Trade, Security, and Authoritarianism:
Domestic Politics of Foreign Economic Policy in China[1]

Hiroki Takeuchi (htakeuch@smu.edu)

Southern Methodist University (SMU)

ABSTRACT

Could trade bring security and stability to international relations? China has become one of the most important players in the global economy without being democratized. In this article, I present a game-theoretic model in which an authoritarian state would behave more cooperatively in international relations if internationalists are empowered vis-à-vis hardliners in domestic politics. The model's equilibrium outcome implies that free trade agreements (FTAs) that require the signatories to be committed to domestic economic reforms will promote international cooperation and strengthen regional security by empowering people who favor reform and internationalism in each nation's domestic politics. This means, if an authoritarian state is involved in the global economy and benefits from international economic transactions, like China does, then concluding and spreading FTAs requiring domestic economic reforms would be more effective policy to bring security and stability than promoting democratic transitions.

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Could trade bring security and stability to international relations? Realist theories argue that states' taking international relations as zero-sum interactions is unavoidable in the anarchic nature of the international system. Liberal theories argue, first, that economic interdependence in the market system produces common interests and therefore decreases conflict among states and decreases the role of military power and the insecurity it breeds (Ikenberry 2011; Mearsheimer 2001). Institutions, then, both international and domestic, can mitigate the effects of anarchy and, as a result, there is opportunity for positive-sum, mutually beneficial cooperation (Keohane 1984; Lake 2011; McDonald 2009). While realists conclude that international cooperation is difficult, and conflict and insecurity are enduring features of world politics, liberals argue that market interactions and institutions can strengthen each state's security by promoting international cooperation. The question of whether trade could bring global security and stability is particularly important to consider when evaluating the implications of China's rise on U.S. foreign policy, considering the United States has a long history of "supporting democratic transitions and economic liberalization around the world" (McDonald 2009, 1). China has become one of the most important players in the global market economy without being democratized. Edward Steinfeld (2012) argues that, even without democratization, China's economic growth enhances the U.S.-led liberal international order because it means China is playing *our* game by *our* rules.

In this article, I advance these liberal arguments by examining the security implications of the emerging intra-industry trade of manufacturing industries induced by the spread of global value chains (GVCs)—where manufacturers are procuring parts produced beyond national borders—of

multinational corporations (MNCs) in the Asia-Pacific region.[2] In manufacturing industries it has become common practice for different stages of production to be located in different countries. The development of GVCs over the last two decades has brought a new international division of labor between developed and developing countries, which includes both authoritarian and democratic countries (Baldwin 2016; Kimura 2013). The spread of GVCs has also changed the rule-making of international trade. In the past, trade negotiations mainly discussed lowering tariffs and other trade barriers imposed at the national border in order to manage inter-industry trade in which nations trade raw materials and final goods among different industries. However, as more international economic interactions have become GVCs based trade, building rules on domestic regulations such as regulations over foreign direct investment, state-owned enterprise (SOE) reforms, and intellectual property rights, is necessary to manage the intra-industry trade, shifting the focus of trade negotiations from national border measures to domestic regulations.

I develop a simple game-theoretic model to explore the political implications of this new trend of trade negotiations on regional security in the Asia-Pacific. Because the World Trade Organization (WTO) has failed to function as a rule-making organization, many nations have concluded free trade agreements (FTAs) that include stipulations over domestic regulations in order to manage GVCs based trade.[3] The shift from the WTO to FTAs was especially prominent in the Asia-Pacific. My model is built on the assumption that these FTAs will empower reformists who want to advance regulatory reforms in their nation's domestic politics. These reformists understand the necessity to maintain good relations with their trading partners in order to benefit from their economic interactions, and therefore adopt cooperative foreign policy. Thus,

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[2] The international division of labor among different production stages is called "international production networks" or "global supply chains." I use the terms interchangeably in this article.
[3] For the malfunctioning of the WTO, see Schwab (2011).

international rule-making on GVCs based intra-industry trade enhances international cooperation by motivating reformists to make a coalition with internationalists, who appreciate a peaceful international environment, in domestic politics. In the meantime, conservatives are motivated to make a coalition with hardliners and to support aggressive and abrasive foreign policy in order to protect their vested interests.[4] Therefore, the failure of international rule-making on GVCs based trade will undermine global security and stability.

The central implications of this game-theoretic model are as follows. In the model's equilibrium, if an FTA empowers internationalists vis-à-vis hardliners in the power balance of domestic politics, it will make the authoritarian state's behavior more cooperative in international relations. Such an outcome is expected in some of the FTAs under certain conditions. If the FTA requires domestic economic reforms, it will undermine the corrupt rent-seeking mechanism enjoyed by the conservatives. The FTAs stipulating comprehensive rules on GVCs based intra-industry trade will require the signatories to be committed to regulatory reforms, imposing external pressure on governments to reform the politically sensitive issues. For example, the SOE reform in China is one of those politically sensitive issues as particularistic vested interests are formed under the SOE system in the Chinese state capitalist economy. Therefore, this kind of international rule-making on trade will make each nation's behavior more cooperative in international relations by empowering the reformist internationalist coalition vis-à-vis the conservative hardliner coalition in domestic politics. Among the FTAs in the Asia-Pacific, the Comprehensive and Progressive Agreement for Trans-Pacific Partnership (CPTPP), which stipulates domestic

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[4] Conservatism here is defined as the position to protect vested interests, and is not related to the conservative ideology in American politics.

regulations, will serve for this purpose, while the Regional Comprehensive Economic Partnership (RCEP), which does not stipulate domestic regulations, will not.

The broader implications of this game-theoretic model are concerned with the debate over whether and how democracy may bring peace to the world. The democratic peace theory has long been influential on American foreign policy. For example, President George W. Bush argued that bringing democracy to the countries of the Middle East would advance U.S. national interests. Therefore, he saw the invasion of Iraq and the other policies designed to encourage democratization of the Middle Eastern countries as vital to bringing stability to that region and reducing the threat of terrorist attacks on the United States ("We Will Finish the Work of Fallen" 2004). Contrary to the democratic peace theory, the literature of commercial liberalism—also called the capitalist peace theory—has argued that nations will not fight war if they trade with each other because it is in neither nation's best interest. Patrick McDonald (2009) takes this capitalist peace theory a step further arguing that capitalist institutions provide a foundation for peace by offering liberal domestic economic institutions such as property rights regimes. It is these competitive market structures that constrain the political rent seeking of leaders and make them more responsive to popular demands for peace. Concurring with McDonald's argument, in this article I suggest that, as the market-promoting domestic institutions bring peace to international relations, the FTA that requires signatories to commit to regulatory reforms will enhance regional security. I argue that international rule-making of the FTAs that stipulate domestic regulations will enhance regional security because such an FTA may motivate an authoritarian country involved in GVCs based intra-industry trade—such as China—to empower the internationalists who appreciate international cooperation with trading partners.

In this article, first, I briefly and selectively discuss previous work on the issue of trade and security in international relations. Second, I present a basic game-theoretic model, examining the game between an authoritarian state and a democratic state in which there is uncertainty over the other player's payoffs. Analysis of this model shows when the bilateral relationship is cooperative and when it is not. Third, I apply the model to domestic politics of foreign economic policy in China. I argue that an FTA requiring the signatories to be committed to domestic economic reforms will enhance regional security in the Asia-Pacific by empowering the reformist internationalists vis-à-vis the conservative hardliners in the power balance of Chinese elite politics.

