

Is "Economic Power"
a Useful and Operational Concept?

by
Richard N. Cooper

Paper No. 04-02

April 2004

Contact:

Richard N. Cooper is a faculty associate and executive committee member of the Weatherhead Center for International Affairs and the Maurits C. Boas Professor of International Economics in the Economics Department at Harvard University.
rcooper@wcfia.harvard.edu

Published by the Weatherhead Center for International Affairs, Harvard University.
Copyright by the author.

The author bears sole responsibility for this paper. The views expressed here are those of the author and do not necessarily represent the views of the WCFIA or Harvard University.

Publications Chair, Weatherhead Center for International Affairs

Robert Paarlberg

Publications Manager, Weatherhead Center for International Affairs

Amanda Pearson

Submission procedures: Weatherhead Center affiliates are encouraged to submit papers to the Working Paper Series. Manuscripts are assessed on the basis of their scholarly qualities—the extent of original research, the rigor of the analysis, the significance of the conclusions—as well as their relevance to contemporary issues in international affairs. Manuscripts should range between 25 and 80 double-spaced pages and must include an abstract of no more than 150 words. We request that each paper be submitted in both electronic format and a hard copy. The electronic format should be on a disk in a standard word processing application (WordPerfect or Microsoft Word preferred) or as an email attachment.

Please submit hard copies and disks to Amanda Pearson, Box #10, Weatherhead Center for International Affairs, Harvard University, 1033 Massachusetts Avenue, Cambridge, MA 02138, and address all email attachments to apearson@wcfia.harvard.edu.

Orders: Working Papers are available for \$7.00 each, plus \$1.00 for shipping and handling, from the Publications Office, 1033 Massachusetts Avenue, Cambridge, MA 02138.

**WEATHERHEAD CENTER FOR INTERNATIONAL AFFAIRS
HARVARD UNIVERSITY
1033 MASSACHUSETTS AVENUE
CAMBRIDGE, MA 02138
TEL: 617-495-4420
Fax: 617-495-8292
www.wcfia.harvard.edu**

ABSTRACT

With the end of the Cold War, and until 9/11/01, many academic and journalistic pundits averred that military power was no longer of great importance, that the future lay with economic power. The claim was made that the United States was an "economic superpower," and therefore would continue to be the world's dominant power in any case. Does this term mean anything other than "biggest national economy?" If so, what exactly does it mean? This paper will discuss the concept of economic power, and then apply the concept to the proposal of John Mearsheimer, that on strategic (balance of power) grounds the United States should take steps to slow down the economic growth of China.

The Evanescent Concept of Economic Power

The dictionary defines "power" as "capability of producing an effect" or, what is probably more directly relevant for normal use in the international arena, "possession of controlling influence over others." Military power involves the capability to coerce a recalcitrant party. That possibility, combined with a perception that the possessor has the will to use it if necessary, is often sufficient to attain the desired effect. Economic power by analogy involves the capability decisively to punish or to reward another party, according to whether that party responds in the desired way, combined with a perception that the possessor has the will or political ability to use it if necessary.

Economic power in this sense surely exists. But apart from its possible connection to national military power through a country's tax base it is largely local, or ephemeral, or both. It is difficult to wield on a global scale. The basic reason is that the locus for most economic decision-making is households and firms, and is thus highly diffuse. Households rarely have enough wealth to matter much beyond the local community, and firms are subject to competitive pressures which penalize them, possibly severely, if they deviate too far from what the "market" will permit. The last decade has seen the failure of such large and well-known and respected firms as the Bank of New England and Barings; and the humbling of huge global firms such as General Motors, IBM, and state-owned Credit Lyonnais.

There are many large corporations in the world, and these corporations surely have "power" over their employees, some of their suppliers, and the towns in which they are resident. But this power is sharply limited both in scope and in time, largely because of the existence of effectively functioning markets, increasingly global in character, such that in anything but the short run, individuals, suppliers, and even communities command a range of choice which sharply limits the leverage even of large employers. In addition, most governments are much on the alert to abuse of corporate power over their employees, suppliers, and communities.

It is moreover a mistake to aggregate corporations by nationality, as is commonly done,

especially with respect to Japan; national corporations are separate entities, often in vigorous competition with one another, and they have great difficulty working together for common aims on a sustained basis without the strong encouragement and usually the coercive power of government. In short, they can sometimes become the instruments of effective national policy; they can rarely if ever exercise sustained leverage on their own.

American firms were demonized by some Europeans and Canadians in the 1960s; Japanese firms were demonized by some Americans in the 1980s. It is true that firms from a particular country sometimes act in a parallel fashion, as when many leading Japanese banks internationalized their activities in the 1980s. However, that is generally not because their actions are coordinated, but because they are in vigorous competition with one another and each is loathe to let any other get a major competitive edge in the presence of new opportunities, such as those opened by deregulation. Since they will be evaluated by the financial market, and by their own managements, not against some absolute standard, but by how they perform in comparison with their leading competitors, initiative by one is quickly imitated by others. That way no one can achieve a striking advantage; and if the action was financially risky, like much lending to developing countries in the early 1980s, then all will experience similar losses. Optimal performance is to be somewhat better than average, and that is achieved by making the same strategic moves as one's competitors, but executing them somewhat more skillfully.

