

The Tiananmen Interlude, 1989-1992 *Assessing China's Motives from Crisis Behavior*

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How the US manages China's rise will be animated by an assessment of the latter's foreign policy motives. Determining actor motives is an extremely difficult task; though taking a theory-guided look at China's behavior during periods of crisis is more likely to reveal fundamental foreign policy preferences. The government's response to the Tiananmen fallout featured two contradictory elements: resistance and opposition, and engagement and reassurance. The conventional wisdom suggests that the policy response was rooted in the Party's desire to restore domestic stability and legitimacy. This paper argues that the domestic explanation is incomplete, and that important external pressures played a prominent role. This paper assesses the relative effectiveness of sanctions and market and competitive pressures in conditioning behavior and changing state policy. Market and competitive pressures do not suffer from the problems that often render sanctions ineffective. The Tiananmen interlude demonstrates how market and competitive economic pressures can work where sanctions fail. Moderate leaders, led by Deng Xiaoping were concerned about reassuring markets and ensuring China's long-term relative competitiveness.

Navigating China's rise is among the most significant foreign policy challenges confronting the US today.¹ As a policy matter, managing China's rise requires a reliable understanding of the state's fundamental foreign policy preferences. The question gets to the heart of the People's Republic of China's (PRC) motives. Understanding them is the most difficult question. It is also the most important because US policy will be determined by an assessment of China's motives.

¹ China's rise is the focus of a large and exciting debate. For a small sample see: Thomas J. Christensen, "Posing Problems without Catching Up: China's Rise and Challenges for US Security Policy," *International Security*, Vol. 25, No. 4 (Spring 2001); Robert S. Ross, "China's Naval Nationalism: Sources, Prospects, and the U.S. Response," *International Security*, Vol. 34, No. 2 (Fall 2009); David C. Kang, "Getting Asia Wrong: The Need for New Analytical Frameworks," *International Security*, Vol. 27, No. 4 (Spring 2003); Alastair Iain Johnston and Robert S. Ross, eds. *Engaging China: The Management of a Rising Power* (New York: Routledge, 1999); Edward Steinfield, *Playing Our Game: Why China's Rise Doesn't Threaten the West* (Oxford: Oxford University Press, 2010); Gerald Segal, "The Coming Confrontation between China and Japan?" *World Policy Journal*, Vol. 10, No. 2 (Summer 1993); Kai He, *Institutional Balancing in the Asia Pacific: Economic Interdependence and China's Rise* (New York: Routledge, 2009); Robert Sutter, *China's Rise in Asia: Promises and Perils* (New York: Rowman & Littlefield, 2005); Martin Jacques, *When China Rules the World: The End of the Western World and the Birth of a New Global Order* (New York: Penguin Press, 2009); Henry Kissinger, *On China* (New York: Penguin Press, 2009); Robert Ross and Zhu Feng, eds. *China's Ascent: Power, Security, and the Future of International Politics* (Ithaca: Cornell Press, 2008); Stefan Halper, *The Beijing Consensus: How China's Authoritarian Model will Dominate the Twenty-first Century* (New York: Basic Books, 2010); Randall Schweller and Xiaoyu Pu, "After Unipolarity: China's Visions of International Order in an Era of U.S. Decline," *International Security*, Vol. 36, No.1 (Summer 2011)

To answer this question, several prominent strategies have been employed. First, motives have been extrapolated from theory. For instance, using offensive realism, Mearsheimer argues that China is out to maximize power with fundamentally revisionist intentions.² This method is sound so long as the underlying theory is right. The second method involves inferring underlying motives from observed policy statements and behaviors. Using this approach, others argue that China is basically a “status-quo” power.³ But this method also suffers from notable problems. First, observed behavior may be consistent with multiple different motives. For example, a “Neo-Bismarckian” strategy of assurance⁴ may be consistent with security, status, or prosperity seeking goals. Second, since Machiavelli we have known that rulers have many incentives to deceive and misrepresent.⁵ Thus, what leaders do or say is not always a reflection of underlying motives.

These pitfalls can be partly remedied by taking a theory-informed look at a state’s behavior in particular crisis situations. Foreign policy crises are dramatic disruptions in normal diplomatic relations in which leaders are forced to make important decisions under pressure. Crises are instances where states may be forced to show their cards, revealing underlying motives and fundamental foreign policy priorities.⁶ They reveal information because what a state does in a crisis situation signals its resolve and determination to prevail in the contest of wills.⁷

² *The Tragedy of Great Power Politics* (New York: W.W. Norton, 2001), Chap. 10

³ David Shambaugh, “China Engages Asia: Reshaping the Regional Order,” *International Security*, Vol. 29, No. 3 (Winter 2004/05); Alistair Iain Johnston, “Is China a Status Quo Power?” *International Security*, Vol. 27, No. 4 (Spring 2003); Margaret Pearson, ‘China in Geneva: Lessons from China’s Early Years in the World Trade Organization’, in Alastair Iain Johnston and Robert Ross, eds. *New Directions in the Study of China’s Foreign Policy*, (Stanford: Stanford University Press, 2006)

⁴ Avery Goldstein, “An Emerging China’s Emerging Grand Strategy: A Neo-Bismarckian Turn?” in G. John Ikenberry and Michael Mastanduno, *International Relations Theory and the Asia Pacific* (New York: Columbia Press, 2003)

⁵ For a recent treatment of the subject see John J. Mearsheimer, *Why Leaders Lie: The Truth About Lying in International Politics* (Oxford: Oxford University Press, 2011)

⁶ This is not always true, particularly where states bluff or test each other’s resolve through brinkmanship games.

⁷ For a useful overview of rationalist theory on signaling, commitment and crisis bargaining see James D. Morrow, “The Strategic Setting of Choices: Signaling, Commitment, and Negotiation in International Politics,” in David A.

Crises are potentially interesting for two reasons. Once involved in a crisis, a state cannot hide and is usually challenged to respond by escalating or acquiescing—crisis forces your hand. Second, because the stakes are higher and the risks of escalation greater, states are more likely to reveal fundamental preferences. Crises force states to signal intentions and resolve under significant political pressure. When blurred, crises help establish where the lines in the sand are.