Trade and Security

The question of how trade matters for security has long been salient in the literature on international conflict and cooperation. The strand of thought is rooted in two classic works: Adam Smith's *The Wealth of Nations* (1979 [1776]) and David Ricardo's *On the Principles of Political Economy and Taxation* (2015 [1817]). The early literature on commercial liberal theories often build their arguments by taking the following simple assumption mentioned previously: nations will not fight war if they trade each other, because no nation is interested in fighting war with another nation with which it trades (e.g., Rosecrance 1986). This theoretically sound assumption originates in the works by Smith and Ricardo. Smith suggests that there is a benefit to the division of labor where people specialize based on their skills or endowments and trade for what they need. In this way, self-interested economic exchange makes everyone better off through the "invisible hand" of the market. Applying Smith's theory to international trade, Ricardo proposes the idea of a "comparative advantage." This theory underlies liberal faith in free markets: that is, a system of free trade, in which countries specialize in the areas where they have a comparative advantage, is

most efficient and leads to economic growth and prosperity for every state. It also underlies commercial liberal views about pacifying effects of economic interdependence, suggesting that the comparative advantage leads to the division of labor, leading to mutual economic dependence, which brings peace to bilateral relations.

McDonald (2009) focuses on the liberal rules within each state that would secure property rights and open domestic markets to international competition. He argues that free trade *policy* (not the trade volume) brings peace highlighting the political implications of market-promoting institutions on the government's foreign economic policy making. He suggests that the liberal domestic economic institutions such as secured property rights and competitive market structures prevent the government from waging war "for particularistic or selfish reasons that undermine the broader welfare of society while simultaneously fortifying the domestic political status of the governing elite" (McDonald 2009, 23), and that the secured property rights push "a government toward peace by influencing the distribution of political power between a government and its citizenry within a domestic political order" (Ibid., 52). Summarizing his argument, to maximize economic gains from international commerce, the state will be committed to free trade policy if it has established property rights regimes and competitive market structures in the domestic sphere. The state that has founded liberal economic institutions not only opens domestic markets to international competition but also behaves cooperatively and peacefully in international politics.

Other scholars have also written on how trade influences conflict and cooperation in international relations. Etel Solingen (1998) argues that domestic politics over economic and regulatory reforms shapes regional orders and security in international relations.[5] Stephen Brooks (2005) presents how MNCs' economic activities have affected the states' calculation of their

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[5] See also the anthology of her work (Solingen 2015).

security policies. Since he wrote the book in 2005, the GVCs of MNCs in manufacturing industries have further spread all over the world, especially in the Asia-Pacific region. Thus, it is time to further examine the security implications of GVCs based intra-industry trade on international relations. Henry Yeung (2016) discusses state-firm relations in East Asia (mainly in South Korea, Taiwan, and Singapore) to reveal how firms' activities influence the government's domestic and foreign economic policies, although he does not explore security implications of state-firm relations. Most recently, William Norris (2016) presents how the Chinese government uses domestic economic policies to achieve its goal in international relations.[6] Norris and Yeung both show that the state's foreign economic policy is influenced by both the external structure of international relations and the internal conditions of domestic politics. When states come to the negotiation table to formalize international trade, their behaviors are influenced by domestic politics whether the states are authoritarian or democratic.

I develop my argument based on these accounts of trade and security in the literature discussed above. The traditional literature of commercial liberalism by Smith and Ricardo presents the motivation for nations to cooperate. With this incentive, economic interactions in the markets may constrain state choices for military power, interactions in international relations may be driven by common, positive-sum interests, and therefore the danger of war may be lessened or eliminated through economic interdependence. Moreover, trade may build a prosperous middle class that sustains democracy, which may promote free markets and trade, and this virtuous circle will bring peace to international relations. Economic interdependence will create a demand for governance on international economic interactions and give a strong incentive for nations to

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[6] Similarly, Scott Kastner (2009) examines how domestic politics influences both trade and security policies of China and Taiwan.

establish international institutions, which will further facilitate cooperation and interdependence. However, what McDonald and others in the recent literature suggest is that liberal domestic economic institutions are needed for these pacific effects to be realized. The market-promoting institutions in the domestic sphere are particularly important to make the government seek the benefits from international economic interactions, rather than nations seek the benefits from the rent-seeking political supporters. In what follows, I present a simple game-theoretic model to explore the security implications of the FTAs that empower the reformist internationalists vis-à-vis the conservative hardliners in domestic politics.

The Game-Theoretic Model

I make three arguments using the game-theoretic model. First, if the democratic state expects the authoritarian state to be internationalist, the authoritarian state will be more likely to take the cooperative stance. The main policy implication to be drawn from this argument is that the United States and its allies should conclude and spread the FTAs that stipulate the requirement of domestic economic reforms such as the CPTPP. Second, if the authoritarian state expects the democratic state to be more bellicose, *ceteris paribus* the authoritarian state is *more* likely to take the cooperative stance. However, this option would be much less effective than empowering the authoritarian state's reformist internationalists. Therefore, to achieve regional security in the Asia-Pacific, the United States should join the CPTPP, putting pressure on the Chinese government to work on SOE reforms, instead of taking an aggressive position against China. Third, if the democratic state expects the authoritarian state to be more bellicose, the democratic state is more likely to *yield* to the authoritarian state's aggression. Now, since the United States withdrew from the Trans-Pacific Partnership (TPP: what is now the CPTPP) immediately after President Donald

Trump's inauguration, the United States is *more* likely to yield to China's aggression. Although the Trump administration superficially takes the aggressive position against China, this model suggests that the administration is likely to make a backdoor deal with the Xi Jinping administration when China becomes or is aggressive.

The Structure of the Model

There are two actors, an authoritarian state and a democratic state. The authoritarian state decides whether to be aggressive to expand its sphere of influence or to be cooperative to enjoy the economic benefit from interdependent relations with the democratic state. If the authoritarian state has taken an aggressive stance, then the democratic state will have to decide whether to retaliate or to yield to maintain the economic benefit from interdependent relations. If the democratic state retaliates, then the authoritarian state will decide whether to escalate the conflict or back down. The crucial dilemma for the democratic state is that it does not know if the authoritarian state is hardliner or internationalist, that is, whether the authoritarian state is inclined to escalate the conflict even if it means sacrificing the economic benefit from interdependent relations.

This scenario can be formalized in a simple incomplete information game, as shown in Figure 1. The nature node indicates whether the authoritarian state is hardliner or internationalist. The hardliner type's payoff for the conflict escalation, F_A^* (for "fighting" to maintain a hardliner position), is higher than its payoff for benefiting from international commerce in a peaceful environment, R_A (for "reward" from economic interdependence). For the internationalist type, the economic benefit from interdependent relations, R_A, is higher than the political benefit from fighting, F_A.

<Figure 1 around here>

The nature node makes the authoritarian state internationalist with probability p on the right branch of the game tree, and hardliner with probability $1 - p$ on the left branch of the tree. As indicated by the information set linking the democratic state's decision nodes, the democratic state is not informed of what type of player it faces. However, the probability that the authoritarian state is internationalist, p, is known to the democratic state; and the greater p is, the more certain the democratic state is that the authoritarian state is internationalist. This prior expectation regarding the authoritarian state's type can be a product of several things. If the authoritarian state has been involved in the global economy, this could result in a higher level of p. For instance, China has advanced market-oriented economic reforms since the 1980s, which has led China to benefit from economic interactions with democratic states such as the United States; and as a result, democratic states may expect China to maintain good relations with those democratic trading partners. The prior expectation could also be a result of a membership of international institutions. If the authoritarian state is enmeshed in U.S.-led international economic institutions such as the WTO, then it may have a stronger incentive to cooperate with the United States and other democratic states, which means a higher p. Finally, the prior expectation could be influenced by domestic politics of the authoritarian state. If those who appreciate the benefit from international cooperation are empowered in the authoritarian state's domestic politics, and if that information is credibly signaled to other states, then the democratic state will believe that the authoritarian state is more likely to be internationalist. For instance, if the reformist internationalists are empowered vis-à-vis the conservative hardliners in Chinese domestic politics, then the United States will expect China to be more likely to cooperate in international relations.