Power is a relative concept; not everyone can have equal economic power, for that creates the capacity to resist the economic blandishments or threats of others. That is, it violates the conditions for power. So if in fact economic capacity is highly diffuse, power is eroded. Widespread economic capacity, in a globally competitive environment, creates options for all parties; and the presence of alternatives undermines the capacity of any one player to achieve its preferred ends, except through good performance in the eyes of its customers.

Can enterprises, the source of economic capability, be harnessed by governments,

aggregating to national economic power? In at least one respect, the answer is affirmative: they can be levied with taxes, as can households. The resulting revenues provide governments the wherewithal to carry out national objectives. Total tax revenue is obviously related to size, with larger economies generating larger revenues. What is not so obvious is that total tax revenue is also related to per capita income, with rich countries being able to tax away a higher portion of income than poor ones do. The share of GDP taken as total tax revenues generally rises from 10-20 percent in the poorest countries, to 20-30 percent in middle-income countries, to 30-50 percent in the rich countries. Such revenues can help finance military expenditure, but also foreign aid, diplomatic representation, and other sources of international influence. The United States enjoys enormous tax revenues, even though (contrary to what many Americans believe) Americans are taxed in total more lightly than citizens in any of the other rich countries. Even Japan and Switzerland tax their citizens more, although not much more; France and Germany, not to mention the Scandinavian countries, have much higher tax burdens.

What about the purchasing and selling activities of corporations? Could Japan really stymie US military power by denying it semi-conductors (memory chips), as Shintaro Ishihara rashly suggested some years ago in Japan Can Say No? Or could countries successfully close markets to other countries, or threaten to, as a source of economic leverage?

Take the closure of markets first. The international community has rules, now embodied in the charter of the new World Trade Organization, which govern much of world trade. They generally prohibit closing markets to other members of the WTO except under special circumstances, such as responding to trade violations by trading partners, or implementing economic sanctions under United Nations auspices. Any country closing markets therefore risks the general opprobrium of the international community, unless the reasons are clear and acceptable. (These rules do not apply to the countries that are not members of the WTO or its predecessor the General Agreement on Tariffs and Trade (GATT), which included most of the communist

countries, such as Cuba and North Korea.)

An interesting example occurred involving an economic threat by China. During the 1994 debate in the United States over whether MFN treatment of China should be renewed, China threatened to deny orders to American firms if the extension were not forthcoming. China quickly came to appreciate that such a threat, unless sharply circumscribed (e.g. to procurement by government agencies), would if exercised violate the rules of the WTO, in which China had a pending application for membership. The threat thus complicated its application, and was withdrawn.

No such rules exist for exports. Countries are free to restrict them, and routinely do for potentially dangerous products, such as weapons or nuclear materials. But in fact most countries are still mercantilistic in outlook and strongly desire to build export markets, which are seen as vital to economic growth. They are in practice, therefore, loathe to jeopardize such markets by restricting exports. That is especially true of Japan, whose sense of vulnerability remains high, especially after the two oil shocks of the 1970s. German law sharply circumscribes the ability of the German government to restrict exports.

Perhaps not surprisingly, it is the United States, far more than any other country, that has attempted to herd American firms into support of national political objectives. US law gives the President discretion to restrict exports not only for reasons of national security, but also for general reasons of foreign policy, and such restrictions have been imposed from time to time. They can even involve the infamous extra-territorial reach to American-owned subsidiaries in other countries, a reach that has been vigorously contested by America's closest allies, especially Britain, as in the Soviet gas pipeline to Western Europe that the US (unsuccessfully) objected to in 1982. The Helms-Burton Act to penalize foreign firms that deal with Cuba attracted similar opprobrium abroad.

If a country, for example the United States, dislikes the decisions by a foreign government,

it has several ways to deal with it beyond diplomatic protest and short of military threats or action.

It can try to:

1) **persuade** the government to change its decision, perhaps by revealing new information, or by successfully encouraging a re-examination of the government's preferences;

2) **induce** the country to change its decision by offering something desirable in exchange, contingent on the change, such as a formal agreement or economic assistance, thereby enlarging its menu of choice;

3) **threaten** action against the country if it does not change its decision, thereby altering the menu of choice of the foreign government by removing the status quo;

4) implicitly **accept** the decision, thereby deciding to live with it (but leaving our country in a less preferred position).

How we define the term "economic power" is a semantic question so long as the underlying concepts are clear. I prefer to confine the term to those cases where coercion is either threatened (perhaps implicitly) or actually used, and the instruments are economic in character. Thus economic power entails the possibility of making the target government worse off than it was before it took the offensive decision. (The use of inducements, in contrast, leaves the target government better off than it was before it took the offensive decision.)

Others consciously use the term more broadly to include inducements as well as threats. This is perhaps implicit in Robert Dahl's celebrated and widely accepted definition of power: the ability to induce another party to do something it would not otherwise do. Economic power implies that economic instruments are the ones used, or expected to be used. Some prefer the term "power" to encompass all of the first three options listed above, introducing the notion of "soft power," where the offended country commands enough respect to get others to reconsider their preferences leading to the offending decision, or even to change the decision to acquire the respect of the powerful country, without either threats or inducements.

