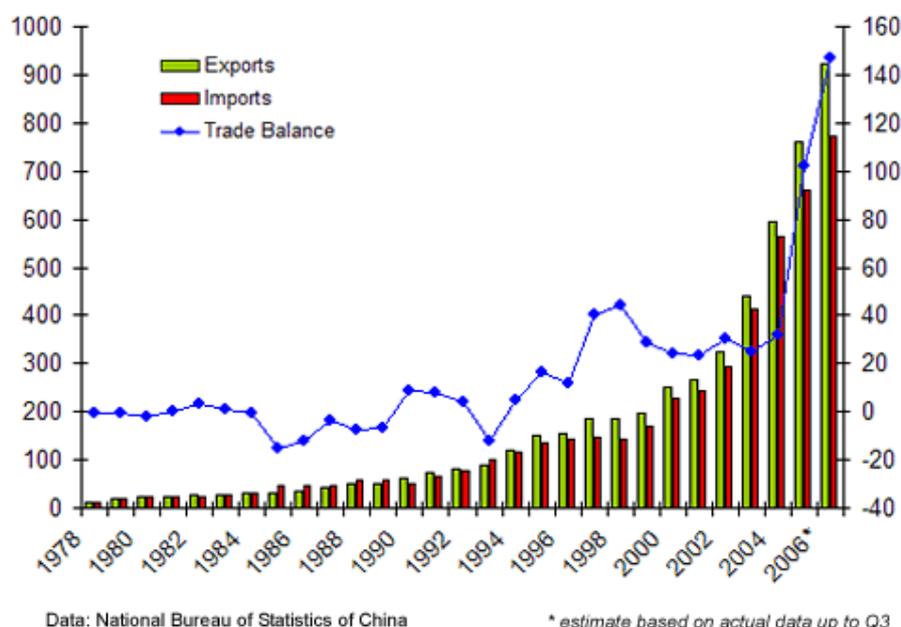
Since China's accession to the WTO in January 2002, the United States and Europe have waged battles with China to protect their declining industries, particularly the textile industry. The multilateral textile quota system ended on 1 January 2005, which led to a flood of Chinese textiles onto the world market. To protect domestic industries, the European Union reached a compromise with China on 11 June, which capped annual growth to 8-12.5 percent in ten categories of textiles. However, since a month lapsed between the signing of the agreement and the announcement of regulations on 12 July, European retailers still received licenses to import Chinese textiles. As a result, the quotas agreed to in June were exceeded by August, which created a major piling up of Chinese clothing (reported to be 80 million items) at European borders. Strong complaints by European retailers who had already paid for the clothing for the Christmas season weakened the bargaining position of the European Union.

The United States adopted a tougher position in a three-month negotiation and struck a deal with China on 8 November 2005. The agreement essentially reintroduced a quota system to last until 2008 for thirty-four categories of textiles or slightly less than half of Chinese textile exports to the United States. As a sure sign that the United States did well, American textile manufacturer groups such as the American Manufacturing Trade Action Coalition were content with the agreement (Blustein 2005). China benefited from the agreement by removing the uncertainties for producers and importers created by the yearly 'safeguard' quota allowed by the terms of China's accession to the WTO.

Unlike the United States and Europe, Japan has not waged major bilateral trade battles with China since China's accession. One of Tokyo's rare trade battles with Beijing took place in April 2001, before China's accession (Yoshimatsu, 2002). The Japanese view of China has shifted from threat to opportunity in recent years, with booming exports to China as an important contributor to Japan's slow economic recovery.

The United States continues to pressure China to open its market more widely. US trade deficits with China have increased rapidly. Chinese statistics show a US deficit of \$144.3 billion for 2006 (China Ministry of Commerce 2007). US statistics show that US trade deficit in goods with China reached \$232.5 billion in 2006, a 15.4 percent increase over the previous record of \$201.5 billion in 2005 (Bureau of Economic Analysis 2007 a). The overall US trade deficit in goods amounted to \$836.0 billion in 2006, surpassing the previous record of \$782.7 billion in 2005 (Bureau of Economic Analysis 2007 b: 8). In such an environment, Congress has become ever more critical of China. To preempt protectionist sentiment in Congress, the Bush administration has put greater pressure on China. Responding to the pressure from the Democratic-controlled Congress, the Bush administration filed a case against China at the WTO on 2 February 2007 over government subsidies and tax policies to boost local companies. On 30 March 2007 the Bush administration raised the stake by imposing sanctions on China over subsidies for glossy paper exports, which could be followed by other industries like steel and furniture. The United States had not used such retaliatory measures against non-market economies for the previous twenty-three years. Then, on 10 April, the United States filed two complaints over piracy against China at the WTO.