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Following the nature node, the authoritarian state has the first move, choosing either an aggressive stance or a cooperative stance. If the authoritarian state decides to take the cooperative stance, the game ends and both players get their reward payoffs, R_A for the authoritarian state and R_D for the democratic state. If the authoritarian state decides to take the aggressive stance, the democratic state has the option to retaliate the aggression or yield to it. If the democratic state decides to yield, the game ends by changing the balance of power in the authoritarian state's favor. In this acquiescence outcome, where the authoritarian state gets ACQ_A and the democratic state gets ACQ_D, the democratic state loses payoffs while the authoritarian state gains payoffs compared with the payoffs earned from economic interdependence of the status quo. If the democratic state decides to retaliate, the authoritarian state has the option to escalate the conflict or back down. If the authoritarian state backs down, then it suffers from the decision to back down although still benefiting from economic interdependence, while the democratic state benefits from continued interdependent relations. Thus, the authoritarian state gets the payoff of B_A, lower than R_A, while the democratic state gets R_D. Finally, if the authoritarian state escalates, then the authoritarian state gets the fighting payoff, F_A^* if hardliner or F_A if internationalist, while the democratic state gets F_D.[7]

Equilibria in the Model

The solution concept I employ is the perfect Bayesian equilibrium, requiring that beliefs be updated on the equilibrium path according to Bayes' rule.[8] There are two types of perfect

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[7] In sum, the authoritarian state's preference ordering is $ACQ_A > F_A^* > R_A > B_A > F_A$, while the democratic state's preference ordering is $R_D > ACQ_D > F_D$ or $R_D > F_D > ACQ_D$.
[8] For the perfect Bayesian equilibrium, see Morrow (1994, 170–80).

Bayesian equilibria in the game, one pooling equilibrium and one semi-separating equilibrium.[9]

In the pooling equilibrium, both types of the authoritarian state will take an aggressive stance and then the democratic state will yield to it. Because the democratic state is expected to yield once the authoritarian state has taken the aggressive stance, even the internationalist type of authoritarian state will take the aggressive stance, benefiting from the changed balance of power in the authoritarian state's favor. This represents the cases in which once the authoritarian state has established the expectation that it is more likely hardliner, even the internationalist type of authoritarian state will have an incentive to be provocative.

In the semi-separating equilibrium, if both the authoritarian state and the democratic state act strategically, the internationalist type of the authoritarian state will take an aggressive stance with the probability b and the democratic state will retaliate with the probability r. The probability that the democratic state retaliates depends on neither the democratic state's expectation of the authoritarian state's type (i.e., the value of p) nor the democratic state's preference ordering (i.e., the values of the democratic state's payoffs), but depends on the authoritarian state's preference ordering (i.e., the values of the authoritarian state's payoffs). In the meantime, the probability that the internationalist type of authoritarian state takes the aggressive stance is negatively associated with both the democratic state's appreciation of economic interdependence (i.e., the value of R_D) and that of conflict escalation (i.e., the value of F_D). That is, if the democratic state benefits more from international economic interactions, *ceteris paribus* the internationalist type of authoritarian state will be more likely to take the cooperative stance; and at the same time, if the democratic state benefits more from conflicting relations, *ceteris paribus* the authoritarian state will be more likely to take the cooperative stance, too.

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[9] I discuss a formal description of this model's equilibria in the appendix.

To examine how changes in certain parameters would affect the equilibrium, I offer a numerical example. Figure 2 shows how the probability that the authoritarian state takes the cooperative stance depends on the likelihood of the authoritarian state expected to be internationalist (p) and how much the democratic state values conflict escalation (F_D). When F_D increases, which means that the democratic state benefits more from conflicting relations, the probability that the authoritarian state takes the cooperative stance *increases*. Moreover, the probability that the authoritarian state cooperates increases more steeply when the democratic state credibly signals that it is more hardliner, if the authoritarian state is more likely to be hardliner (i.e., the smaller value of p). However, the magnitude of the democratic state's bellicose preference inducing the authoritarian state's cooperation is much smaller than that of the authoritarian state becoming more internationalist. This equilibrium outcome has the following implications for my argument. If requiring regulatory reforms to the signatory nations, the FTA will undermine vested interests based on the collusive and corrupt rent-seeking mechanism and hence empower the reformist internationalists vis-à-vis the conservative hardliners, which means the increase in the value of p. As a result, the authoritarian state will be more likely to take the cooperative stance, strengthening regional security.

<Figure 2 around here>

Figure 3 examines how the probability of the democratic state's yielding depends on the likelihood of the authoritarian state being internationalist (p) and how much the democratic state values conflict escalation (F_D). Overall, the more the democratic state benefits from conflict escalation, the less likely the democratic state yields. However, the magnitude of this impact is small. In the meantime, the more likely the authoritarian state is hardliner, the more likely the democratic state *yields*. This equilibrium outcome implies that one of the democratic state's

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equilibrium strategies is first to empower hardliners vis-à-vis internationalists in the authoritarian state's domestic politics—which means the decrease in the value of p—then to raise the likelihood that the authoritarian state chooses aggression, and finally to yield to the authoritarian state's aggression. Although the democratic state is apparently aggressive in this equilibrium, in the end it will compromise with the authoritarian state, weakening regional security.

<Figure 3 around here>

Summary

The game-theoretic model suggests that the more likely the authoritarian state is expected to be internationalist, the more likely the authoritarian state takes a cooperative stance. If the authoritarian state is less likely to be internationalist, not only is the authoritarian state more likely to take an aggressive stance but also the democratic state is more likely to yield to the authoritarian state's aggression. If the democratic state is expected to have a more bellicose preference, *ceteris paribus* the authoritarian state is more likely to cooperate and the democratic state is less likely to yield; however, the impact of the democratic state's bellicose preference is much smaller than if the authoritarian state became internationalist. Thus, if the United States wants China to cooperate, concluding and spreading an FTA empowering the reformist internationalists vis-à-vis the conservative hardliners in Chinese domestic politics would be more effective policy than taking an aggressive stance toward China. Moreover, if the conservative hardliners are empowered vis-à-vis the reformist internationalists in Chinese domestic politics, it would not only increase the likelihood of China's taking an aggressive stance but also make it more likely for the United States to yield to China's aggression.

The "Beyond-Economics" Importance of Free Trade Agreements

To provide some empirical background for this game-theoretic model, I discuss how FTAs would influence regional security in the Asia-Pacific, with special attention to the impact on Chinese domestic politics and China's foreign policy making. FTAs that require regulatory reforms to the signatory nations would enhance regional security and increase international cooperation, because such an FTA would change the balance of power in each state's domestic politics in favor of reformist internationalists. The reformists who see GVCs based intra-industry trade as a means to achieve sustainable economic growth would have a strong incentive to use the FTAs stipulating domestic regulations as external pressure to advance domestic economic reforms when facing backlash from conservatives who give a priority to protecting their vested interests of the corrupt rent-seeking mechanism. The reformists would appreciate a peaceful and cooperative international environment while the conservatives would use aggressive and abrasive foreign policy as a means to resist the reformist agenda that would undermine their vested interests. Therefore, the empowered reformists would make the nation's behavior more cooperative in the international sphere by making a coalition with the internationalists.