All these are valid concepts. But analysts should make distinctions, not blur them by applying the same term to quite different phenomena. "Influence" and "inducement" are perfectly good nouns, without the connotation of coercion, which the word "power" has. And all these are different from "importance" or even "dominance." A country can be economically dominant without being powerful; the former implies that events within the country have great influence on other national economies, i.e. that there are large spillovers, e.g. from a recession. The latter implies a purposeful or willful action, not merely incidental spillovers. Of course, dominance can sometimes be translated into power and purposeful influence, on which more below.

"Economic leverage" can be exercised through inducements or sanctions, carrots or sticks. The principal inducements are financial grants or concessional loans (e.g. foreign assistance or military aid), trade preferences (through government procurement or through tariff and non-tariff policies), and willingness to export military equipment (or occasionally other high tech products not generally available). The principal sanctions involve partial or full embargo of exports to the target country, partial or full embargo of imports from the country, and freezing or confiscating assets owned by the country or its residents. If financial assistance is provided on a regular basis, cutting or eliminating expected assistance also represents a sanction. Leverage of course might also arise from the direct or implied threat of the introduction of sanctions; they may not actually have to be used.

Economic Sanctions

High hopes were once entertained for the efficacy of economic sanctions against internationally anti-social national behavior. In 1919 Woodrow Wilson said: "A nation boycotted is a nation that is in sight of surrender. Apply this economic, peaceful, silent, deadly remedy and there will be no need for force. It is a terrible remedy. It does not cost a life outside the nation boycotted, but it brings a pressure upon the nation which, in my judgment, no modern nation could resist."

The field of economic sanction used to provide lots of grounds for more or less informed conjecture, usually based on a few examples, with much room for continuing disagreement on the question of efficacy. Thanks to Hufbauer, Schott, and Elliott (HSE) at the Institute for International Economics those days are now past with respect to economic sanctions. They have undertaken detailed study of 115 uses of economic sanctions (Economic Sanctions Reconsidered, 1985, revised edition 1990), including all those by major countries in the period 1950-1990, and have drawn various conclusions from their comprehensive survey. Their study does not cover the use of inducements, and only a few threats of sanctions that were not exercised, especially since some examples in the latter category are not publicly known.

HSE draw an important distinction between whether the sanctions actually had discernible economic impact on the target country and whether they contributed to a desired change in government policy. The impact could be weak, in which case it is not likely to change policy. But even if the impact is strong, it may not change policy if the government leaders are impervious to the well-being of some or all of the population under their rule (Iraq under Saddam Hussein comes to mind), or if the sanctions themselves help to mobilize public sentiment against yielding to foreign pressure (Cuba in 1960 comes to mind, although extensive assistance from the USSR also weakened the material effect of the US sanctions after the initial impact).

HSE are somewhat surprised by their findings: in about one-third of the cases they judge sanctions to have been successful, in that they made at least a modest contribution to attaining the goal desired by those imposing the sanctions, although possibly at some cost to those imposing the sanctions. The success ratio was highest (52 percent) when the goal was to destabilize the government; it was lowest (20 percent) when military impairment was sought (HSE, p.93).

HSE attempt to derive from their case studies circumstances under which economic sanctions are most likely to be effective. They judge that sanctions are most likely to be successful when: 1) the objective is modest and well specified; 2) the target country is in a weakened position

at the outset; 3) economic relations with the target country are relatively great before imposition of the sanctions; 4) the sanctions are relatively heavy; 5) the duration of the sanctions is limited (i.e. the passage of time erodes their effectiveness); and 6) the impact on the target country's GDP is relatively high (2.4 percent for successes as against 1.0 percent for failures).

Somewhat surprisingly, two potentially important factors did not seem to be very important: 1) international cooperation was modestly higher in cases of failure than in successful cases, perhaps because the goals were more ambitious when international cooperation was involved; and 2) the cost to the country imposing the sanctions was only modestly higher in the failures than in the successes, although HSE caution against a government undertaking sanctions if the costs to its own public will badly erode public support.

The HSE study is impressive and carefully constructed. But the judgments expressed there are inevitably subjective and not beyond challenge. For example, I would judge two of their cases (in both of which I had some involvement) quite differently from the way they do: British and UN sanctions against Rhodesia over the period 1965-79, and US sanctions against the USSR in 1980, following the invasion of Afghanistan. HSE give the first case here the second highest mark, and the second case the lowest mark. I consider the Rhodesia economic sanctions largely a failure, and the US sanctions against the USSR a modest success. The difference hinges in the first case on differences in judgment about the role of the sanctions in bringing about eventual majority rule in Rhodesia (now Zimbabwe), the desired objective; and in the second on what the objective was. Without Portuguese and especially South African cooperation, economic sanctions against Rhodesia could not be expected to be effective in squeezing Rhodesia significantly, and did not. GNP grew an average of six percent a year for a decade after the sanctions were imposed. The ultimate objective was achieved largely through prolonged civil war and exhaustion of the minority population, although after the withdrawal of Portuguese (1975) and South African (1976) support helped to isolate the Rhodesian government, sanctions can be said to have played some role, but

much less than HSE accord them.