## China Trade (\$ billions)



Similarly, the European Union has urged China to give Europe equal access to the Chinese market. On 23 February 2006 the EU Commission announced anti-dumping measures against shoe imports from China and Vietnam. On 30 March the European Union requested consultation at the WTO about new Chinese measures regulating imports of automobile parts. The next day, the European Union resumed anti-dumping charges on Chinese color television enterprises. In fact, there is now growing concern in the European Union that Europe needs a new strategy to deal with China's challenge because China and India are becoming competitive in the high-skill sectors as well. The European Parliament adopted the Lucas report overwhelmingly in October 2005, which essentially calls for more trade protection from China and questions the high cost of free trade.[2] Shortly afterwards, EU Trade Negotiator Peter Mandelson said that the European Commission would produce a communication on the European Union's trading relationship with China and urged China to open its market to European products and stop counterfeiting.[3] Mandelson issued a green paper on the European Union's trade policy on 6 December 2006.

The European Union has good reason to be concerned. According to Chinese statistics, China's trade surplus with the European Union reached \$91.7 billion in 2006 (China Ministry of Commerce 2007). According to the EU statistics, the EU25 (the 25 members of the European Union) had a deficit of 117.1 billion (\$154.1 billion at \$1 = 0.76) with China in January-November 2006 compared with 97.4 billion in January-November 2005. The EU25's trade deficit with the world was not nearly as bad as that for the United States, totaling 172.6 billion (\$227.1 billion) in 2006 (Eurostat 2007: 1). But the EU25's largest trade deficit is now with China. Accordingly, European complaints about China's trade policy now rival those of the United States.

China's trade pressure is increasing on everyone. This is primarily because China's overall trade surplus has grown so large so quickly. China's overall trade surplus in 2006 reached \$177.5 billion (China Ministry of Commerce 2007). China's foreign currency reserves surpassed \$1 trillion by November 2006. China surpassed Japan as the country with the largest foreign reserves in the world in February 2006.[4] As a result, the United States and the European Union will have more reasons to complain. We should expect more coordinated measures aimed at China. A case in point: on 30 March 2006 the European Union and the United States both requested consultation from the WTO (DS339 and DS340, respectively) regarding China's policy measures on imports of automobile parts, followed two weeks later by Canada (DS342).[5]

Japanese companies have complained about China's weak enforcement of intellectual property protection rulings and lack of transparency in regulations. According to a 2004 survey by the Japan Patent Office, Japanese companies put China on the top of the list for infringing their intellectual property rights.[6] But all is quiet on the Eastern front. Japan's trade with China, including transshipment through Hong Kong, has been basically balanced, unlike China's booming trade surpluses with the United States and the European Union. Chinese statistics show a Japanese surplus of \$24.1 billion in 2006 (China Ministry of Commerce 2007). Japanese statistics show that it had a trade surplus of 1,086.4 billion (\$9.1 billion at \$1 = 119 yen) with China and Hong Kong combined in 2006. Japan had an overall trade surplus of 8,090.7 billion yen (\$68.0 billion) for the year (Japan Ministry of Finance 2007). In fact, through direct investments, Japanese firms have transferred part of their trade surpluses with the West to China. Nevertheless, Japan joins the West periodically to push China to open its market more. Thus, a few days after the United States filed a complaint at the WTO about China's export subsidies, the Japanese government indicated that it was thinking of joining the United States.

### China's currency policy

There has been greater verbal cooperation among the United States, the European Union, and Japan over China's currency policy to maintain a low peg to the US dollar (about 8.28 yuan to a US dollar set at 1994), which is believed to have contributed to its export competitiveness at the expense of its trading partners, particularly the United States. American, European, and Japanese officials have been voicing similar concerns in different forums. At the same time, European and Japanese officials have taken a more moderate approach than the Americans, emphasizing that the Chinese government should decide when and how to change its currency policy. More important, there has been no threat implied by the Europeans and Japanese. In contrast, the US Congress has periodically threatened to introduce high tariffs on China unless the Chinese government changes its currency policy, which as the 'good cop' the Bush administration has used to its advantage in discussions with the Chinese government. China ended the peg on 21 July 2005, adopted a basket of currencies, appreciated the value of the yuan by 2.1 percent, and allowed the yuan to fluctuate as much as 0.3 percent daily against other major currencies. Initially, the yuan did not change much relative to the dollar after the change. But the yuan has fallen over time, lowering to 7.7 yuan per dollar by mid-March 2007. But Western pressure is increasing, given China's growing trade surpluses.

### China's market economy status

The United States, the European Union and Japan are not interested in granting China market economy status, which would make it far more difficult to use anti-dumping measures against Chinese firms. China won recognition from several sizable economic powers, including Russia in September 2004, Australia in April 2005, and South Korea in November 2005.[7] But China is unlikely to change the mind of the big three in the foreseeable future. It is next to impossible for the United States to grant China market economy status since Congress wants to have more, rather than fewer, tools to pressure China. It is less urgent to persuade Japan because the Japanese government has rarely used anti-dumping measures against Chinese exports, living in a glass house themselves.[8] So the Chinese government has worked harder on the European Union. However, after studying the situation in China, the EU Commission announced on 28 June 2004 that the state still interfered too much in the Chinese economy. Before China could receive market economy status, China needed to reduce state interference and ensure equal treatment to all companies, improve compliance with the existing Accounting Law, treat all companies equally in bankruptcy procedures and respect property and intellectual property rights, and let the market determine allocation of capital.[9] When Mandelson visited China in early June 2006, he told the Chinese that China still does not qualify for market economy status. The European Union is at one with the United States on this issue.