The post-Tiananmen diplomatic crisis is an important and unique case for several reasons. The incident was the first and perhaps most significant foreign policy crisis in the reform era. Prior to this, Sino-US relations were reasonably good. Kissinger goes so far as to refer to the relationship as a “quasi alliance.”⁸ Tiananmen represented a sudden and surprising rupture in the West’s perceptions of China, and China’s relations with the West. As one State Department specialist put it: “We are no longer dealing with that nice fuzzy China of panda bears... We are now dealing with a big developing garrison state, with few redeeming qualities other than the fact that it sits next to the Soviet Union.”⁹ Second, unlike the Taiwan Strait Crisis, the Tiananmen crisis was not one that the Chinese Communist Party (CCP) initiated for strategic purposes or whose pace it subsequently controlled. The government, caught by surprise, was forced into a bargaining game it never wanted to enter in the first place.

In the days, weeks, and months following the June 4th crackdown, China became the target of international criticism, diplomatic isolation, and a range of economic sanctions. China’s response is puzzling because the CCP pursued a policy of firm opposition to Western political pressure while at the same time pushing for increased commercial integration with the very

Lake and Robert Powell, eds., *Strategic Choice and International Relations* (Princeton: Princeton Press, 1999) Chap. 3

⁸ *On China*, Chap. 8

⁹ Quoted in Thomas Friedman, “Turmoil in China; A Rocky Period Lies Ahead For Washington and Beijing,” *New York Times* (June 10, 1989)

powers that were united against it. The response featured elements of opposition and resistance, as well as engagement and reassurance.

What explains China's puzzling response and what does this tell us about fundamental motives and foreign policy preferences? The conventional wisdom suggests that the CCP's primary motives were to restore internal order and the Party's legitimacy. Nationalism and resistance to foreign interference were used to justify harsh means while also shoring up the Party's legitimacy. An accommodation strategy was necessary to restore the prosperity based social contract upon which post-Mao era single-party rule rested. But this internal explanation is not full satisfactory because rebuilding Party legitimacy on nationalist-ideological foundations was more logical and perhaps less risky. Second, the conventional wisdom ignores important external factors that bring to the fore other fundamental foreign policy motives. In the aftermath of Tiananmen, the CCP was responding to two types of external pressures: sanctions and political pressure, as well as market and economic pressures.

First, China's opposition and resistance to external political pressure can be accounted for by sanctions theory which explains why sanctions usually fail to change a target state's behavior. Often, target states find ways to resist pressure by, for example, fanning nationalism or lessening the impact of sanctions by cooperating with willing third parties. The second aspect of China's response—engagement and accommodation—is more puzzling and underexplored in the literature. It is especially peculiar given that it occurs during a period when China was under significant political pressure. In this article, I argue that the CCP was responding to external economic imperatives and competitive pressures.

Mostly due to a recession, which itself fueled the Tiananmen protests, China's growth rate dropped precipitously in 1989 and 1990. After Tiananmen, China experienced a dramatic

decline in foreign direct investment (FDI); for good reason, investors were jittery about internal stability and the future of the reform and opening policy. Meanwhile, there was concern about continued access to Western markets. Moderates were worried about short-term economic growth and long-term international competitiveness. In addition to the domestic implications of a slowing economy, the leadership was also haunted by a historically rooted fear of falling behind in the struggle for relative power. Beyond the Party's eroding legitimacy, moderates led by Deng Xiaoping, were moved by an overriding concern: sustaining China's mid to long-term relative economic competitiveness and enhancing China's relative power position in the world.

The case supports the conclusion that whereas sanctions are generally ineffective, a fear of falling behind combined with market pressure is fundamentally different. While economic pressure and sanctions both inflict pain, the former is fundamentally different and lacks the features that render sanctions problematic. There is strong theoretical reason to believe that where sanctions fail, market and competitive economic pressures will often succeed in conditioning and altering state behavior. The Tiananmen interlude offers a unique opportunity to examine each in a single case.

The argument unfolds in four parts. First, I will discuss the CCP's puzzling post-Tiananmen response. Second, the article reviews economic sanctions theory and compares it to the theory of market and competitive pressure, exploring important differences between the two. This section leads to the last, which will examine how the expectations of each theory played out in this case. The article will conclude by returning to the question of foreign policy motives, offering four lessons for US policymakers concerned about managing a rising and potentially assertive China.

The Puzzling Nature of China's Response

In the aftermath of Tiananmen, China's leadership faced two problems: one internal and another external. Internally, the Party needed to restore stability while restoring its legitimacy.

Externally, the Party confronted a highly critical international community. China's policy course is puzzling because it featured contradictory elements. On the one hand, the response was confrontational. Leaders appealed to nationalism, drawing on China's historical narrative rooted in the 'Century of Humiliation', in order to shore up legitimacy and resist foreign pressure. On the other hand, moderates within the CCP were eager to further engage the West. The goal of China's policy was to oppose and accommodate, resist and reassure.

On the eve of June 3, 1989, the leadership could have scarcely anticipated the world's reaction to the Tiananmen crackdown. The memorable image of the lone "Tank Man," firmly holding his ground as he obstructed the path of a long column of tanks, captured the front page of countless Western newspapers and with them the sympathies and imaginations of the world. This individual came to symbolize the struggle against tyranny and oppression, galvanizing public opinion against the CCP. Overnight, Deng Xiaoping had gone from an admired reformer to the "Butcher of Beijing."

In the weeks following the crackdown, Western governments moved to impose a range of sanctions known as the "Tiananmen Sanctions." Immediately, President Bush moved to suspend all arms sales and military contacts with China. A few weeks later, the administration suspended all high level government exchanges and announced that it would not support China's bids for new loans from international institutions, most notably the World Bank. At about the same time Japan announced that it was suspending negotiations on a multi-billion dollar loan scheduled to go in effect in the spring of 1990.

In late June, European countries moved to impose sanctions. Arms sales were banned, high level contacts suspended, and new economic projects and World Bank loans were postponed. In early July negotiations on China's accession to the General Agreement on Tariffs and Trade (GATT) were postponed. In mid July the G-7 summit made the individual sanctions multilateral: the collective response was to sever high level contacts and postpone World Bank review of new loans, while disbursement of existing loans would continue.

From the beginning, members of the US Congress pushed for the suspension of most-favored nation (MFN) status, a move that would have dramatically decreased the competitiveness of Chinese goods on the American market. Later, the question of MFN status would become the centerpiece of candidate and President Clinton's efforts to link the trade and human rights issues, with central focus on the treatment and detainment of dissidents. The failed linkage strategy was ultimately abandoned in 1994.