There is a large literature discussing Chinese elite politics, although the debate ends up with conflicting interpretations on almost every issue due to the difficulty of collecting empirical evidence (e.g., Baum 1994; Economy 2018; Fewsmith 1994, 2001; Li 1997, 2001, 2016; Vogel 2013).[10] My goal here is to try to reinterpret Chinese domestic politics over foreign economic policy by showing how reformists and internationalists make coalitions to confront the coalitions of conservatives and hardliners. The discussion here is built on Julien Gewirtz's (2017) argument

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[10] One of the best collections is Alice Miller's series of essays in *China Leadership Monitor*, https://www.hoover.org/profiles/alice-l-miller.

that a coalition of Chinese reformers and Western economists was what made it possible for the post-Mao economic reform to emerge in the 1980s. Gewirtz suggests that the origin of China's current prosperity is not nationalism but internationalism.

Donald Trump's election to be U.S. President has added two complications to the debate about Chinese elite politics and its implications on China's foreign economic policy. First, it is now salient to ask the question of whether the U.S.-led international order is dead as anti-internationalism is rising in the United States and in other parts of the world. In *Liberal Leviathan*, published in 2011 as a response to the George W. Bush administration's Iraq War, John Ikenberry (2011, 310–31) discussed the possibility of a breakdown of liberal international order but argued that the breakdown would be unlikely because the United States benefited from the U.S.-led liberal international order. However, since the election of President Trump the breakdown has become a much more likely scenario. Thus, I examine how the GVCs created by MNCs affect international politics in what Richard Haas (2017) calls "a world in disarray" in his book published just before the election of Trump. Second, the implications drawn from the model suggest the changing political economy of the Asia-Pacific region and the world due to China's economic rise, the relative decline of U.S. economic power, and deepened regional integration.[11] Backed by newly acquired economic power, China is certainly interested in lowering U.S. influence in East Asia, taking an initiative of forming international order, and breaking the ties between the United States and its allies. Although the Trump administration has been using provocative rhetoric, the administration's unpredictable nature raises a suspicion that the United States may suddenly make

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[11] I do not mean that the *absolute* decline of U.S. power has taken place. What I mean by the "decline of U.S. power" is simply a logical inference from China's rise. If one country's power rises, the other country's power at least relatively declines, but it does not mean that the country's power absolutely declines.

a backdoor deal with China by promising to lower the U.S. commitment to regional security in East Asia. This would diminish the credibility of the commitment of the United States, but the Trump administration may not prioritize the reputation of the United States among its regional allies. I do not claim that this scenario is inevitable but suggest that it is consistent with the equilibria of the model examined in this article.

Internationalists Meet Reformists

The model distinguishes between the internationalist type of actor and the hardliner type. According to Miyamoto Yūji (2013)—former Japanese ambassador to China—the Chinese leadership is divided into reformist internationalists (*kokusai kyōchō kaikaku-ha*) and conservative hardliners (*taigai kyōkō hoshu-ha*) over how to respond to internal issues such as maintaining social stability, as well as external issues such as responding to globalized world politics.[12] The 2008 global economic crisis empowered the hardliners, and since then the hardliners and the internationalists have been in conflict over China's foreign policy. At the same time, Miyamoto suggests that the reformists on domestic policies and the internationalists on foreign policies are aligned while the conservatives resisting domestic economic reforms are aligned with the hardliners arguing for abrasive foreign policies. Reformist internationalists argue that to maintain one-party rule China should achieve sustainable economic growth by committing to the SOE reform, and that China should join FTAs requiring domestic economic reforms, which would impose external pressure on China regarding politically difficult reforms. By contrast, conservative hardliners insist that agreeing to reform in the name of trade would jeopardize one-

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[12] When introducing a Japanese source, I put the author's surname first and given name last.

party rule, and hence China should adopt policies that project its power even if they cause friction while promoting nationalism.

In the game-theoretic model, empowered internationalists bring more likelihood of international cooperation in the semi-separating equilibrium. As the value of p increases, the authoritarian state is more likely to take the cooperative stance. Translating this to Chinese domestic politics over FTAs, the reformist internationalists who argue that China should commit to domestic economic reforms and cooperative foreign policy are empowered. Perhaps the most important point to note is that the effect of empowering the reformist internationalists would occur even if China is not an immediate signatory of the FTA. China is not a signatory of the CPTPP. However, the model's equilibrium outcome suggests that as long as China still has the option to join, the CPTPP would still empower the reformists in debates regarding economic reforms. Hence, the potential to sign the FTA is enough to strengthen regional security. By contrast, any policy lowering the value of p would empower the conservative hardliners and undermine regional security. The failure to found the CPTPP or any other FTA stipulating domestic regulations would continue to empower conservative hardliners and weaken security.

In the 1980s, Deng Xiaoping introduced the concept of "keeping a low profile" (*taoguang yanghui*) as a pillar of Chinese foreign policy, proclaiming that China should take a cooperative foreign policy to introduce the market economy. He supported reformist ideas and policies even as he purged those who were sympathetic to the demand for democratization. For example, taking the opportunity to announce reformist Hu Yaobang's purge in 1987, Deng expressed his intention to break with the economic ideology championed by conservative Chen Yun (Gewirtz 2017, 184). Deng punished Hu for being sympathetic to democratization, while he himself supported market-oriented economic reforms. In the game-theoretic model, Deng's gestures can be conceived as an

increase in the value of p, empowering the internationalists vis-à-vis the hardliners. As the model demonstrates, if internationalists are empowered vis-à-vis hardliners the authoritarian state will be more likely to take the cooperative stance. Reformists like Zhao Ziyang were empowered by Deng's support for economic reforms in the 1980s but, as predicted, faced backlash from the conservatives. Responding to the backlash, Chinese reformers and Western economists formed a coalition, making economic reform possible (Ibid., 28).

The Tiananmen democratization movement in 1989 reminded Deng that the market economy would lead to increasing popular demands for democratization. After this democratization movement, conservative leaders launched a nationalist movement called the Patriotic Education Campaign, forging a coalition with hardliners on foreign policy issues (Ibid., 234). The new President Jiang Zemin was different from the reformist internationalists such as Deng, Hu, or Zhao. His commitment to reformism and internationalism was much weaker (Ibid., 257–61). He employed the cooptation strategy, encouraging former officials and former SOE managers to start businesses by using their political connections, and this strategy prevented the market economy from threatening China's one-party rule (Chen and Dickson 2010; Tsai 2007). In this way, the Chinese Communist Party (CCP) created the state capitalist system where the CCP distribute the rent to various societal groups (Huang 2008; Wright 2010).

Although Hu Jintao, who succeeded Jiang, tried to curb the corruption rooted in the state capitalist system by raising the slogan of "harmonious society" (*hexie shehui*), he was never able to consolidate his power base to achieve this goal (Kokubun 2017, 217–21; Miyamoto 2015, 69–71, 85–88). Hu's reform floundered due to backlash from the conservative hardliners, but he did have one success. In 2006, he accused Chen Liangyu, a conservative close to Jiang, of a serious violation of disciplines (i.e., corruption), dismissed him from his position as Party Secretary of

Shanghai, and suspended him from taking any other position in the CCP. In 2007, Jiang promoted Xi Jinping into Party Secretary of Shanghai as Chen's successor; Xi felt indebted to Jiang for the promotion (Kokubun 2017, 86). Xi had been empowered by Jiang, and as a result, Hu was unable to select his favored candidate to be his top potential successor in the National Party Congress of 2007, but had to select Xi (Ibid., 219).