### **Competition for China projects**

The United States, the European Union and Japan have been competing for lucrative commercial deals with China. These projects typically involve only a few big players in a strategic sector that is politically powerful at home, thus guaranteeing high-level political attention and prominent media coverage. China is using awards of major contracts to reward pro-Chinese governments and penalize anti-Chinese ones. While the Chinese government does not say so explicitly, its action reveals a preference for Europeans over Japanese. At the same time, Beijing is interested in using its growing market power to prevent a monopoly from emerging in any strategic sector to reduce China's dependence on a single source.

As a case in point, Europe's Airbus and America's Boeing have both recognized the importance of the Chinese market and have worked hard to secure deals with the Chinese government. Airbus has offered China's largest aircraft producer China Aviation Industry Corporation I a 5 percent share in the research and development of its new A350 aircraft. Airbus's new German CEO Gustav Humbert explained the decision simply as a necessary globalizing strategy to trade Chinese participation for sales of planes to China. In contrast, the Japanese have an arrangement with Boeing that will allow a third of the company's new 787 aircraft to be made in Japan.[10] For both security and welfare reasons, such a deal would not be possible between the Chinese government and Boeing. After all, the China Aviation Industry Corporation I is also China's principal manufacturer of jet fighters and bombers. When Chinese Premier Wen Jiabao visited France in December 2005, China agreed to purchase 150 A320 aircraft from Airbus for \$10 billion. At the same time, to maximize publicity, the Chinese government also announced decisions to purchase Boeing aircraft during visits by Chinese and American leaders. Chinese President Hu Jintao visited the Boeing factory during his April 2006 visit to the United States. A few days earlier, China had agreed to purchase another eighty 737s.

### **Concluding remarks**

Welfare concerns are overwhelming in American, European and Japanese political economy approaches to China. Profit seeking is obviously a legitimate endeavor for the three centers of capitalism. At a fundamental level, the United States, European Union and Japan want economic transactions with China because there is money to be made. While critics of global capitalism have been voicing concerns and protesting in the streets, business interests still have a disproportionate influence on policy toward China. China is a rapidly enlarging and opening market. China may not be a democracy but it is marching toward capitalism, thus there are some shared values between China and the advanced market economies and a justification for engaging with China. Whereas this paper focuses on relative gains and disputes, one should keep in mind that the United States, the European Union, Japan and China are increasingly bound in a globalizing world, which explains why there have not been more conflicts with China.

The United States, Europe and Japan all want reciprocity where they are strong and protection where they are weak. It is well understood how interest groups at home affect a country's foreign economy policy. The government pursues national priorities and sectors seek rent. The uneven impact of economic ties with China in domestic political economy, i.e. creating winners and losers, causes division in the United States, Japan and Europe as well as among them.

It follows that the China game has to be highly strategic and fluid, which makes it difficult for the United States, the European Union and Japan to coordinate a common strategy. It makes sense for them to cooperate where they can and compete where they must. In fact, if the three advanced economies cooperate too much, it might create a backlash in China, which would jeopardize the larger purpose of China's integration into the global system.

The West and Japan find a ready economic partner as well as a competitor in China thanks to its evolving national interests and identity. China wants to modernize, which can logically be achieved only in interactions with the countries that are already modernized. At the most fundamental level, China wants to join the rich men's club and some elites now identify with Western social and economic values. Deng's reform and opening should logically lead to this outcome, although it appeared far-fetched to anticipate this development in the 1980s. Welfare gains are thus a crucial consideration in China's foreign economic policy, which is consistent with the new social value of getting rich at home. China's evolving identity affects its foreign policy. China wants to present itself as a major responsible country; it does not intend to destroy global capitalism but to rise in it. China's new interest and identity also have specific policy implications. For example, China does not want to lead the developing nations in an epic fight with the developed nations, a preference revealed by its reserved stance in the December 2005 WTO meeting in Hong Kong. China's trade interests are no longer the same as those of the developing nations. China has no reason to complain about the WTO. After all, with trade expanding by over 20 percent annually since 2002, China is now the third largest trading nation in the world. As Chinese officials often point out, many anti-dumping charges on China now come from developing nations.[11] China is now as interested in opening up the markets of the developing nations and exploiting their natural resources as the advanced market economies have been and is increasingly criticized as such.

### **Relative gains**

A political economy approach in a bilateral relationship is not about economic issues alone. Rather, a political economy approach is fundamentally about a state's calculations of power and plenty when dealing with another country (Viner 1948). There can be a huge variation in one country's economic foreign policy. Causal factors for such a variation include a country's position in the international system, its strategic vision, its larger purposes, its national system of political economy, and the nature of its interaction with another country. In particular, power rather than simply plenty drive great powers because they play a dominant role in shaping the international system and they engage in strategic rivalries (Gowa 1994).