As a result of the crackdown, China faced diplomatic isolation, strong international criticism, and a range of sanctions. The CCP felt itself under a concerted Western assault. Though not an impending military threat, Western policy undermined China's national interests to be sure, and represented a challenge and threat to the Party's rule. The perceived threat stemmed from multiple sources.

After Tiananmen, the Party believed that its hold on power was being threatened by internal instability fomented, if not orchestrated, by the West. The belief was that Western powers were carrying out a short-term strategy of creating trouble by supporting and encouraging subversive elements. The long-term strategy was to bring about a peaceful overthrow of socialist rule through gradual capitalist evolution. The Tiananmen turmoil and the Western response to the government's efforts to restore order were a powerful confirmation of

these fears. According to conservatives, economic cooperation and Western style reforms were equivalent to sleeping with the enemy: the act itself was morally corrupting and socially degrading. The effects of these seeds threatened to destroy Chinese socialism altogether. In this way, China's internal and external problems were in fact seen as related and linked.

In the eyes of the CCP, sanctions crystallized the view that whatever China's dealings with the Western powers, their intentions were ultimately not benign. The US led coalition was bent on keeping China down. The West did not accept the CCP's right to rule. Their ultimate goal was to encourage and support regime change. The only way the CCP could guard itself against Western subversion and interventionism was through strength and vigilance and a renewed focus on "political thought work."

Whether accurate or not, leaders sensed heightened external interference reminiscent of the century of humiliation. As some observers recognized, the parallels were quite striking. The cast of oppressors—US, UK, France, Russia, Japan, Germany—were largely the same. Conservatives believed that the imperial powers were again interested in exploiting markets for gain and controlling China's fate by undermining internal rule. Whereas in the 19th century the imperial powers brought Christianity, this time the religion was liberalism and capitalism. The underlying motives, greed and "hegemonism", were the same.

The Soviet Union's shift westward in the mid-1980s, and later the collapse of communism, one regime after another, was viewed with concern. Particularly alarming was Ceausescu's violent overthrow in Romania. Communism was under fire—or perhaps actively burning—and the CCP was feeling the heat. As seen from Beijing, the Cold War containment policy, which appeared to have contributed to the collapse of the USSR, was now being

redirected toward China. The balance of power imperative that had moved the US and China closer was fast disappearing.

While an internal power struggle raged within the CCP itself, there was broad consensus among moderates and conservatives that Western interference was partly to blame. On June 9, 1989 Deng declared that the incident was “the inevitable result of the domestic microclimate and the international macroclimate.”¹⁰ Later, he explained that “In inciting unrest in many countries, they [Western countries] are actually playing power politics and seeking hegemony. They are trying to bring into their sphere of influence countries that heretofore they have not been able to control.”¹¹

Conservatives, led by the likes of Li Peng and Yao Yilin, used the opportunity to launch an assault on reform and opening. Deng famously explained how when windows were opened, some flies would invariably get in. Tiananmen confirmed that more than just flies were getting in. This assessment warranted a more hard-line response and fundamental reevaluation of China’s relations with the West. If the imperialist powers were fomenting trouble and bent on undermining CCP rule, the logical solution would be to roll back reform and opening and withdraw into greater international isolation while at the same time resisting foreign pressure.

Even as Deng agreed with conservatives that the outside world was bent on undermining China’s government, he remained strongly committed to the policy of reform and opening. For example, in a June 26th talk with the Central Committee, Deng warns that the PRC is under attack by the “Western imperialists” and the “media worldwide” but goes on to explain how “economic development should not slow down.”¹² Moderates led by Deng agreed with party

¹⁰ Quoted in Joseph Fewsmith, *China Since Tiananmen: The Politics of Transition* (Cambridge: Cambridge University Press, 2001), p. 22

¹¹ Excerpt from a December 1989 talk. *Selected Works*, vol. 3, p. 335-36

¹² *Selected Works*, vol. 3, pp. 302-4

leftists regarding the threat that Western subversion and interference posed, but disagreed on the policy course to be pursued in response. While the CCP strongly resisted political pressure, moderates led by Deng were also eager to forge ahead with reform and opening and increase economic cooperation with the West.

The conventional wisdom suggests that the CCP's contradictory policy can be explained by the exigencies of the domestic political situation. There were two problems: restoring order and securing the Party's legitimacy. The military crackdown was necessary to end the "turmoil" and restore order. Framing its policy as a response to subversive capitalist elements in society, as well as external interference by the imperialists, enabled the leadership to justify harsh measures and divert criticism. In this way, appealing to nationalism was a strategy designed to shield the Party from criticism by serving to justify a harsh response.

Second, according to the internal explanation the Party's ideological sources of legitimacy had been steadily eroding in the post-Mao era. As Robert Sutter argues, "Recognizing that communist ideology was not popular enough to support their continued monopoly of power, leaders in Beijing played up more traditional themes of Chinese nationalism to support their rule."¹³ Meanwhile, high inflation and a severe recession had contributed to the discontent that fueled mass demonstrations. During the crisis, ideology and prosperity were less appealing, forcing the Party to turn to nationalism in an effort to restore legitimacy.

But why was China eager to reconcile and "de-isolate" itself?¹⁴ The internal explanation again refers to the Party's legitimacy deficit. Deng was convinced that the Party could survive only if it continued to deliver strong growth. Referring to the Party's legitimacy, he asked "Why

¹³ *Shaping China's Future in World Affairs: The Role of the United States* (Boulder, Co: Westview Press, 1996), p. 33

¹⁴ Jean-Pierre Cabestan, "How China managed to de-isolate itself on the international stage and re-engage the world after Tiananmen," in Jean-Philippe Beja, ed. *The Impact of China's 1989 Tiananmen Massacre* (New York: Routledge, 2011)

do the people support us? Because over the last ten years our economy has been developing and developing visibly.”¹⁵ Declining growth rates were a “political problem” for the CCP. If the Party delivered strong growth it would “stand firm as Mount Tai.” Should it fail, it would find itself in a “blind alley.” The fate of the Party was tied to growth; the fate of growth was tied to the policy of opening and reform.

The conventional wisdom suggests the CCP’s policy is primarily motivated by an interest in maintaining one-party rule. Though maintaining power is fundamental, this explanation is not fully satisfactory. The Party had essentially two options: first, it could restore legitimacy by emphasizing Chinese nationalism and communist ideology; or second, it could move forward with Deng’s prosperity based social contract. It is not at all clear why the second would emerge as the logical or politically necessary choice.