In the case of US sanctions against the USSR in early 1980, in particular the embargo on sale of US grain (with understandings from Australia, Canada, and the EC, but not from Argentina, that they would not make up the difference), there was no serious expectation that the USSR could be induced to withdraw from Afghanistan, or even that it would be hurt seriously beyond an impact effect in the spring of 1980 that hinged on bottlenecks in Soviet transportation. Rather, the real target was the nervous countries in southern Asia, whose sense of vulnerability would rise sharply (particularly after the Iranian Revolution and hostage crisis, which was contemporaneous) if the West, and the United States in particular, seemed to treat the Soviet invasion of Afghanistan with indifference. It was understood by US officials that, short of war, US sanctions could not greatly hurt the USSR (one consequence of having isolated that country economically for so many years), and that the damage of the grain embargo would be short-lived. But it was a dramatic action. Ironically, loud protests by American farmers reinforced the fact that it was a difficult, serious action. Saudi Arabia, in particular, remained firmly in the western area of influence instead of drifting to a more neutral, standoffish position. In that respect the embargo was a success.

These examples illustrate how difficult it sometimes is to assess the efficacy of a given action, leaving the question of economic sanctions open to debate despite the careful work of Hufbauer, Schott, and Elliott. In any case, on the basis of their comprehensive survey HSE find a sharp decline in the efficacy of US sanctions: from 1945 to 1973 economic sanctions contributed to US foreign policy objectives in 18 of 35 cases examined (51% success); in the period 1973-1990 sanctions failed to contribute to US objectives in 38 of 46 cases examined (17% success).

Robert Pape (1997) has systematically examined the 40 cases HSE judge to be successes. Pape concludes that in only five of them did economic sanctions clearly lead to the desired objective, three were indeterminant, and in the remainder, he argues, "success" was due to factors other than the economic sanctions. So in his judgment economic sanctions were successful in only

six percent of the cases studied, far less than the 34 percent reported by HSE. Pape however does not re-examine any of the HSE failures to see if they should be re-classified as successes.

I can say much less systematically about the threatened use of sanctions, although HSE include a few such cases, which are often not made publicly, and sometimes are not made at all, but remain implicit in the situation and thus may influence the behavior of governments that feel structurally vulnerable. Japan's sense of vulnerability with respect to OPEC comes to mind.

An interesting case arose when Japan was the only country to vote against establishment of an Antarctic sanctuary for whales in the deliberations of the International Whaling Commission. Several Caribbean countries abstained, allegedly to demonstrate quiet support for the Japanese position. Since these countries have no interest in whaling one way or another, their vote raises the question whether they felt vulnerable to a reduction or cutoff of Japanese foreign aid. Japan provided the world's largest bilateral aid program; its size and expected growth could lead actual and prospective recipients to be more sensitive to Japan's positions in international fora. This is not to suggest that Japan buys support explicitly – one would need inside information to determine that – but only that recipients may feel vulnerable to a cutoff of aid if Japan is displeased with the positions they take.

I know much less about the use of inducements, which has yet to find its systematizers. There are, however, many examples, one of the best known of which is periodic US negotiations with countries such as the Philippines and Greece over military base rights. The Philippines continued to raise the price to a point at which a deal could no longer be struck (complicated fortuitously by a violent volcanic eruption that badly damaged the Clark Air Base), and the US withdrew from its naval base at Subic Bay. Germany (FR) also allegedly used economic inducements in the 1960s and 1970s to dissuade countries from formally recognizing the DDR, Taiwan to retain diplomatic recognition, and France to sell various high technology products.

The European Community has used trade policy extensively to influence the broad political

attachments of governments of countries around the Mediterranean and in central and eastern Europe, and the US Caribbean Initiative of 1983 can be seen as an effort to stabilize that area politically and economically. These efforts, however, were designed to create broad pro-western attachments in the target political systems rather than to influence the behavior of foreign governments in specific ways.

The relative efficacy of leverage through inducements may well increase, but they will be seen less often because of the tight fiscal condition that exists in almost all the rich countries these days, and the shift in their attention from foreign to domestic concerns. Rapidly growing domestic entitlements will weaken their willingness to use financial inducements to foreigners.

The main point, however, is that economic power is generally weak and uncertain in its effects – it fails to meet the standard of producing a "controlling influence over others" – even when it is wielded by the state, and even when states collaborate in attempting to exercise it. One only has to think of Libya, Iraq, Serbia, Cuba, and North Korea in a contemporary setting. In each case economic sanctions were applied, with varying degrees of pressure, in the first three instances under UN resolutions. Populations in all these countries suffered as a result of the sanctions, but they did not bring the desired political response. Leaders survived despite the sanctions, and the sanctions were eroded in various degrees – even in the case of Iraq, where the physical conditions for sanctions were good and the neighboring governments were hostile to the regime of Saddam Hussein. Arbitrageurs are omni-present, ready to run risks for high rewards. The case of Serbia was complicated by the fact that Greece was not entirely unsympathetic with Serbian objectives, if not with Serbian means, and a lively border trade occurred in petroleum, denial of which could have throttled the Serbian economy and military efforts, despite strong European Community support for the sanctions. But Brussels cannot assure the full cooperation of Athens; and in any case Athens would have difficulty stopping all arbitrage even if it wanted to.