### **Great power games**

By any measures, the United States, the European Union, Japan and China are great powers in the contemporary world. Economically, the United

States, the European Union, Japan and China accounted for 74 percent of world gross domestic product (IMF 2006) and 63 percent of global trade in 2005.[12] Judging by purchasing power parity (PPP), seven of the top ten countries in the world in 2003 are included.[13] In the security area, the four powers accounted for 77 percent of the world's military expenditure in 2005 (SIPRI n.d.). In terms of global governance, the countries discussed in the paper take up four of the five permanent seats at the UN Security Council and six seats at the G8 summits.

How should great powers deal with each other in the economic realm when security concerns are present? Realists have argued that countries that operate in a self-help international system should be concerned about relative gains, that is, whether another country will gain more relatively in its economic transactions since such a development has implications for the long-term balance of power between them. Accordingly, the concerned parties should seek to reduce economic cooperation (Grieco 1990; Mastanduno 1991). It follows, then, that great powers with security concerns about other great powers should be more concerned about relative gains. Based on realist calculations, John Mearsheimer, for example, has argued that "the United States has a profound interest in seeing Chinese economic growth slow considerably in the years ahead" (Mearsheimer 2001: 57).

### **Arms embargo on China**

Security concerns indeed prevail when it comes to dual-use technologies for the United States and Japan, while Europeans are somewhat less worried. On 13 October 2003 the Chinese Foreign Ministry issued a document on China's EU policy, which in the last sentence urged the European Union to lift the arms embargo. The advanced market democracies imposed arms embargo on China after the 1989 Tiananmen Incident. Beijing's 2003 request generated much discussion in Europe through 2004. Despite domestic criticism, the French and German governments were early supporters while some other governments were opposed owing to concerns over human rights in China and Taiwan's security. By mid-2004, British Prime Minister Tony Blair expressed support for lifting the arms embargo. EU leaders affirmed their political willingness to lift the embargo in a summit with Chinese Premier Wen Jiabao on 8 December 2004. European leaders announced on 17 December that the European Union would lift the ban by mid-2005. The major European governments were keenly interested in boosting economic and diplomatic ties with China.

US opposition to the lifting of the EU arms embargo has been strong. The American reasoning was spelt out in the Pentagon's 2005 report on Chinese military power, released in July 2005. The Pentagon reasons that lifting the embargo would give China more access to military and dual-use technologies, create competitive pressure on Russia and others to sell China better weapons and allow greater military-to-military exchanges with the Europeans that would help China improve its software such as military management, doctrines, training and logistics (US Department of Defense 2005: 24-5). The US government exerted great pressure on the Europeans, characterizing the embargo issue as one of choosing either America or China. Congressional leaders threatened to sanction Europe by stopping transfer of advanced defense technologies to Europe. In February 2005, the US House of Representatives passed a resolution 411 to 3 urging the European Union to maintain the arms embargo on China. The House also passed a bill in July to subject those firms that have been selling arms to China to export permit and Congressional investigation if they seek sensitive American technologies, which is aimed clearly at European firms as a deterrence. In a related development, the US government succeeded in stopping Israeli arms sales and sensitive technology transfer to China by mid-2005.

As a reflection of its growing anxiety about China's rise and Chinese intentions toward Japan, starting with Prime Minister Koizumi, Japanese leaders and officials waged a high-profile lobbying campaign in both bilateral and multilateral forums against the European Union lifting the arms ban. What is significant about Japan's posture is a resolve to confront China in matters related to Japan's security. The Japanese government continues to pressure the European Union not to lift the arms embargo on China based on the argument that such a decision would have a negative impact on East Asian security. During his trip to Europe in early January 2007, Prime Minister Abe Shinzo urged the European leaders he met not to lift the embargo. This was immediately before his scheduled meeting with Wen in the Philippines, and in the context of an improving relationship between the two countries.

China has characterized the EU embargo as political discrimination. To soften opposition among EU countries, Beijing said that it did not expect large-scale European arms sales to China.[14] But a lift would not be just symbolic. It would undercut the United States and enhance China's diplomatic influence. A loosening legal restraint would also mean more European technology transfers. Moreover, Russia, which would no longer monopolizes the Chinese market, would have to improve the terms of its arms sales to China. Thus, Beijing made a strategic move in light of its strategic environment in East Asia and invited strategic responses over an issue that is sensitive to US security interests. In such a highly sensitive situation, Beijing's ability to drive a wedge between the United States and Europe is severely limited.

In the end, the European Union decided on 18 June 2005 to postpone discussion of the issue until the following year. While significant US pressure was an important factor, China's anti-secession law enacted in March earlier that year made it easier for the European Union to say no. Since the 25 EU members have to approve the lift unanimously, the prospect of China achieving its goal is now slim. Moreover, with Angela Merkel replacing Gerhard Schröder as the German chancellor in November 2005, China lost a vocal supporter for lifting the arms embargo. Merkel is eager to repair Germany's relationship with the United States. During her May 2006 visit to China, she was silent on the arms embargo and China's market economy status. In late January 2007, during bilateral talks with China, the European Union indicated that it would continue the arms embargo until China ratified a human rights convention, released prisoners from the Tiananmen Incident, and ended the education through labor system.