First, Deng’s authority had been weakened by high inflation and a severe recession that contributed to the Tiananmen unrest. During the 1980s Deng successfully reinterpreted Maoist thought because his pragmatic reforms were delivering results. The economic downturn challenged the soundness of the reform policy while the unrest confirmed that the policy had triggered socio-political trends that threatened to destroy socialism altogether. Reform and opening was vulnerable because it had not become consolidated as the reigning orthodoxy. The 1980s—in sharp contrast to the post-1993 era—were a period marked by significant ideological divisions within the Party epitomized by the tension between Deng Xiaoping and Chen Yun. As Legro has argued, an emerging orthodoxy’s collapse is likely when the social expectations generated by a policy idea are disconfirmed by critical events.¹⁶ Thus, the recession and protests severely undermined reform and opening and the Party’s legitimacy as rooted in prosperity. It is

¹⁵ *Selected Works*, vol. 3, p. 342

¹⁶ Jeffrey Legro, *Rethinking the World: Great Power Strategies and International Order* (Ithaca: Cornell University Press, 2005)

perfectly plausible, as it was politically likely, that legitimacy would be restored on more ideological-nationalistic grounds.

Second, in the aftermath of Tiananmen the Party did fan the flames of nationalism. The nationalist political narrative is very much rooted in the Century of Humiliation. Under the CCP's leadership China has "stood up", never to be bullied by the imperial powers again. Appealing to nationalism meant that the Party would be creating hostility toward the West and an expectation that the leadership would pursue a hard-line posture. In this way, the nationalistic response created audience costs that would constrain the Party's policy in a way that could damage reform and opening. The nationalistic response built momentum against reform and the Party's prosperity based legitimacy. This was risky.

Third, the conventional wisdom assumes that ideology could no longer serve as the fountainhead of legitimacy. But ideology was far from dead in 1989. Though Deng had moved the Party in a less ideological and more pragmatic direction, he had done so by reinterpreting Mao's political thought in a way that created ideological space for a reformist policy. Pragmatism was justified as "seeking truth from facts"; market oriented reforms were labeled "socialism with Chinese characteristics"; while reform and opening became "revolutionary" acts. These theoretical interpretations were by no means uncontroversial and uncontested. But the point is simply this: though revolutionary ideology was the principal source of legitimacy during the Mao years, ideology was by no means dead during the early years of the reform era. Perhaps quite easily, more orthodox interpretations of Maoist ideology could have been reestablished after Tiananmen, as indeed conservatives aimed to do. One of the principal long-term solutions to the corrupting influence of capitalist forces, advocated by Deng himself, was to refocus on "ideological work", devoting large amounts of resources to propaganda.

If securing one-party rule was the sole motivation, it remains puzzling why the more theoretically coherent nationalist-ideological track did not succeed. From the standpoint of party rule, the opposition-engagement strategy was more risky. An engagement and accommodation policy toward the West undermined the Party's nationalist credentials. How could the Party claim to be tough when they were also trying to reassure and engage the West? Moreover, an accommodation policy would permit a continuation of the West's pernicious policies of fomenting internal disorder and encouraging a peaceful evolution toward capitalist democracy. These conservative sentiments were on full display during the purging of Zhao Ziyang. Wang Renzhong's remarks are indicative: "In foreign policy he [Zhao] bowed to anti-communist, antisocialist forces and their peaceful evolution attacks, and at home he let the dream of a bourgeois republic created by his liberal brain trust go to his head."¹⁷

In assessing China's fundamental motives, the internal explanation is not fully satisfactory because legitimacy could have been reestablished on prosperity or ideological grounds. Prosperity had been discredited to a significant extent while ideology was far from dead. From a domestic politics perspective, reestablishing legitimacy on nationalist-ideological grounds would have been more coherent and perhaps less risky.

When viewed from a historical distance, the unfolding of particular events is always less puzzling than when viewed up close as they unfold. But in the wake of Tiananmen a great deal of confusion prevailed. Among policymakers and China observers things appeared to be at an uncertain "crossroads".¹⁸ During the Tiananmen interlude it was by no means clear who was in charge and whether Deng's reform agenda could be revived. Above, I have argued that while

¹⁷ Remarks made at an enlarged meeting of the Politburo on June 19th. See, Andrew Nathan and Perry Link, eds. *The Tiananmen Papers* (New York: Public Affairs, 2002) p. 434

¹⁸ David M. Lampton and Alfred D. Wilhelm, *United States and China Relations at a Crossroads* (Lanham, MD: University Press of America, 1995)

legitimacy and domestic stability are extremely important policy motives, these do not adequately account for the contradictory and puzzling nature of the CCP's response. In addition to the various domestic pressures, the Party was also responding to two different kinds of external forces: sanctions and economic pressure. After exploring theories of sanctions and economic pressure, I will consider whether these explanations give added insight into the CCP's motives.

Economic Sanctions versus Market Discipline: a theoretical discussion

Both sanctions and economic pressure involve the infliction of pain on a state. States experience this pain because both sanctions and market pressures can harm economic growth. The important question is whether these mechanisms of discipline are effective in changing or conditioning a government's behavior, especially when important political interests are at stake.¹⁹ Because theories of economic sanctions and financial statecraft are more developed, it is useful to draw on these insights in formulating a theory about the disciplining effect of the international economic structure.