The United States embargoed US trade with Castro's Cuba in 1960, and has maintained

strict control over economic transactions by American firms and citizens since then. But other countries disagreed both with the American objective and with its means, and refused to isolate Cuba economically. From the mid-1960s to the early 1990s the Soviet Union provided Cuba with substantial aid and trade, especially oil. The main impact of the US embargo, beyond the initial harm to a Cuban economy heavily dependent on trade with the United States, has been to provide Castro with a continuing political excuse for the evident failings of the Cuban economy, and to maintain in the Cuban public a strong nationalistic fervor against oppression by the United States.

There is an ever-present temptation, especially but not only in the United States, to use economic leverage, especially trade sanctions, to influence the behavior of other countries. This instrument is seen as preferable to war and more effective than diplomatic representations. It is built into the escalating sequence of discipline in the United Nations Charter. Its use, if not its success, has become more common with the political rapprochement between Russia and the United States, on the one hand, and with increasing regional disorder made possible in part by the disappearance of client state relationships that provided some stability with the ending of the Cold War. But the increasing globalization of world markets is also likely to erode the effectiveness of trade sanctions as a source of leverage. There are today so many decision-makers – individuals and enterprises – with so many options that governments can do no more than shape in broad terms the environment in which they function, and provide incentives to operate in desired ways.

Slowing Down China

Mearsheimer (2001a, 2001b) has reminded his readers that traditional "realism" considerations have not vanished in international relations, and has applied balance of power reasoning to the world of states roughly two decades from now. Most of his analysis is applied to Europe, which will not concern us here, but he also addresses the future balance of power in Northeast Asia, with and without the presence of US military forces there. His conclusion is that

China will become the regional power, and that without US troops the configuration will be unstable. He urges the United States to take steps to slow down China's growth, to postpone the rise of China as a regional power. This proposal is simply asserted, not developed. This section will address how such a proposal might be executed, with a view to testing the viability, in an operational context, of the notion of economic power.

I will not address, except briefly at the end, whether the proposal has merit, i.e. whether it should govern US policy; the focus rather will be on the possibility of carrying it out. The conclusion, in brief, is that the United States does not have the economic power to slow down China's growth, beyond a transition period of several years immediately following the introduction of such a policy, and that the costs to the United States of introducing such a policy would be considerable, since it would involve a transformation of the framework for international transactions that would at a minimum introduce much uncertainty into the nature of the world economic order and at a maximum would alienate the United States not only from China but from many other countries as well.

But first it is worth saying a bit about Mearsheimer's conception of China's medium-term evolution, which can only be described as fantasy, and a bit about the realistic prospects of the Chinese economy over the next two decades.

Mearsheimer is concerned with the "latent power" of countries, which operationally he identifies as Gross National Product (GNP) for countries of similar levels of economic and technological development, while putting some (unquantified) discount on GDP of poorer and more technically backward countries (2001a, pp. 63-67). (Since he is mainly concerned with Europe, including Russia, this discount need not be applied for most of his analysis.)

Mearsheimer, it should be clear, is concerned mainly with military capacity, including nuclear weapons, but in the long run, he argues, the interests of states drive them to develop their latent power into the required military capacity. Latent power is therefore the starting point. Here is

the context he provides for China (2001a, pp.397-398):

"China is the key to understanding the future distribution of power in Northeast Asia. It is clearly not a potential hegemon today, because it is not nearly as wealthy as Japan. But if China's economy continues expanding over the next two decades at or near the rate it has been growing since the early 1980s, China will surpass Japan as the wealthiest state in Asia. Indeed, because of the vast size of China's population, it has the potential to become much wealthier than Japan, and even wealthier than the United States.

"To illustrate China's potential, consider the following scenarios. Japan's per capita GNP is now more than 40 times greater than China's. If China modernizes to the point where it has about the same per capita GNP as South Korea does today, China would have a GNP of \$10.66 trillion, substantially larger than Japan's \$4.09 trillion economy [table provided, 1998 data]. If China's per capita GNP grew to be just half of Japan's present per capita GNP, China would have a GNP of \$20.04 trillion, which would make China almost five times as wealthy as Japan..."

Just reach South Korea. Sounds easy, doesn't it? But for China to reach South Korea's per capita GNP in twenty years, per capita GNP would have to grow by 12.5 percent a year, a figure rarely seen for any country for a single year, never seen continuously over 20 years. And to reach half of Japan's per capita income in 20 years, China's GNP would have to grow by more than 17 percent a year. Considering the huge obstacles and uncertainties China faces, these "scenarios" can only be considered fantasy.

Mearsheimer also holds out the possibility of China's becoming more wealthy (i.e. having a higher GNP) than the United States. He neglects that as time goes on countries other than China are also likely to grow, even if less rapidly. The Council of Economic Advisers (2001) has suggested that for the next decade full employment growth for the United States is 3.4 percent a year. The World Bank (1997) has suggested that China's growth to 2020 might average 6.5 percent a year, a figure that others (e.g. RAND 2000) consider too high. We can pose the following question:

suppose China's GNP grows indefinitely by 3 percent a year more than US GNP: how long will it take for China's GNP to equal that of the United States, given their relative starting positions in 2001? The answer is 74 years, i.e. China's "wealth" will equal that of the United States in 2075 – more than half a century beyond Mearsheimer's two decade horizon. And even then per capita income in China would be less than one quarter that in the United States, a fact that bears on potential tax revenues available to the central government of each country.