### **Different security priorities**

The arms embargo aside, the European Union does not have as high a security stake in Chinese affairs as the United States and Japan. For example, the Taiwan issue is far more important for the United States and Japan than for Europe. Such a difference explains Europe's somewhat lesser concern about relative gains, i.e. China might gain security advantages through economic transactions. China's participation in the European Union's global positioning system, the Galileo system, is a case in point. The Galileo system, scheduled to be operational in 2008, will end the monopoly of the Global Positioning System (GPS) controlled by the American military.[15] The Galileo system will cost € 3.5 billion (around \$4.5 billion), have thirty satellites and have better civilian coverage than GPS. The European Union has already said that it will provide China only with civilian use. China does not want to depend on the United States and feels safer with Europe since its political relations with Europe are less troubled. China signed an agreement with the European Union on 9 October 2004 to contribute 200 million to the project, the largest cooperation project for China in the field of science and technology. China was also the first non-EU country to join the project ahead of India, Israel, Morocco, Saudi Arabia and Ukraine. In July 2005, Chinese firms signed a deal with the European Union to develop three commercial application contracts for the Galileo system. According to the Chinese media, the project is progressing smoothly. By contrast, while Japan remains as interested as Europe in seeking technological autonomy from the United States, it is inconceivable that the Japanese would enter into a similar arrangement with China.

The relative gains concerns matter more for the United States and Japan than for Europe because of geography. The US-Japan alliance manages Pacific Asian security. NATO does not. Unlike the Soviet Union during the Cold War, China simply does not pose a two-front security challenge across the Eurasian landmass. The European Union also does not have issues that may trigger a security conflict with China. The United States handles the Taiwan issue. Japan has territorial disputes with China in addition to Taiwan and worries about its shipping lanes to Southeast Asia

and the Middle East. This asymmetry of geopolitical interests explains why security matters more in US and Japanese economic policy toward China than in the European Union's handling of economic ties with China. Also, for a hegemon like the United States, China's rise poses a transition problem in which a challenger to the existing international system often leads to conflict with the status quo countries. The Quadrennial Defense Review Report issued by the Pentagon in early February 2006 singled out China as possessing 'the greatest potential to compete militarily with the United States and field disruptive military technologies that could over time offset traditional US military advantages absent US counter strategies' (US Department of Defense 2006: 29).

Thus, China's rise strengthens the security alliance between the United States and Japan. American and Japanese strategic interests now overlap to a large extent (Amacost and Pyle 2001; Mochizuki 2004). It also makes the United States focus more on China than on Japan for its trade deficits, which makes the management of the economic relationship between the United States and Japan easier relative to its past rocky history. The domestic political economy rules in US-Japan economic relations, which explains why we will not see a US-Japan free trade agreement any time soon. But to some extent China's rise explains shared American and Japanese concerns over East Asian regional integration.

China has always been important in the relationship between Japan and the United States. By contrast, China has been a secondary concern in US-European relations. A rising China obviously makes the country more important for Europe politically and economically. The European Union's policy toward China in a particular issue area sometimes takes on more significance than it deserves (e.g. the arms embargo issue), but the US-European relationship will continue to be shaped by issues that are between them than by their different attitudes toward a third party half way around the world.

Concluding remarks

Having discussed the cases in which security concerns prevail, we should put them in perspective. Empirically, great powers have not always been that concerned about relative gains. As some scholars have shown, relative economic gains do not tend to interfere with economic cooperation in a multipolar international system even when the threat of war is great. British-German trade before World War I and American-Japanese trade before World War II are cases in point (Liberman 1996).

Looking at the China case, the relative gains are not that strong in the current American, Japanese, and European political economy approaches to China. It is true that if some critics of China in the US Congress get their way, it would affect a larger share of the economy. But as things stand now and in the foreseeable future, the arms embargo has not created serious restrictions on China's economic transactions with the advanced market democracies, which have been growing by leaps and bounds. The Japanese government has until recently refrained from publicizing export control over sensitive technologies. In a harbinger of things to come, the Japanese authorities raided Yamaha Motor Co. in January 2006 on suspicion that the company had exported unmanned helicopters to China, which could be used for military purposes.[16] A few weeks later, the Japanese authorities raided the headquarters of Mitsutoyo Corporation, a major Japanese maker of precision equipment, on suspicion that the company had exported precision equipment to China and Thailand in 2001-02 that could be used for nuclear weapons programs.[17] In February 2007, Japanese police arrested three Yamaha employees in the unmanned helicopter case. Nevertheless, the chances of the Japanese government severely restricting exports to China remain slim.

It makes sense that relative gains matter little in the China case. For Europe, China is a distant power that shows no hostility, and a focus on economic cooperation to its own advantage thus makes sense. Also, the United States and Japan still enjoy a clear military edge on China. In such a situation, it does not make sense to halt economic cooperation, which would have a self-fulfilling effect. It is smarter to engage and be prepared, which is what the two countries are doing. Even if the United States and Japan want to halt economic cooperation with China, it simply means transfer of business to Europe and others in a multipolar world. As is often pointed out, correctly, the United States can isolate China only if others follow - an unlikely prospect at the moment. The presence of Europe and other players makes it impossible for the United States and Japan to practice a relative gains approach. If Americans and Japanese did so, it would constitute less an adjustment of gains with China and more an adjustment between them and Europe. Europeans can offer most of what Americans and Japanese offer. In fact, the European Union was for a long time the largest source of China's technology imports. The United States, Japan, and the European Union have taken turns in being the largest exporter of technologies to China in recent years, the United States in 2002, Japan in 2003, and the European Union in 2004 (Wan 2006: 57). The European Union has maintained the lead since 2004. More broadly, globalization means that it is increasingly less governments and more market forces that shape political economy approaches. Thus, globalization explains why welfare concerns are so important and why it is difficult to follow relative gains policy prescriptions.