In general, economic sanctions are not very effective in forcing targets to make desired concessions.²⁰ Even proponents concede that sanctions are at best partially effective in this

¹⁹ For literature on sanctions and financial statecraft see: Daniel Drezner, *The Sanctions Paradox: Economic Statecraft and International Relations* (Cambridge: Cambridge Press, 1999); Otto Wolff von Amerongen, "Economic Sanctions as a Foreign Policy tool?" *International Security*, Vol. 5, No. 2 (Autumn 1980); David Baldwin, *Economic Statecraft* (Princeton: Princeton Press, 1985); Elizabeth Rogers, "Using Economic Sanctions to Control Regional Conflicts," *Security Studies*, Vol. 5, No. 4 (Summer 1996); Jonathan Kirshner, *Currency and Coercion: The Political Economy of International Monetary Power* (Princeton: Princeton Press, 1995); Kimberly Ann Elliott, "The Sanctions Glass: Half Full or Completely Empty?" *International Security*, Vol. 23, No. 1 (Summer 1998); Robert Pape, "Why Economic Sanctions Do Not Work" *International Security*, Vol. 22, No. 2 (Fall 1997); Lisa Martin, *Coercive Cooperation: Explaining Multilateral Economic Sanctions* (Princeton: Princeton Press, 1992); Jon Hovi, Robert Huseby and Detlef Sprinz, "When Do (Imposed) Economic Sanctions Work?" *World Politics*, Vol. 57, No. 4 (July 2005); Jean-Marc Blanchard and Norrin Ripsman, "Asking the Right Questions: When Do Economic Sanctions Work Best?" *Security Studies*, Vol. 9, No. 1 (1999)

²⁰ Literature on economic sanctions and financial statecraft suggests that these methods of coercion are rarely effective. Robert Pape, "Why Economic Sanctions Do Not Work"; Benn Steil and Robert Litan, *Financial Statecraft: The Role of Financial Markets in American Foreign Policy* (New Haven: Yale Press, 2006); David

regard, most successful when used in conjunction with other strategies and toward limited objectives.²¹ A few caveats: It is important to note that sanctions are more effective at the threat phase.²² Second, while sanctions may fail to “rehabilitate” they may succeed in other objectives including punishment, deterrence, or condemnation.²³ Sanctions may succeed in weakening a target state.²⁴ Finally, they may also have international symbolic and/or domestic political value.²⁵ The following analysis shows that the elements that render economic sanctions less effective are absent in the case of market and competitive pressure, supporting the claim that they may be more effective in altering state behavior.

ECONOMIC SANCTIONS

Economic sanctions are designed to inflict pain in order bring about a shift in a target states behavior. Sanctions are coercive, involving what Thomas Schelling calls “compellence.”²⁶ Pain is inflicted—sometimes increasing amounts of pain—until the target state submits to the will of the sanctioning power and makes desired concessions. Typically, economic sanctions take the form of trade and financial restrictions.

Economic sanctions, and financial statecraft more generally, are problematic for a number of reasons. First, nationalism most often causes states, and the societies they govern, to

Andrews, “Monetary Power and Monetary Statecraft,” in Andrews, ed. *International Monetary Power*; A. Cooper Drury, “Revisiting Economic Sanctions Revisited,” *Journal of Peace Research*, Vol. 35, No. 4 (1998); Daniel Drezner, *The Sanctions Paradox*

²¹ Kimberly Ann Elliott, “The Sanctions Glass: Half Full or Completely Empty?” *International Security*, Vol. 23, No. 1 (Summer 1998); Richard Haass, ed. *Economic Sanctions and American Diplomacy* (New York: Council on Foreign Relations, 1998);

²² Daniel Drezner, “The Hidden Hand of Economic Coercion,” *International Organization* 57 (Summer 2003); Dean Lacy and Emerson Niou, “A Theory of Economic Sanctions and Issue-linkage: The Roles of Preferences, Information and Threats,” *Journal of Politics*, Vol. 66, No. 1 (2004)

²³ Gary Hufbauer, Jeffrey Schott, Kimberly Ann Elliott, and Barbara Oegg, *Economic Sanctions Reconsidered* 3rd ed. (Washington: Peterson Institute, 2007)

²⁴ George Lopez and David Cortright, “Containing Iraq: Sanctions Worked,” *Foreign Affairs* (July-August 2004)

²⁵ James Lindsay, “Trade Sanctions as Policy Instruments: A Re-examination,” *International Studies Quarterly*, Vol. 30, No. 2 (1986)

²⁶ *The Strategy of Conflict* (Cambridge: Harvard Press, 1960), p. 195

be willing to endure lots of pain. Mussolini's response to League sanctions in 1935 is indicative: "To sanctions of an economic character we will reply with our discipline, with our sobriety, and with our spirit of sacrifice."²⁷ Whereas sanctions may be designed to destabilize a government, because rulers can point to an external "enemy" they may in fact solidify their position as a result of economic pressure—a "rally around the flag" effect. It is imaginable that sanctions may in fact have the opposite effect to that intended: instead of weakening the target, they may increase resolve and the regimes hold on power.²⁸ Examples ranging from Cuba to Iran suggest that this tendency is not uncommon.

Second, states have a variety of strategies at their disposal—like substitution and conservation—that help them mitigate the effects of sanctions.²⁹ Consider how Iran tightened its belt by ending its \$100 billion annual oil, gas, and electric subsidies in order to change consumer habits.³⁰ Moreover, if a sanctions regime is not multilateral, and alternative partners are available, it is likely that states can simply take their business elsewhere, even if doing so is costlier in the end.³¹ In response to the US embargo, Cuba moved closer to the Soviet Union.³² After rejecting the 1968 Non-Proliferation Treaty (NPT), the US ceased the supply of fuel to the Indian reactor at Tarapur. Thereafter, India turned to France for nuclear fuel. Today, even as the West is trying to isolate Iran, the regime has moved to strengthen its ties with energy starved emerging powers like China, Turkey, and Brazil.

²⁷ Quoted in Gary Hufbauer, Jeffrey Schott, Kimberly Ann Elliott and Barbara Oegg, *Economic Sanctions Reconsidered* 3rd ed. (Washington: Peterson Institute, 2007), p. 8

²⁸ Pape, "Why Economic Sanctions Do Not Work," pp. 106-107

²⁹ States can also evade sanctions by using "middle men" and setting up front companies.

³⁰ "The regime tightens its belt and its fist," *The Economist* (January 15, 2011)

³¹ As Daniel Drezner has argued, the ability of creditor countries to leverage debtor countries is limited to the extent that alternative creditors are available. Compellence strategies are likely to be more effective if undertaken through institutionalized multilateral cooperation. Drezner, "Bad Debts: Assessing China's Financial Influence in Great Power Politics," *International Security*, Vol. 34, No. 2 (Fall 2009); also, Drezner, "Bargaining, Enforcement, and Multilateral Economic Sanctions," *International Organization*, Vol. 54, No. 1 (Winter 2000); Lisa Martin, *Coercive Cooperation*

³² Susan Kaufman Purcell, "Cuba" in Haass ed. *Economic Sanctions and American Diplomacy*

In general, authoritarian societies are able to “hunker down” and resist.³³ There is also reason to believe that resource rich rogue states have more options. Europe’s dependence on Russian energy gives the latter some degree of leverage and freedom of maneuver in relation to the former. This fact, for instance, greatly complicated the West’s response to the 2008 invasion of Georgia. The West was largely forced to resort to soft measures including diplomatic isolation and threatening to withhold membership in important commercial institutions like the World Trade Organization (WTO). Despite vocal opposition and expressions of solidarity—John McCain’s notable “Today, we are all Georgians” remark—hard support for this important democratic partner was not forthcoming.