In fact, while it is possible, China will have great difficulty sustaining a 6.5 percent annual growth rate over the next two decades, much less beyond that. First, China faces a series of domestic challenges in order to sustain that high a growth rate. It must grow the private and township sectors enough to compensate for declining production in parts of the state-enterprise sector. It must reform and recapitalize the banking system, and build a viable financial system beyond banking. To close many loss-making state enterprises it must create a social safety net (unemployment compensation, pensions, health care) for urban employees. It must deal with rapid growth in need for water, sewage disposal, and new housing in urban areas, into which migrants are flooding from rural areas. It must greatly improve agricultural productivity, partly through large and more efficient irrigation projects. Et cetera, et cetera. Moreover, on current projections China will experience a sharp decline in population growth beyond 2020, as the one-child policy, introduced in 1979, begins to affect significantly the number of women of child-bearing age, especially in view of the marked bias during the past two decades toward birth of boys. However desirable a decline in population growth may be on other grounds, it will make sustaining future high growth in GNP more difficult.

A team at RAND, responding to a request by the Office of Net Assessment of the Defense Department, has recently published a study of various adverse scenarios, along with estimates of their negative impact on Chinese growth over the period 2005-2015 (Wolf et al., 2003). The adversities cover a socially disruptive increase in unemployment, increased corruption, a major

epidemic (focused on AIDS, written before SARS), failure to solve the emerging shortage of water in northern China, a major disruption to world oil supplies, a domestic financial crisis, a sharp decline in inward foreign direct investment, and a military conflict over Taiwan or elsewhere. Others are imaginable, e.g. a severe world recession. Each scenario has an adverse impact on Chinese growth ranging from 0.3 to 2.2 percent a year on the scenario assumptions made in the study, lowering Chinese GDP by 3 to 24 percent by 2015 from an unspecified baseline. Of course, none of these adversities may materialize, a possibility which the authors consider implausible. If one occurs, others may be triggered, at least in part, because of interdependencies among them. Good luck as well as skillful management will be required for China to continue on a course of sustained growth.

What economic actions could the United States take to affect China's long-term growth, representing exercise of US economic power? (Note that of the adverse scenarios considered by the RAND team, the only one subject to possible US action would be foreign direct investment [FDI], a topic taken up below.) The United States could think of reducing China's export growth by reducing US imports from China; reducing China's imports by restricting US exports to China, especially high technology exports but arguably also food and animal feed; reducing US FDI in China (and incipient Chinese FDI in the United States); reducing other flows of US capital to China; and reducing Chinese migration to the United States, especially students. I assume that we are attempting to follow Mearsheimer's advice, and not responding to some extremely provocative act by China, such as an unprovoked attack on Taiwan. This assumption assures that the United States would be acting alone, in pursuit of its strategic interests as Mearsheimer sees them, and that it would not have the cooperation of other countries, particularly Europe, in pursuing parallel actions.

Imports

The United States could reduce its imports from China in three ways: by reducing overall

US demand, by slowing US growth; by restricting imports (or imports of products relevant to China) from the world; and by restricting imports from China on a discriminatory basis, all relative to prospects in the absence of these strategically motivated actions. At first glance it might seem as though greatly reducing China's exports to the United States would have a major impact on China's growth, since exports account for about a fifth of China's GDP and exports to the United States amount to about a quarter of China's exports, or five percent of GDP. However, exports are measured at gross value, not value-added in China, and many of China's exports involve processing imports, which come especially from southeast Asia, Korea, Taiwan, and Japan. Total cessation of exports to the United States would thus have a much smaller impact on China's GDP than the five percent would suggest, and indeed would at least in the short run have a significant negative impact on China's overseas suppliers.

The first of the three approaches, probably the most effective in terms of total value, would also be self-defeating; maintenance of strategic superiority, in Mearsheimer's framework, if anything involves enhancing, not retarding, US growth. The second would be welcomed by certain US firms producing the products in question; import protection is helpful to firms in direct competition with the imports. But it would reduce US standards of living and would be harmful to firms, relative to their foreign competitors, that use Chinese products as inputs. Moreover, it would be not only resented but seriously challenged by all countries exporting such goods to the United States, as violation of their rights – and US commitments – under the terms of the World Trade Organization (WTO). Except under special circumstances, product by product, they would succeed in this challenge, so the United States would be faced with backing down on the import restrictions, or backing out of the accepted principles of international trade that the United States, in particular, has worked so hard to achieve over the past six decades.

Restricting imports from China on a discriminatory basis, again except under special circumstances, product by product, entails an analogous dilemma. Now that China has become a

member of the WTO, subject both to its rights and obligations, a membership that followed especially intense negotiations with the United States, China could challenge general discriminatory restriction of imports from China, and would win the challenge. They would involve the United States welching on a recent international commitment, unless the United States formally invoked the national security clause in WTO. Yet invocation of that clause without clear provocation by China would signal to the rest of the world a sudden unilateral change in the basic trade rules by the United States, unpersuasive to others, indeed potentially threatening to them.

Given China's heavy dependence for exports on the US market, any sudden move by the United States to restrict such imports would of course have a negative impact on the Chinese economy in the short to medium run. But in the longer run Chinese manufacturing would adjust to the diminished sales possibilities in the United States and would sell elsewhere – not perhaps in the same magnitude, given the size of the US market, but enough to prevent stifling Chinese growth. Moreover, China now has foreign exchange reserves in excess of \$400 billion, and therefore could continue to import critical products from abroad (e.g. oil) for a considerable time even after the loss of sales to the United States.