In short, whereas this paper has chosen largely disputes and relative gain issues as harder cases for achieving collaboration between the United States, Europe, and Japan for dealing with China, the larger picture for the political economy approaches of the advanced market democracies is that they see large absolute gains from interaction with China and hope to integrate and transform that country in the process, as will be discussed in the next section.

## Transforming China

When it comes to China, economic transactions are often described as 'engagement', with an embedded normative rationale of transforming the country through interaction. Identities matter. The United States, Europe and Japan share common values in human rights and democracy and view China differently. That is why they talk about engagement with China but not with each other. Viewing itself as a champion of democracy and human rights in the world, the United States feels strongly about spreading these universal values to China. The declared bipartisan objective of changing China has been repeated so often to both domestic and Chinese audiences that no citation is needed. Europeans and the Japanese share this objective with the Americans.

According to the website of the EU Commission, the European Union seeks the following four objectives in relations with China: (1) 'to engage China further, both bilaterally and on the world stage, through an upgraded political dialogue'; (2) 'to support China's transition to an open society based upon the rule of law and respect for human rights'; (3) 'to encourage the integration of China in the world economy through bringing it fully into the world trading system, and supporting the process of economic and social reform that is continuing in China'; and (4) 'to raise the EU's profile in China'. [18] These four objectives came from the 1998 EU Communication for building a 'comprehensive partnership' with China, which had another objective of making EU funding go further in the 1998 document.

According to the website of the Japanese Foreign Ministry, Japan seeks the following objectives in relations with China:

"In order to ensure the stability and prosperity of the Asia-Pacific region, it is important to encourage China to become an even more constructive partner in the international community. In particular, the following points are stressed: (a) Support for

China's open and reform policy helped (b) Promotion of bilateral and multilateral dialogue and cooperative relations." [19]

Put simply, economic dealings with China are supposed to serve a higher purpose of changing that country for the better. To start with, the West and Japan want to see a more open political system in China, i.e. a democratizing China. The United States, Japan and Western Europe all encouraged China's reform by placing the country in a more favorable position than other socialist countries before the Cold War ended. Moreover, Japan and Europe have extended official development assistance to China.

However, engagement does not trump welfare concerns, particularly when China emerged as a competitor. When the United States, Japan and Europe resort to protectionism driven by domestic politics, engagement is on the backburner. Moreover, as the Chinese government resisted Western human rights pressure after 1989, Western resolve weakened. Japan did not put explicit human rights pressure on China in any case (Wan 2001). Welfare gains have largely trumped human rights for governments in recent years. To some extent, engagement is now a nicer way to describe normal economic transactions, which is why China does not protest that loudly. China is surely being transformed by its integration into the global market, but it is hard to see whether that is due to any specific engagement policy of the advanced democracies.

At the same time, the rhetoric of transforming China makes a substantive difference in that it offsets relative gains calculations in the public discourse. As students of China's relations with the West and Japan know well, the tone of the diplomatic discourse makes a major difference in the actual conduct of those relationships. Also, if we look at domestic politics in the United States, Europe and Japan, human rights concerns still matter. Advocates of human rights have continued to exert pressure on the US government not to sacrifice American values when dealing with China. European concerns about human rights in China and Tibet, particularly among parliamentarians and the public, also create constraints on how far Europe's relations with China can go. Japanese criticism of human rights in China came largely after their relations with Beijing had already begun to deteriorate. But an enhanced identity of a democratic Japan versus a non-democratic China offers a convenient explanation for some Japanese to attribute tension to differences in political systems and consequently to put blame squarely on the Chinese government. Japan can also use human rights and democracy as a tool to check on China. For example, the Japanese government now advocates an Asian community based on shared values in human rights and democracy, which would put China in an awkward position.

Moreover, shared values help push Japan and the United States closer together and limit China's ability to divide and conquer among the United States, Europe and Japan. The best Beijing can hope for is to exert leverage on any tension that already exists between the advanced democracies.

Equally important, if by changing China we mean the system of Chinese political economy, the West and Japan have actively sought to change China and have succeeded to a large extent. In the case of China's accession to the WTO, there was a convergence between welfare gains and transformative logic. Since China was to join the free trade regime it had to make legal and administrative changes to be more consistent with international practices (Potter 2001). The United States, the European Union and Japan continue to demand market reforms from China. One tool at their disposal is the market economy status. To acquire that status, Beijing has been told to implement further market reforms. The West and Japan are more energized to make China conform to international commercial standards because their economic interests are at stake.