Even where a state is forced to sustain a blow, the regime can sometimes succeed in allocating the burden of sanctions in ways that are least harmful and destabilizing to the government; often, opposition groups and lower classes bear the brunt of the pain. The sanctions regime imposed on Saddam Hussein’s Iraq, lasting nearly 13 years, was widely criticized for its harsh impact on the populace. With the hundreds of thousands of children believed to have died prematurely in mind, Denis Halliday, the UN humanitarian coordinator for Iraq put it bluntly: “We are in the process of destroying an entire society. It is as simple and terrifying as that.”³⁴ Though sanctions may have frustrated a military buildup, Saddam’s Baath Party and elite cronies were largely untouched by the economic misery plaguing the masses.

Finally, sanctions and financial statecraft are likely to be effective only where large asymmetries exist; that is, in cases where the target is unable to retaliate with painful measures of its own. As Drezner notes, “There is little precedent for great powers being able to

³³ Richard Haass, “Conclusion: Lessons and Recommendations,” in Haass, ed. *Economic Sanctions and American Diplomacy*

³⁴ Quoted in David Rieff, “Were Sanctions Right?” *New York Times Magazine* (July 27, 2003)

asymmetrically punish other great powers.”³⁵ Great power interdependence nullifies the attractiveness of financial statecraft and economic sanctions as a coercive policy tool. Where asymmetries are less pronounced or where interdependence is greater, sanctions are likely to be costly for both the target as well as the sanctioning state.

For the above reasons, economic sanctions usually fail to bring about desired changes in the target state’s behavior. There is theoretical reason to believe that economic sanctions will usually be met with strong resistance and defiance by the target state.

MARKET DISCIPLINE AND COMPETITIVE PRESSURE

The international economic structure conditions state behavior through two general mechanisms: market discipline and diffuse competitive pressure. Market discipline operates by impacting the short to mid-range economic prospects of a state. Diffuse competitive pressure conditions behavior because states are concerned about long term relative competitiveness and power. I will review each of these in turn.

Capital movements rose dramatically when governments, led by the countries of the Organization for Economic Cooperation and Development (OECD), began to relax capital controls in the late 1970s and 1980s. Since, an explosion of capital movement has taken place. There are two principal categories of foreign capital: portfolio investment and foreign direct investment (FDI). The former, including stocks, bonds, and equities are commonly referred to as “hot money” because of the ease with which these are bought and sold. FDI involves investment by multi-national corporations (MNCs) on foreign soil, factories, infrastructure projects, and so on. These are investments that cannot be withdrawn at the click of a mouse. These investments take time to plan and involve a more long-term commitment. For these reasons, governments

³⁵ “Bad Debts,” p. 19

typically value FDI more than short-term portfolio investment, which is more subject to the whims and vagaries of speculative investors.

Since the 1980s total FDI and portfolio flows have increased dramatically. For instance, portfolio inflows increased from about \$21 billion in 1985 to \$912 billion in 2005. Volumes of foreign direct investment exhibit a similar trend.

World total, portfolio equity net inflows (in billions of current US dollars) 1985-2005³⁶

1985	1990	1995	2000	2005
21.5	4.5	127	740	912

Source: International Monetary Fund, Balance of Payments database, and World Bank, Global Development Finance.

World total, selected indicators of FDI (billions of dollars) 1982-2005

	1982	1990	2004	2005
FDI inflows	59	202	711	916
FDI outflows	28	230	813	779

Source. UNCTAD, *World Investment Report 2006*

The growth in capital flows has been a dramatic trend in the post-Cold War stage of globalization.

For some time we have known that the market acts as a prison that disciplines policymakers. Markets discipline governments because policymakers are generally concerned about the state of their economies.³⁷ Capital mobility refers to the ease of movement of capital across national borders. The greater the volume of capital flows, and the fewer restrictions on such mobility, the greater the disciplining effect this has on states. The literature on capital

³⁶ Portfolio equity includes net inflows from equity securities other than those recorded as direct investment and including shares, stocks, depository receipts (American or global), and direct purchases of shares in local stock markets by foreign investors. Data are in current U.S. dollars.

³⁷ Charles Lindblom, "The Market as Prison," *The Journal of Politics*. Vol. 44, No. 2 (May 1982)

mobility—the ‘capital mobility hypothesis’ in particular—has arrived at several important conclusions. Mobile capital is a structural feature of the international system that disciplines states.³⁸ It is a systemic structural property in the Waltzian sense because it “systematically constrains state behavior by rewarding some actions and punishing others.”³⁹ Capital mobility is an enduring property of the international system. As Andrews argues, “The practical difficulties confronting individual governments attempting to limit or reduce capital mobility (or its policy effects) provide the most substantive rationale for treating this phenomenon as a structural feature of the international system.”⁴⁰ This structure conditions state behavior by leading some strategies to dominate over others. It pulls states by rewarding them; it pushes them by punishing them. Finally, it leads dissimilar states to behave in similar ways.⁴¹

Portfolio investment, or so called ‘hot money’, has an almost immediate disciplining effect. Because of the ease with which such money moves, capital flight can have an almost immediate effect. The rapid and at times devastating impact of such movement was experienced in the late 1990s during the Asian financial crisis and in many European countries today. The disciplining effect of foreign direct investment is less immediate. FDI involves foreign companies making long-term investments in the target country. These investments and commitments are not easy to liquidate. The disciplining usually manifests in a dramatic slowdown in FDI inflows because companies are reluctant to make new long-term investments.