Recall also that the United States did embargo products from China during the period 1951-1972. Yet other countries continued to trade with China, and China's economic growth during 1952-1959 was over 6 percent a year, before it was disrupted by Mao's Great Leap Forward and slowed by the Cultural Revolution, both events internal to China (calculated from Maddison, 1998, p.157; official figures suggest an annual growth of 9.2 percent 1952-1957; from Maddison, p. 160).

Exports

China might acquire some critical products from the United States, which could therefore harm China by restricting US exports. Curiously, restrictions on exports are not covered by the same tight and comprehensive international rules as are restrictions on imports, so exports could be

restricted without violating the WTO. Indeed, exports of military equipment and so-called dual use technology to China are already restricted, resulting in complaints by China and a reponse when China is challenged to reduce its large trade surplus with the United States. Dual use technology involves technology, including technology embodied in equipment such as high-end computers, that in the view of the Defense Department has potential military as well as civilian uses. Exports to China (and indeed to most countries) require licenses from the Commerce Department, and exports to China operate under a special regime designed to inhibit any US contribution, through exports, to enhancement of China's military capacity. US industry chafes at the way these regulations are implemented, arguing that in many (most?) cases they simply cause Americans to lose Chinese orders to foreign, mainly European and Japanese, firms. The key point here is that US firms rarely have a monopoly on modern technologies, and that others are eager to sell where American firms are denied the sale. The United States has generally been unable to persuade its high-technology European and Japanese allies to forego the sales of such dual use technology, except in limited areas (e.g. involving nuclear weapons or missile technology). This was a problem even with the Soviet Union during the height of the Cold War, when a procedure for vetting and challenging such sales was in place; it is even more difficult today. Tightening these restrictions or widening their coverage would have negligible effect on China's growth, and indeed might have some negative impact on US growth, although probably small.

China is increasingly dependent on imports of agricultural products, particularly soybeans and feed grains, and must soon make some strategic decisions regarding its agricultural policy. The United States arguably could influence those decisions by restricting agricultural exports. There are two problems with this action: first, other agricultural exporters, especially Canada, Australia, Argentina, Brazil, and the European Community, would be happy to take up any slack left by the United States. Second, American farmers would complain bitterly, as they did following President Carter's embargo on grain sales to the Soviet Union following that country's invasion of

Afghanistan, an item that figured heavily in Ronald Reagan's presidential campaign the following fall, when he promised never, under any circumstances, to restrict exports of American farm products.

FDI

As in the case of high-technology exports, the United States already has a procedure for vetting foreign direct investment in the United States, and for denying FDI if it might act as a vehicle for transferring sensitive technology abroad (see Graham-Krugman, 1995). Chinese FDI in the United States is small. It is likely to grow over time, but tightening the regulations or even prohibiting it altogether would have a negligible impact on China's economic growth, and is likely to hurt the United States more than it hurts China, although again the impact would be small.

Foreign direct investment in China, in contrast, has been substantial, and has made a substantial contribution both to China's growth in exports and to its industrial technology. Indeed, during 2002 China was the largest recipient of FDI, and for previous years followed only the United States as a destination for FDI. The RAND team includes a sharp drop in FDI as one of its adverse scenarios for China. On its admittedly sketchy and uncertain calculations China's growth would decline by 0.6-1.6 percent a year over the period 2005-2015 following a decline in FDI of \$10 billion a year (Wolf et al., p.156). However, the relevant question for Mearsheimer is not the impact of a general decline in FDI, which would almost certainly occur as a result of perceptions of developments within China adverse for foreign investors. Rather, it is the impact of a policy-induced decline in American direct investment in China. The stock of US FDI in China amounted to only \$10 billion in 2002, only a small percentage of total FDI in China; and it actually declined by 10 percent from 2001 (this may have been related to consolidation of some investments in a Singapore holding company that year), even while total FDI on Chinese figures rose by over \$50 billion. Thus the question becomes: how crucial is this FDI for China, and in its absence how much would FDI from other countries fill in behind it? With respect to two important sectors,

automobiles and finance, in both of which US firms have expressed interest, we can reasonably guess the answer: FDI has been controlled by the Chinese authorities, demand for it exceeds supply, and with US restrictions the Chinese authorities could allow others in instead (but might choose not to, if they felt the gains were not sufficient). A general proposition, then, is that FDI from other countries would quickly fill in behind prohibited FDI from the United States, Chinese authorities permitting. And in any case US firms have shown much less interest in investing in China than have firms from many other countries. Thus the impact of US restrictions on Chinese growth would be small to negligible. US firms wanting entry into the Chinese market, however, would complain bitterly that they were being penalized in favor of their global competitors by a misguided US policy. (Some labor unions, in contrast, might favor the restrictions on FDI, as involving the "export of jobs," a controversial proposition, although their ire has been directed more at US FDI in Mexico than in China.)