The West and Japan have been more successful in transforming the Chinese economic structure than the political structure because the Chinese government also wants to change its economy to achieve modernization in a competitive and globalizing international system. Increasingly in external public relations, more sophisticated Chinese officials play a game of ambiguity. They emphasize the transitional nature of the Chinese political economy and talk about 'changing with time', which is really not that different from 'peaceful evolution'. The fact that interpretations of what is happening in China vary provides a basis for continuing economic ties.

## **Regionalism**

The US-Japan alliance is being strengthened while East Asian regionalism is making steady progress. The US-Japan alliance per se has not been in the drivers seat of East Asian regionalism but it does provide a security cushion for the region. The most immediate reason is that the United States and Japan do not have a free trade agreement (FTA) and will not for a long time to come due to domestic opposition.

Regionalism may logically diminish the influence of the United States as the world's only superpower. The United States accepted and facilitated European integration because it was in its interest to see a stronger and united Europe against the Soviet Union. Now that the Cold War is over, European integration, if furthered, could clearly pose a challenge to US leadership. A united Europe would also be a powerful alternative to the American dream.

If a united Europe is no longer in America's best interest (even if it would be futile and counterproductive to oppose it), East Asian regionalism independent of the United States would be far more problematic for the United States. The United States maintains a multilateral alliance structure across the Atlantic while maintaining only bilateral alliances with a small number of East Asian countries. Seeking to maintain primacy in East Asia, the American policy community is highly suspicious of an exclusive East Asian group (Armstrong 2007). Americans were concerned about Japan in the late 1980s and the early 1990s. The fact that China has gained much influence in the process of Asian integration makes the United States that much more uncomfortable. Japan is sensitive to American concerns in this area and it is also concerned about China's rise. The United States now prefers to see Japan play a prominent role in East Asia. The problem for Japan is that the economic slowdown and the powerful agricultural sector have weakened Japan's leadership position in East Asia, although progress has been made in recent years.

To be sure, regionalism takes place in the context of globalization. WTO rules permit preferential trade arrangements provided that duties and other restrictions are eliminated on 'substantially all the trade' items and that such arrangements do not increase protection against the rest of the world. At the same time, regional groupings often have defensive strategic implications. East Asia's more formal institutionalization after the Asian Financial Crisis is in part a reaction to Western domination.

China has been proactive in regional integration. At the November 2000 ASEAN Plus Three summit, Chinese Premier Zhu Rongji made it clear that China considers the forum to be the main venue for East Asian cooperation (Hu 2002). A benign view is that China is trying to promote a free trade arrangement as a building block for a broader regional trade framework (Feng 2002). This line of argument reflects the more liberal elements in the Chinese policy community. But a more dominant view is clearly to seek regional dominance and weaken American and Japanese influence. Were Japan and the United States to join a regional group later they would have to play by the Chinese rules.

Recent developments have eased American concern to some extent. When Japan and Singapore helped to ensure the attendance of Australia, New Zealand and India in the first East Asian Summit, the United States became more confident in having its voice heard. But the drama of East Asian regional integration continues. Logically, a successful East Asians-only East Asian regionalism would hollow out the US-Japan alliance by

absorbing Japan but excluding the United States. That is an unlikely scenario given the growing rivalry between China and Japan. Accordingly, East Asian regionalism may stall. Another scenario is that East Asian regionalism and the alliance will mutually reinforce each other when the United States is included. It is also conceivable to have a leaner but meaner East Asian regionalism that essentially marginalizes both the United States and Japan. It is not yet clear how East Asian regionalism will play out. But China's rise and East Asian regionalism are happening at the same pace, which will present a major challenge for the United States and Japan.

## Conclusion

While the United States, Europe, and Japan adopted similar approaches to China in the aftermath of the Tiananmen Incident in 1989, they have now diverged somewhat. From a theoretical perspective, the paper confirms an obvious geopolitical logic that great powers with a greater security concern in dealing with another major country care more about power while those with less of a concern are preoccupied with calculations for plenty. China's rise and its actions have posed a far greater security challenge to the United States and Japan and are therefore driving the two countries closer together. By contrast, Europe, which is distant from East Asia, has a weaker sense of responsibility for Asian security matters. Some core European nations also have significant misgivings about US dominance in global affairs. All this serves as the backdrop for the political economy game involving China, which still reveals a dominant welfare motive among the advanced market economies. The ambition to transform China politically has diminished. China's integration into the global market makes a relative gains approach difficult to implement. Globalization simply limits the ability of a state to follow a politics-in-command approach in the absence of actual military conflict, which explains why the political economy approaches of the United States, Europe, and Japan are not that different in the scheme of things. China's own grand strategy to reach out to the world to outflank the US-Japan alliance has also contributed to a divergent European policy toward China although there are severe limitations to Beijing's ability to drive a wedge between the United States and Europe.

What the China case says about the US-Japan alliance versus the US-European Union alliance is that the former has taken on a greater strategic significance given China's rise while the latter is becoming less relevant for the United States in the big picture. Put simply, we know where Japan fits in US strategy toward Asia and China but not where Europe does. The arms embargo issue apart, Europe and China already operate in their relations with each other as if they live in a multipolar world. The China case reflects, rather than is the cause of, a slow drift in the US-European alliance.