³⁸ David Andrews, “Capital Mobility and State Autonomy: Toward a Structural Theory of International Monetary Relations,” *International Studies Quarterly*, Vol. 38, No. 2 (Jun 1994); John Goodman and Louis Pauly, “The Obsolescence of Capital Controls? Economic Management in an Age of Global Markets,” *World Politics*, Vol. 46, No. 1 (Oct 1993); Michael Webb, “International Economic Structures, Government Interests, and International Coordination of Macroeconomic Adjustment Policies,” *International Organization*, Vol. 45, No. 3 (Summer 1991); Adam Baines, “Capital mobility and European financial and monetary integration: a structural analysis,” *Review of International Studies* 28 (2002); David Andrews, ed. *International Monetary Power* (Cornell University Press, 2006)

³⁹ Andrews, “Capital Mobility and State Autonomy,” p. 197

⁴⁰ Ibid. pp. 197-98; also, Cohen, “Phoenix Risen: The Resurrection of Global Finance,” *World Politics* 48 (1996)

⁴¹ According to Waltz, this is a basic systemic structural effect. *Theory of International Politics* (Reading: Addison Wesley, 1979) pp. 69-73

Hence, a drop in FDI has a harmful impact on the mid to long-term economic wellbeing of a country.

Second, the global capitalist order conditions behavior because states value relative power and are concerned about long-term competitive prospects. States are primarily moved by an interest in growing their economies and a fear of falling behind in the contest for relative power. For the so called rising powers—most notably Turkey, India, China, and Brazil—growing power and status rest on economic foundations. Their economic rise has in turn been driven by successful integration into the liberal capitalist international order. Political leaders spend time thinking about long-term relative power trajectories. States that fail to do the right things simply ‘fall by the wayside,’ or experience losses in relative strength. The international economic structure punishes states that opt out—fail to liberalize and integrate—by simply leaving them behind.⁴²

For many countries, whose economic strength and power are increasingly tied to the global economy, disruptions to these commercial relations threaten the state’s long-term competitive prospects. Isolation and autarky are self-defeating in so far as these strategies will lead to an unacceptable loss in relative competitiveness. Excluded outsiders do not have access to the ‘network’ benefits of the capitalist order. Network benefits—foreign direct investment and market access—have been key ingredients contributing to the economic success of emerging powers. To the extent that states worry about falling behind, they are likely to be mindful of competitive economic pressure, especially if their economic strength heavily depends upon FDI and foreign markets. In this way, continuing economic integration and commercial relations can be expected to assume a high priority in the state’s foreign policy calculus.

⁴² The logic of system-level competitive pressure is developed in Author (forthcoming)

Because of the above causal mechanisms the global capitalist economic structure has immediate, mid-range, and long-term disciplining effects. The disciplining effect will always depend upon the specific country and is likely to vary over time. For example, ‘hot money’ was not a factor in post-Tiananmen market discipline, whereas FDI and long-term competitive pressures were more prominent. Overall, the disciplining effect is likely to be greater wherever states are more deeply integrated into the commercial order.

There are important theoretical differences between economic sanctions and economic pressures, a matter taken up next.

THEORETICAL DIFFERENCES

In general, states wish to avoid economic harm. Although financial statecraft and economic sanctions are plagued by various problems, market and competitive pressures differ in fundamental respects. First, there is no sanctioning agent. For example, states feel competitive pressure when they are experiencing slower growth than rivals. The suffering state does not necessarily have to be a target. Sometimes it has fallen victim to its own folly and mismanagement—as for example the Soviet Union was brought to its knees by gross mismanagement of industry and agriculture. Alternatively, a state may be falling behind because others are doing things more successfully. Consider how ‘network externalities’ function. Network externalities are pressures created, often unintentionally, as a byproduct of the interaction of multiple players. Consider how a state excluded from the World Trade Organization may be disadvantaged in terms of market access and investment. Excluded outsiders may be disadvantaged not necessarily because they are targeted, but simply because they find themselves on the outside.

Market pressure is also diffuse. The government is not able to manipulate nationalist passions against the “market”—or countless multinational corporations (MNCs), individual investors, firms, and banks from around the globe—in the same way it can demonize an aggressor state or coalition of states. The disciplining is fundamentally different in that there is no agent at which the targeted state can direct its propaganda machine. Because leaders cannot place blame an important diversionary tool is not available.

Second, the standard bag of tools that may be effective in combating an economic sanction are likely to be less effective in the case of market pressure. When a state experiences capital flight or in cases where foreign investment dries up, this usually has a direct impact on that state’s productive industries—the heart of the economy. It is likely to stultify growth in a rather direct manner by slowing down the development and expansion of various sectors. In cases where market response and international political isolation converge, the suffering state’s options for relief may be quite limited. The International Monetary Fund (IMF) stepped in to stave off contagion and assist a number of economies during the 1997-98 Asian financial crisis; the international community is unlikely to be sympathetic to the difficulties experienced on account of an pariah’s own reprehensible political behavior.

Third, target states can try to combat sanctions by building cooperative partnerships with third parties. In the case of market discipline, this is rarely an option. As Thomas Friedman observes, investors often exhibit a kind of herd mentality.⁴³ Whereas sanctions may give third parties a window of opportunity to cooperate with the target, market pressure often results in snowballing to the disadvantage of the suffering state. Partly this is a psychological phenomenon as a panicked individual may lead observers to panic regardless of whether they are actually aware of the initial cause of distress. But partly it is because the return on investment often

⁴³ *The Lexus and the Olive Tree* (New York: Anchor Books, 2000), Chap. 7

depends on the amount of investment taking place and the overall level of confidence in the market. The problem in Europe today is that even solvent countries like Italy have fallen victim to a general loss of confidence stemming from the EU's inability to manage Greece's debt crisis.

Fourth, whereas the burden of sanctions can in some instances be shifted onto the opposition or the disenfranchised, market pressure is likely to hurt the rich as well as the poor. Market pressure is likely to inflict pain on the upper precisely because it often strikes at a country's leading industries. This may cause more direct pressure on the ruling coalition by turning elites against it.

Fifth, even as the government is likely to experience pressure from elites, it is also likely to feel the heat from the masses. The primary way governments can counter popular pressure is by fanning nationalism. Where there is no sanctioning agent, governments are likely to be blamed for their country's economic woes, as the Tiananmen protests were fueled by discontent resulting from a recession and high inflation. Recently, governments in Tunisia, Egypt, and Libya have been brought to their knees in great part for failing to deliver prosperity. The crucial point here is that in the case of economic failures, the people are likely to focus their collective frustrations on the government and not a foreign oppressor.

Sixth, in the case of market discipline, deterrence does not matter. While less integrated and resource rich states are more immune to the effects of market pressure, governments cannot (or do not) retaliate against markets. Governments do not deter foreign investors by threatening to hurt them. Great powers that can harm each other can deter each other; markets and governments can also harm each other. But governments have no incentive to hurt markets and are incapable of deterring them.