In short, since the 1990s the CCP has used the state capitalist system to maintain popular support for one-party rule by distributing the economic rents. The power struggle over distributing these economic rents became especially severe after Deng's death in 1997, when China lost its last charismatic leader who had participated in the Communist Revolution. Such a severe intra-party power struggle over distributing rents among the collective leadership was a necessary consequence of maintaining one-party rule while advancing a market-oriented economy. However, the CCP has to face the dilemma that real economic reform, which would undermine the collusive and corrupt scheme of state capitalism, will be necessary to achieve sustainable economic growth and China will need to take a cooperative foreign policy. The reformist internationalists and the conservative hardliners have opposing stakes in the domestic economic reform, making the idea of an FTA requiring regulatory reforms a sensitive issue in the intra-party power struggle.

Critics of the above argument focusing on the CCP's cooptation strategy point out that the number of private firms increased rapidly in the 1990s (Chen and Dickson 2010, 18). However, as Yasheng Huang (2008) argues, although private entrepreneurs in the 1980s contributed significantly to rapid development, those since the 1990s have not. While most studies only include the firms that are formally registered as "privately managed enterprises" (*siying qiye*) in the private entrepreneurs, Huang also includes small-scale unregistered individual household enterprises (*getihu qiye*) in that category. These small-scale household enterprises usually try to

avoid interactions with the state (Tsai 2007). In the meantime, many of the registered private entrepreneurs were successful in business by using their political ties that had been established from their previous professional experience as an SOE manager or as a government official (Chen and Dickson 2010, 36). Not surprisingly, those nominally private entrepreneurs who have strong ties to the CCP do not demand democratization but support the current one-party rule (Wright 2010). Because the CCP successfully created the collusive and corrupt vested interests of the nominally private entrepreneurs, nominal privatization of the SOEs in the 1990s formed the basis of the CCP's cooptation strategy under state capitalism. Applying this argument to the game-theoretic model, the increasing number of nominally private firms would indicate the *decrease* in the value of *p*.

Is China a Responsible Stakeholder?

When Xi Jinping succeeded Hu Jintao in 2012, he inherited the collusive and corrupt vested interests under state capitalism, the problem that Hu was unable to solve. Now that China is the second largest economy in the world, whether China is a responsible stakeholder is a $64,000 question, and the answer depends on whether Xi is reformist internationalist or conservative hardliner. The most optimistic answer suggests that China benefits from the current U.S.-led liberal international order and hence that Xi has plenty of reasons to be reformist internationalist. In the 1990s, immediately after the end of the Cold War, the United States was confident in its ability to solve many, if not all, of the problems in the world. However, the 9/11 terrorist attacks in 2001 combined with the subsequent failure of the Iraq War shook the confidence of the United States. The United States would have to prioritize global issues. Later, the Barack Obama administration prioritized Asia in its famous pivot to Asia. Then U.S. Secretary of State Hilary

Clinton (2011) wrote in *Foreign Policy*: The background of this renewed interest in Asia is the dynamic economic development of the Asia-Pacific and the rise of China in both the security and economic aspects. Thus, Thomas Finger, political scientist and former Chairman of the National Intelligence Council, argued that by incorporating China into the U.S.-led international order the pivot to Asia would help the United States maintain supremacy in post–Cold War international politics (interview by author 2014). In this scenario, any policy incorporating China into the U.S.-led international order, like encouraging China to join an FTA—such as the CPTPP—can be interpreted as an increase in p in accordance with the game-theoretic model. Of course, no FTA will alter China's worldview or ambitions. However, proposing an FTA requiring domestic economic reforms will positively influence China's intention by empowering the reformist internationalists vis-à-vis the conservative hardliners in domestic politics. Therefore, such an FTA brings security and stability in the Asia-Pacific by making China's behavior more cooperative.

Conversely, the less optimistic answer suggests that China's goal is building a Chinese-led international order, and hence China has chosen a policy of aggression by challenging the U.S.-led international order. For example, in the South China Sea, China has ignored exclusive economic zones (EEZs) originally agreed upon by the surrounding nations. Patrick Walsh, former commander of the U.S. Navy Pacific Fleet, said that he asked a Chinese military man of the legitimacy of this declaration, and he responded: "Because we claim it" (interview by author 2014). This answer suggests that China's goal is building a Chinese-led international order and hence China will reject being incorporated into the U.S.-led international order. The current EEZs were determined when China's resources were limited, and therefore, from China's standpoint the EEZs should be drawn taking China's own new strength into consideration.

I propose a third answer, which focuses on China's attempt to build a Chinese-led international order. This answer would be the same as the second one if conservative hardliners are empowered in Chinese domestic politics; however, it would be similar to the first one if reformist internationalists are empowered. China has established international economic institutions, such as the New Development Bank (formerly referred to as the BRICS Development Bank) and the Asian Infrastructure Investment Bank (AIIB), and led the Belt and Road Initiative (also called the One Belt One Road). China has also taken the initiative in the negotiation of the RCEP to compete with the TPP. China has not participated in the CPTPP because it is not ready to commit to the required regulatory reforms such as the SOE reform. However, an official of the Office of the United States Trade Representative said that China was interested in joining the TPP and the official argued that the United States should keep the possibility open for China to join the TPP in the future (interview by author 2014). This comment suggests that the Chinese leadership is divided and that those who argue for advancing the "real economic reform" and implementing cooperative foreign policy would intend to use the CPTPP as the *gaiatsu* (literally meaning "foreign pressure") to empower the reformist internationalists vis-à-vis the conservative hardliners in Chinese domestic politics.[13]

Today, Xi's nationalist slogans, such as the "Chinese dream" (*Zhongguo meng*) and the "great rejuvenation of the Chinese nation" (*Zhonghua minzu weida fuxing*), make other nations in the Asia-Pacific doubt whether China will behave as a responsible stakeholder for regional stability and security. Elizabeth Economy (2014) argues that Xi gives the highest priority to tightening his grip over anything. In the domestic sphere, Xi tightens his grip on the control of political power

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[13] The term *gaiatsu* was frequently used during U.S.-Japan trade negotiations in the 1980s and 1990s (e.g., Schoppa 1997).

and social stability by cracking down on dissidents and curbing corruption. Meanwhile, in the international sphere, he tightens his grip on the control of the international order by projecting China's power in whatever way he can. According to Economy, China projected its power by establishing the AIIB, expanding its sphere of influence in Central Asia and more broadly in Eurasia by leading the Shanghai Cooperation Organization, and trying to build a Chinese-led security system by undermining U.S. influence in the Asia-Pacific.

What implications does building a Chinese-led international order have on regional security and stability in the Asia-Pacific? The division between the reformist internationalists and the conservative hardliners suggests that they both attempt to use the formation of Chinese-led international institutions to their own advantage. On the one hand, the reformist internationalists think that administrating an international development bank like the AIIB will provide China with an opportunity to learn the know-how of loaning for infrastructure projects in developing countries. Developed countries participating in the AIIB, such as Germany and the United Kingdom, will work as a *gaiatsu* to implement reformist policies to refine China's market economic institutions. In the model, this would translate as an *increase* of p. On the other hand, the conservative hardliners think that infrastructure projects invested by the AIIB will create demands for the Chinese manufacturers and construction companies that have excessive productive capacities. China's state capitalist system has allowed many zombie companies to survive thanks to political connections under the cooptation strategy. Thus, if taken as a cornucopia of reward for zombie companies, the AIIB will empower the conservative hardliners vis-à-vis the reformist internationalists in domestic politics and make China's behavior more aggressive in international relations, which can be modeled as a *decrease* in the value of p.