The dynamic of great power relations may and does often change. Looking into the future, the importance of US-European relations in the China game is likely to increase greatly because of China's growing global commercial and political presence. It is astonishing how quickly China has expanded its global influence in the past few years. Its impact is just beginning to be felt. This development means a far more engaged Sino-Europe relationship. China is expanding into Central Asia, spearheaded by the Shanghai Cooperation Organization. India, Iran, Pakistan and Mongolia have become observers since 2004. While not a formal alliance, the Eurasian grouping may be viewed by Europeans with suspicion at some point. Europeans have strategic interest in that region. After all, NATO has thousands of troops in the International Security Assistance Force in Afghanistan that borders on China. More important, Britain, France, and Germany are playing a central role in resolving the Iranian nuclear issue. How China acts over those issues will affect European strategic interests directly. Greater Chinese activities in Africa and the Middle East will also confront European interests and human rights sensibilities. Thus, China as a global player may serve to highlight the common interests and values between the United States and the European Union and help bring them closer together. The Bush administration has mentioned the need to 'globalize' US-China relations. In that effort, Washington will most likely turn to Europe as a partner given Europe's historical presence around the world, diplomatic savvy, shared values, representation in the existing platforms for global governance such as the UN Security Council, and Europe's good ties with China.

By contrast, the US-Japan alliance is ill-suited for such a global mission despite a recent goal to globalize the alliance declared by Prime Minister Koizumi and President Bush in June 2006. The United States and Japan have not been particularly successful in managing global affairs. Even during the Japanese bubble years, 'joint leadership' was really about economic development and even in that arena coordination was not smooth given drastically different national interests, development philosophies, and operational modalities. More important, Japan has so far failed to establish its leadership in East Asia, which makes it difficult to achieve a global role, and its growing rivalry with China is likely to make the country a less attractive partner for the United States in the global game, where China is heavily involved.

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*This paper was part of a joint research project "Managing the American Medusa: The U.S.-Japan Political-Economic Relationship in Comparative Perspective" led by Chris Hughes of Warwick University, Verena Blechinger of Free University of Berlin, and Ellis Krauss of University of California at San Diego. The resulting article benefited from helpful comments from the conference organizers and participants. The article appeared in a special issue of *The Pacific Review* (Vol. 20, No. 3, September 2007, pp. 397-421). Posted at *Japan Focus* on November 17, 2007.*

## Notes

[1] The information for the Japanese calculations cited in the paragraph came from conversations with two China specialists in the Japanese Foreign Ministry on 1 July and 25 September 1999.

[2] European Parliament calls for more trade protection. *European Report*, 15 October 2005, p. 406.

[3] Mandelson promises new trade strategy. *European Report*, 5 November 2005, p. 409.

[4] People's Bank of China, 14 July 2006; Retrieved from People's Bank of China website: [here](#).

[5] *China and the WTO*. Retrieved 14 July 2007 from WTO website: [here](#).

[6] Asahi Shimbun. (2007, April 12) 'WTO complaints against China put Japan in a bind', *Asahi Shimbun* Retrieved from Asahi Shimbun website: [here](#).

[7] According to the Chinese Ministry of Commerce, sixty-six countries have granted China market economy status. China News Agency. (2007, January 14); Retrieved from China News Agency website: [here](#).

[8] Chinese Commerce Minister Bo Xilai did raise the issue at a meeting with his Japanese counterpart. China News Agency. (2006 February 23); Retrieved from China News Agency website: [here](#).

- [9] 'Beijing's market access request rebuffed', *European Report*, 30 June 2004, p. 510.
- [10] 'A new pilot for Airbus', *The Economist*, 1 October 2005, p. 64.
- [11] Jingji Guanchabao [Economic Observation]. (2005 December 17) *Jingji Guanchabao* Retrieved from Jingji Guanchabao website: [here](#).
- [12] The trade data are calculated from WTO, *International Trade Statistics database*. Retrieved 14 July 2007 from WTO website: [here](#).
- [13] 'A survey of the world economy', *The Economist*, 2 October 2005, p. 8. The top ten are as follows: the United States (1), China (2), Japan (3), India (4), Germany (5), France (6), Britain (7), Italy (8), Brazil (9), and Russia (10).
- [14] Some in the Chinese government do not have high expectations in relation to the European Union's possible lifting of the arms embargo. As a senior Chinese security official who specializes in European affairs put it, the arms embargo is a 'plastic cap' while regulations on military items represent an 'iron cap'. He believed it would be harder for China to achieve market economy status than the lifting of the arms embargo. Conversation, March 2006.
- [15] Russia also has its own system in GLONASS, with fewer satellites, which is scheduled to be operational by 2010.
- [16] *Nihon Keizai Shimbun* (2006 January 23). Retrieved from Nihon Keizai Shimbun website: [here](#). It was reported later that the company had exported eleven helicopters to China, including one directly to a Chinese defense company. *Yomiuri Shimbun* (2006 February 8). Retrieved from Yomiuri Shimbun website: [here](#).
- [17] *Nihon Keizai Shimbun* (2006 February 13) accessed at [here](#).
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