Other Capital

Restrictions on exports of capital other than FDI would have no impact whatever. China is a high saving country, and is not reliant on foreign capital per se. Indeed, it is a major exporter of capital, via its central bank's purchases of foreign exchange, held mainly in US Treasury securities, while the United States has been a major importer of capital during the past two decades. The London-based financial market is worldwide in scope, and denial of US-origin funds to China would result in modest re-arrangement of flows. US votes against loans by the World Bank or the Asian Development Bank to China would not stop those loans unless the United States could garner sufficient support from other lending countries, which it could not do under the postulated circumstances.

Migration

Finally, the United States could attempt to restrict Chinese migration to the United States.

Some of this migration is illegal and is subject to restriction now. US authorities are likely to have as much, or as little, influence on that flow in the future as they have in the past, and in any case the influence on overall Chinese growth (as distinguished from the well-being of particular families or villages) would be negligible even if it were stopped altogether.

More serious in the long run might be denial of entry to Chinese students. They seek American education in large numbers – 63,000 were studying in the United States in 2002 (IIE website). Those returning to China bring both technical knowledge and new ideas about how to organize and manage firms, and even society. Disadvantages of such a policy are that it would hurt American colleges and universities, just when especially public institutions are under heavy budgetary pressure; it would deny the US economy the benefit of the many highly trained and diligent Chinese who one way or another end up staying in the United States; and it would weaken future American influence on the evolution of policy in China ("soft power," according to some), in a direction plausibly more favorable to the United States, just as US-trained Mexican officials took a more confident and less paranoid view of the United States when they came to power. Moreover, it does not sit well with America's self-image, fostered around the world, to deny access to American colleges and universities to qualified and eager prospective students, each wanting to improve his or her life chances.

Conclusions

The implicit assumption of those who expound on the economic power of the United States is that the US government is a unitary actor that can mobilize at will the US economy to pursue its foreign policy ends, much as it can instruct the US ambassador to the United Nations what resolutions to table and how to vote at the UN. Nothing could be further from reality, even though some, like Mearsheimer, consider themselves "realists" when it comes to foreign policy

and the interactions of states. Economic issues in a plural society involve many interests, and in a democratic society agents will try to protect those interests. They will often be successful. The government, particularly a government that invokes the rule of law and the sanctity of private property, cannot ignore much less disregard those interests when framing foreign policy, except possibly in circumstances of extreme national emergency when calls to patriotism overwhelm these interests.

Political constraints on actions by the political leadership blur the frequently made distinction between capability and willingness when it comes to the exercise of power, or leverage. A country may be technically capable of achieving a particular result, and the leadership may be willing to take a decision to that effect, but the political system may fail to support the leadership, making their willingness otiose. Thus I prefer to include the acceptability of the proposed exercise of power to the political system as part of its capability – if the constraints are effective, action cannot be taken – and apply the term "willingness" to the leadership. This is semantics again; the important point is to keep the concepts straight.

Finally, back to China. The United States is not capable of exercising its "latent power" to slow China's growth for two quite different reasons. First, domestic economic interests translated into political constraints on actions will not allow it, absent some clear provocation. Second, the existence of world markets, ample competition with US products, and an unwillingness of foreign governments to cooperate all undermine the effects of any US actions – assuming it could take action – beyond the immediate impact lasting a few years.

We turn, in conclusion, to the desirability of the proposal, as distinguished from its feasibility. There is no doubt that China is growing rapidly, and if well managed has the

possibility of reaching the level of US GNP, although many decades later than Mearsheimer suggests. Moreover, nationalist sentiments in China are high, fed by years of teaching about the humiliations China experienced at the hands of foreigners. They are likely to be heightened further, not diminished, by Chinese economic success. They could at some point be mobilized demagogically. In addition, the surplus of young males creates a potentially explosive situation. The world, especially China's neighbors, thus relies on the good sense and political skills of China's leaders to maintain China on a stable, peaceable, growth-oriented path. As Joseph Nye has said somewhere, the best way to make an enemy of China is to treat it like one.

References

- Council of Economic Advisers, Economic Report of the President, US Government Printing Office, January 2001.
- Graham, Edward M., and Paul R. Krugman, Foreign Direct Investment in the United States, 3rd edition, Washington: Institute for International Economics, 1995.
- Hufbauer, Gary Clyde, Jeffrey J. Schott, and Kimberly Ann Elliot, Economic Sanctions Reconsidered (2nd edition), Washington: Institute for International Economics, 1990.
- Maddison, Angus, Chinese Economic Performance in the Long Run, Paris: OECD, 1998.
- Mearsheimer, John J., The Tragedy of Great Power Politics, New York: W.W. Norton, 2001.
- Mearsheimer, John J., "Great Power Politics in the 21st Century," Foreign Affairs, 2001.
- Pape, Robert A., "Why Economic Sanctions Do Not Work," International Security, 22 (fall 1997), 90-136; also a rebuttal by Kim Elliot and a rejoinder by Pape in International Security, 23 (summer 1998), 50-77.
- Wolf, Charles, Jr., K.C. Yeh, Benjamin Zycher, Nicholas Eberstadt, and Sung-Ho Lee, Fault Lines in China's Terrain, Santa Monica, CA: RAND, 2003.
- Wolf, Charles, et al., Asian Economic Trends and Their Security Implications, Santa Monica, CA: RAND, 2000.
- World Bank, China 2020: Development Challenges in the New Century. Washington: The World Bank, 1997.