Now that the U.S. influence in the world retreats under the Donald Trump administration, the role of the stabilizer falls to China. Therefore, the reformist internationalists must prevail over the conservative hardliners in the power struggle under the Xi administration. Furthermore, concluding and spreading the FTA requiring regulatory reforms—such as the CPTPP—and keeping it open for China's participation will be necessary to achieve this goal, and hence such an FTA will be the foundation of regional security in the Asia-Pacific.

U.S.-China Relations Under the Trump Administration

Since Donald Trump was elected President of the United States in 2016, the United States has become the epicenter of uncertainty against liberal international order—the president uses 140-character (now 280-character) messages on Twitter to announce policy. John Ikenberry (2017, 2) says that "the world's most powerful state has begun to sabotage the order it created." Although the Trump administration's decision-making lacks consistency, unfortunately it is consistently anti-internationalist and anti-institutionalist. Moreover, Trump is unpredictable. I suspect that the reason why Trump is unpredictable is that his agenda is not based on his strategy but based on his psychology. *New York Times* columnist David Brooks (2017a) wrote: "It's not clear if Trump is combative because he sees the world as dangerous or if he sees the world as dangerous because it justifies his combativeness. Either way, Trumpism is a posture that leads to the now familiar cycle of threat perception, insult, enemy-making, aggrievement, self-pity, assault and counterassault." While many analysts have struggled to identify a strategy behind his erratic announcements, it seems much more likely that he chooses his stance based on what will satisfy his ego. Trump is also a hard-core anti-institutionalist. Even if some of the voices in his administration who do not share his view try to explain how rule-making through multilateral institutions benefits U.S.

strategic interests, he will not listen to their advice because his ears do not respond to strategy but only to what satisfies his ego. Furthermore, he demonizes the economic regulations that make the market system function. He also attacks the political institutions such as the separation of powers and freedom of speech that make democracy work, because those institutions hurt his ego. Unfortunately, for his supporters the less civil he is the more attractive his rhetoric is, as his anti-institutional attitude and lack of civility are criticized by those who, he tells his supporters, look down upon them (Brooks 2017b).

Given the political climate discussed above, it is possible that the United States will withdraw from its commitment to regional security in East Asia in exchange for a superficial compromise from China on economic issues, such as voluntary export restraints to the United States or the appreciation of the renminbi to U.S. dollars. This kind of "deal" may satisfy the interests of both China and the United States at the cost of regional stability. While China will be satisfied with the decreased presence of the United States in East Asia, the United States will be satisfied with maintaining economic interactions with China. Although U.S. credibility will plummet, as mentioned before, this might not concern the Trump administration. I do not claim that this scenario is inevitable but suggest that it is consistent with the model's equilibrium. If the Trump administration's decision-making is influenced by anti-internationalists such as Robert Lighthizer, Peter Navarro, and Wilbur Ross while neglecting internationalist security experts such as James Mattis, this scenario becomes more likely.

Finally, I would also like to emphasize the roles of other countries in the scenario that the Trump administration's anti-internationalist "America First" policies deepen the crisis of the American-led system. The second largest economy next to the United States is China. In the 2017 World Economic Forum in Davos, Xi gave a clear statement opposing protectionism, and China

has shown its intention to take over the driver's seat of international order. However, as shown in this article, any country who plays a decisive role in the rule-making of international trade will have to be committed to regulatory reforms. Thus, for China to lead the global economy, it is inevitable to be committed to the SOE reform and the Xi administration must face the backlash from the conservative hardliners. The third and fourth largest economies following the United States and China are Japan and Germany.[14] Chancellor Angela Merkel of Germany took a clear position on the refugee issue, and hence Germany has seemed to lead international order in democracy and human rights. Meanwhile, Japan has the ability to lead international order in free trade. Indeed, Japan took the initiative to conclude the CPTPP. Although the U.S. withdrawal prevented the original TPP from taking effect immediately, its agreed rules are an important model for any forthcoming FTA; the NAFTA renegotiation among Canada, Mexico, and the United States also used the TPP's agreed rules as a benchmark—even though the Trump administration has criticized both deals.

Conclusion

The overall implication of the model and case study presented here is that an FTA requiring domestic regulatory economic reforms can enhance regional security in international relations by empowering reformist internationalists vis-à-vis conservative hardliners in domestic politics. The model suggests that this type of FTA makes the authoritarian state behave cooperatively in international relations. This process can be seen at work in the political economy of China's

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[14] Ikenberry (2017, 3) says Prime Minister Shinzo Abe of Japan and Chancellor Angela Merkel of Germany are "the only two leaders of consequence left standing who support it [the liberal international order]."

foreign policy making since it started market-oriented reform in the 1980s. The model suggests a way to make an authoritarian state to behave cooperatively and peacefully without democratization.

This is an encouraging message for those interested in building support for FTAs and free trade. Trump declared the withdrawal from the TPP immediately after his inauguration in January 2017. The model in this article implies that the failure of the TPP would empower the conservative hardliners vis-à-vis the reformist internationalists in Chinese domestic politics, make China's behavior in international relations more aggressive, and undermine the regional security of the Asia-Pacific. Fortunately, Japan took over the driver's seat of this FTA's negotiation and took the initiative to conclude the CPTPP.

The model also provides a theoretical underpinning for the security implications of the emerging intra-industry trade of manufacturing industries induced by the spread of GVCs. The development of GVCs in the Asia-Pacific over the last two decades has brought a new international division of labor between developed and developing countries, which also include both authoritarian and democratic states. Thus, in the international sphere, the states in the Asia-Pacific have a strong incentive to establish internationally adopted rules by concluding FTAs to manage GVCs based intra-industry trade. Meanwhile, in the domestic sphere, governments in the Asia-Pacific have a strong incentive to use the FTAs as external pressure to advance regulatory reforms to achieve sustainable economic growth. The argument developed in this article has particularly important implications for policy debates over the FTAs such as the CPTPP or the NAFTA, which are expected to play an important role as rule makers in further developing GVCs. Skeptics of the TPP have often overlooked the new trend of international trade in the Asia-Pacific, assuming that the mainstream of international trade is inter-industry, and argue that the tariffs are already low making the TPP unnecessary (e.g., Krugman 2014). However, in reality, the CPTPP would be

necessary economically to promote GVCs based intra-industry trade in the Asia-Pacific, and it would be necessary politically to strengthen regional security with the empowerment of reformist internationalists against conservative hardliners.

Appendix

Certain features hold across both equilibria. First, backward induction indicates that in the last node, on the left branch where the authoritarian state is hardliner, the authoritarian state will escalate the conflict, and on the right branch where the authoritarian state is internationalist, the authoritarian state will back down. Second, suppose that p' is the democratic state's perception of the updated probability that the authoritarian state is internationalist once the democratic state has seen that the authoritarian state has taken an aggressive stance. Then, the democratic state's expected payoff from retaliating is $p'R_D + (1 - p')F_D$, and this will be greater than ACQ_D if p' exceeds a critical threshold $p*$ defined in the following equation: $p^* = \frac{ACQ_D - F_D}{R_D - F_D}$. If $p' > p*$, the democratic state expects that the authoritarian state is more likely to back down if it retaliates, and it will indeed retaliate.[15] If $p' < p*$, then the democratic state expects the authoritarian state more likely to escalate if it retaliates, and hence the democratic state will yield.

In the pooling equilibrium, $p' = p$. If $p > p*$, the democratic state will retaliate, and the authoritarian state will respond by escalating if it is hardliner and by backing down if it is internationalist. If $p < p*$, the democratic state will yield. This equilibrium is a Bayesian perfect equilibrium if and only if $p < p*$. If $p > p*$, the internationalist type of authoritarian state will have an incentive to deviate from taking the aggressive stance given that the democratic state chooses

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[15] If the democratic state's preference ordering is $E_D > F_D > ACQ_D$, then the democratic state has a dominant strategy in choosing to retaliate regardless of the value of p'.

to retaliate. If $p < p^*$, neither the hardliner type nor the internationalist type of authoritarian state has an incentive to deviate from taking an aggressive stance.

In the semi-separating equilibrium, both the authoritarian state and the democratic state randomize their strategy, taking a mixed strategy. Suppose that the hardliner type of authoritarian state will always take an aggressive stance, but that the internationalist type will take an aggressive stance with probability b ($0 < b < 1$) and a cooperative stance with probability $1 - b$.[16] Thus, $p' = \frac{pb}{pb+(1-p)}$. Let r be the probability that the democratic state retaliates. The condition for the semi-separating equilibrium to hold with respect to r is $rB_A + (1 - r)ACQ_A = R_A$. Thus, $r = \frac{ACQ_A - R_A}{ACQ_A - B_A}$. The condition for the semi-separating equilibrium to hold with respect to b is $p' = p^*$, which means $\frac{pb}{pb+(1-p)} = \frac{ACQ_D - F_D}{R_D - F_D}$. Thus, $b = \frac{(1-p)(ACQ_D - F_D)}{p(R_D - ACQ_D)}$.

The probability that the authoritarian state takes the cooperative stance could be denoted ρ_C and defined as: $\rho_C \equiv p(1 - b) = \frac{pR_D - ACQ_D + (1-p)F_D}{R_D - ACQ_D}$. Thus, $\frac{\partial \rho_C}{\partial p} = \frac{R_D - F_D}{R_D - ACQ_D} > 0$ and $\frac{\partial \rho_C}{\partial F_D} = \frac{1-p}{R_D - ACQ_D} > 0$.

The probability that the authoritarian state takes the aggressive stance and the democratic state yields to it could be denoted ρ_Y and defined as: $\rho_Y \equiv pb(1 - r) + (1 - p)(1 - r) = \left(\frac{(1-p)(ACQ_D - F_D)}{R_D - ACQ_D}\right)\left(\frac{R_A - B_A}{ACQ_A - B_A}\right)$. Thus, $\frac{\partial \rho_Y}{\partial p} = \left(\frac{F_D - ACQ_D}{R_D - ACQ_D}\right)\left(\frac{R_A - B_A}{ACQ_A - B_A}\right) < 0$ and $\frac{\partial \rho_Y}{\partial F_D} = -\left(\frac{1-p}{R_D - ACQ_D}\right)\left(\frac{R_A - B_A}{ACQ_A - B_A}\right) < 0$.

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[16] The separating equilibrium is an extreme version of the semi-separating equilibrium, where $b = 0$. However, this equilibrium is not a perfect Bayesian equilibrium. In the separating equilibrium, only the hardliner type of authoritarian state will take an aggressive stance while the internationalist type will always take a cooperative stance. Thus, $p' = 0$ and hence $p' < p^*$; and therefore the democratic state will always yield. However, in this equilibrium, the internationalist type has an incentive to deviate from taking the cooperative stance given that the democratic state will choose to yield. Therefore, there is no separating equilibrium.

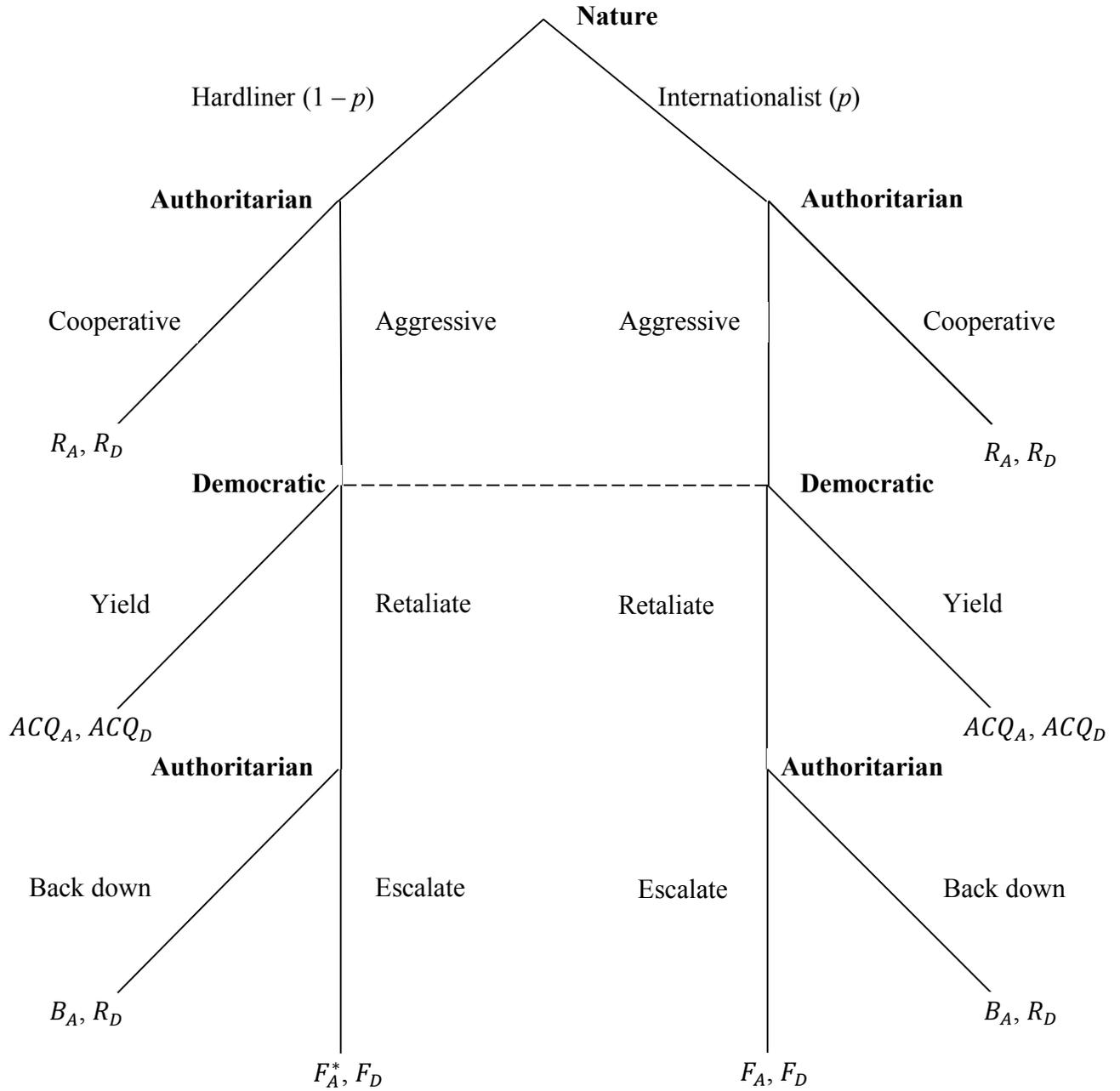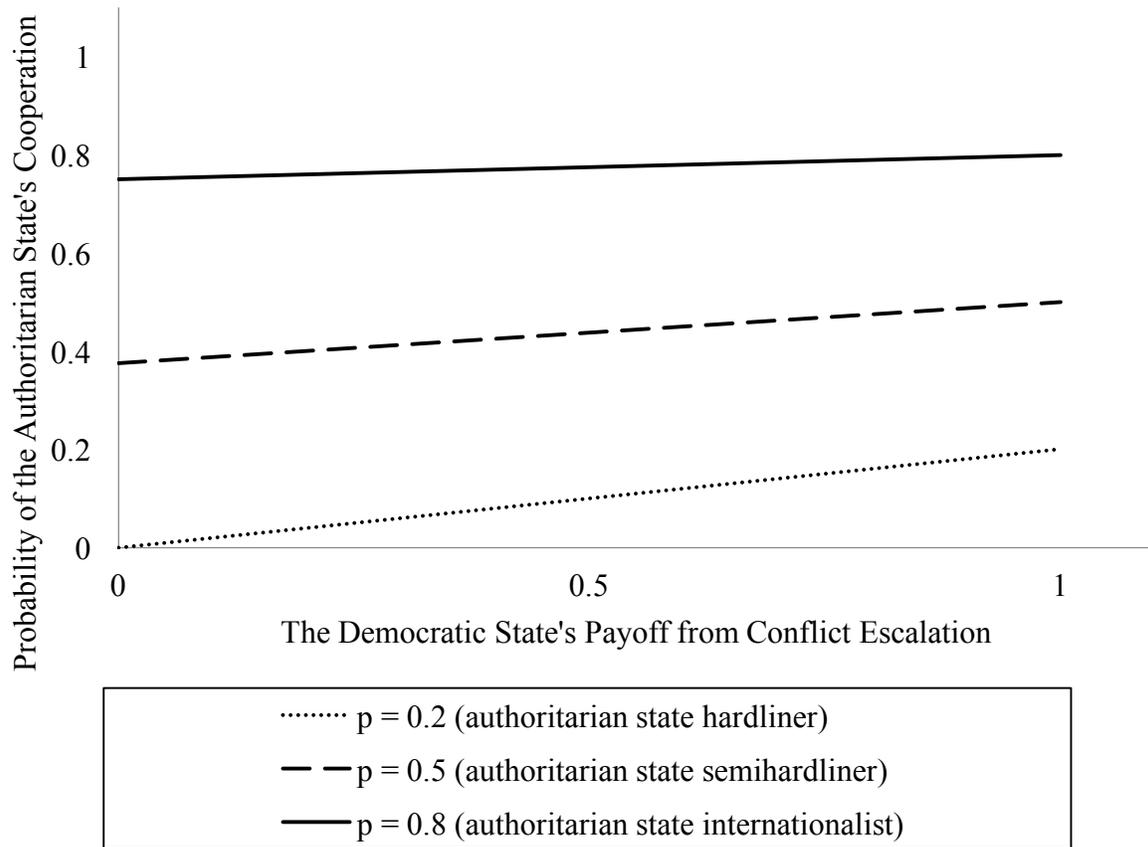**Figure 1.** The incomplete information game

Nature

Hardliner $(1 - p)$

Internationalist (p)

Authoritarian

Authoritarian

Cooperative

Aggressive

Aggressive

Cooperative

R_A, R_D

R_A, R_D

Democratic

Democratic

Yield

Retaliate

Retaliate

Yield

ACQ_A, ACQ_D

ACQ_A, ACQ_D

Authoritarian

Authoritarian

Back down

Escalate

Escalate

Back down

B_A, R_D

B_A, R_D

F_A^*, F_D

F_A, F_D

Figure 2. Probability of the authoritarian state's cooperation

Note: $R_D = 5$ and $ACQ_D = 1$.

Figure 3. Probability of the democratic state's yielding
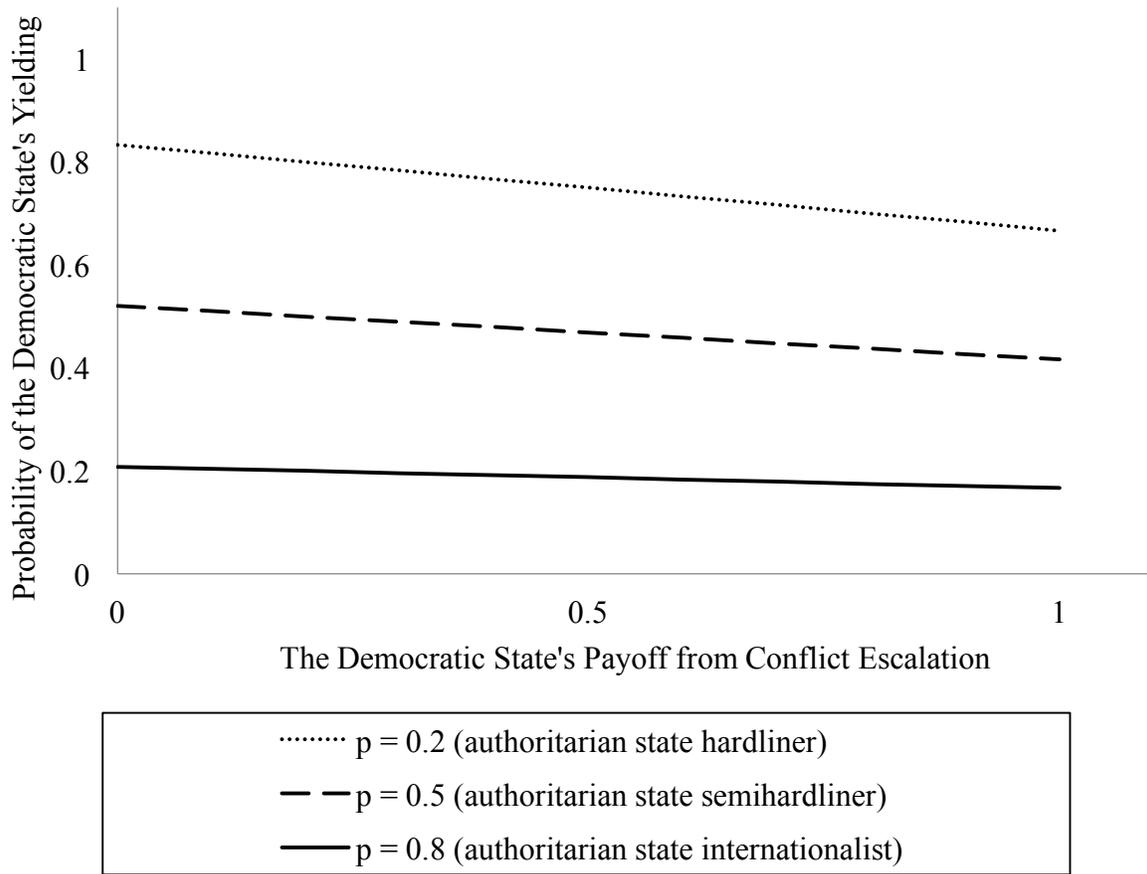
Note: $R_D = 5$, $ACQ_D = 1$, $ACQ_A = 6$, $R_A = 5$, and $B_A = 0$.

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