Finally, whereas sanctions are unlikely to be effective against a Great Power, market and competitive pressures are fundamentally different. Among the leading powers, competition for relative power is always acute. Where they begin to lag, strong states will be moved by a fear of falling behind. Market pressure is no different: even strong states watch the markets closely, knowing that they can wreak tremendous havoc on a country's strength and wellbeing. This is why powerful governments routinely pursue fiscal and monetary policies designed to restore confidence.

The causal logic of sanctions also differs from the causal logic of market discipline. In a successful case of sanctions, the expected outcome is a policy concession. The target state acquiesces to the demands and conditions of the sanctioning state or coalition. In the case of market discipline, the expectation is slightly different. Sometimes governments and markets are concerned about similar kinds of things. Most of the time, markets are interested in stability and a friendly business environment. In general, human rights issues or worries about a state's nuclear program will be less of a concern for markets; conversely, governments are not likely to sanction particular states for their macroeconomic or tax policies.⁴⁴

Concessions are designed to satisfy the demands of the sanctioning state or coalition. In a successful case of market discipline, governments respond by altering their behavior in order to reassure markets. Reassurance is designed to restore confidence by working to address the concerns that have made investors jittery.

Both concession and reassurance involve potentially costly adjustment in behavior. But here again, they usually differ in important respects. In most cases, sanctions are designed to force the target to make politically charged, high profile, changes in policy. In the reassurance game, states are more often forced to make adjustments, albeit sometimes very large ones. They

⁴⁴ Though loans and aid are often made conditional upon such reforms and adjustments. Witness the case of Greece.

are required to adjust the sails; whereas sanctions involve a visible ceremony in which the target takes down its flag and hoists a new one. Adjustments designed to reassure may indeed be very costly—as bond market pressure is forcing many European countries to tackle their deficits and spending—but ultimately a bit easier to swallow because the disciplining pressure of markets is more diffuse. In the case of market discipline, there is no bargaining with the sanctioning agent, you simply make adjustments and send signals, waiting to see how the markets react. Concession involves adjustment and political submission, reassurance merely adjustment.

Sanctions and market pressure can both inflict harm on a state's economic well-being. But the two differ in fundamental respects. All else equal, there is theoretical reason to believe that governments are likely to be more responsive to market and competitive economic pressure than sanctions. This is particularly true if exports, foreign investment, and investment in export sectors account for a large percentage of economic growth.

Economic Pressures and Sanctions after Tiananmen

The dramatic period in Chinese politics, spanning from 1989 to 1992, was notable for a number of reasons: The military crackdown, international outcry, resurgent Leftists, and Deng's political genius and herculean weight. But perhaps most significant, and least appreciated, was the disciplining force of the global market and diffuse competitive pressures.

The sanctions and market pressure causal logics generate different predictions regarding the PRCs likely response. In this case, what the sanctioning states wanted—the US in particular—was the release of dissidents and political reform. International sanctions and issue linkage strategies were designed to coerce China into making desired concessions. Investors, motivated more by profit than politics, valued stability and the government's commitment to maintain and expand an amiable business environment. Above all, investors wanted reassurances

that reform would not backtrack and that the PRC would stay stable and friendly in the long run. The logic of competitive pressure predicts that as the PRC sees itself falling behind, it will do more of the things that brought it and others success in the past.

	<i>Causal logic</i>	<i>Predicted outcome</i>
<i>Sanctions</i>	Economic coercion	CCP makes concessions
<i>Market Pressure</i>	Investors grow nervous	CCP will try to reassure
<i>Competitive Pressure</i>	Fear of falling behind	CCP will push for integration

In addition to protecting single-party rule and restoring internal stability, Deng Xiaoping and his moderate allies were moved by two related concerns: First, reassuring markets and Western governments; second, ensuring that China’s long-term relative competitiveness remained strong.

First, in order to prevent the derailment of modernization, China had to reassure markets and Western governments. Most problematic was the slowdown in economic growth and the drying up of foreign investment. In 1990 growth was about a third of what it had been in 1988. A recession was the immediate problem; FDI inflows jeopardized recovery and growth in the years to come. FDI inflows from the top six source countries dropped by a combined \$2.2 billion in 1989 compared to the year before.⁴⁵ Between 1984 and 1988, FDI inflows into China increased by an annual rate of 38.1 percent; during the years 1989 through 1991, inflows slowed to a modest annual rate of 11 percent.⁴⁶

⁴⁵ Yigang Pan, “The inflow of foreign direct investment to China: the impact of country-specific factors,” *Journal of Business Research* 56 (2003). Data source is the Almanac of Foreign Economic Relations and Trade of China (1984– 1998)

⁴⁶ Manoranjan Dutta, *China’s Industrial Revolution and Economic Presence* (World Scientific Publishing Company, 2005), p. 126

Following the example of the other ‘Asian Tigers’, foreign direct investment and exports became the cornerstone of China’s modernization and growth plan. GDP growth increased along with net inflows of FDI. For example, strong periods of growth in China (1983-1985 and 1992-1994) were associated with large surges in FDI.⁴⁷ Foreign capital, technology, and know-how allowed China to industrialize quickly, enabling it to enter more advanced manufacturing sectors. The Tiananmen fallout threatened the future of China’s modernization plan.

Maintaining strong growth required continued infusions of foreign capital and increased access to foreign markets. Reassurance was needed. Deng advised the Central Committee in mid-June 1989 with the following:

Since foreigners are afraid that we shall close our doors again, we should do some things to demonstrate that our policies of reform and opening to the outside world will not change but will be further implemented. The highest objective of our political restructuring is to keep the environment stable...China’s overriding interest is in stability.⁴⁸

Markets were watching closely the unfolding of events in post-Tiananmen China. Meanwhile, an increasingly impatient US Congress was demanding tougher action. President Bush struggled to appease and restrain a Congress bent on removing China’s MFN status.⁴⁹

Successful reassurance was stymied as a result of the leftist resurgence. In effect, the reform plan was stuck up to the axel in Tiananmen mud, in danger of being towed out from the left-rear by Party conservatives. This was reflected in a report issued by the Central Committee in November 1989 that called for new restrictions on private enterprise and an increase in state planning.⁵⁰ Measures on “Furthering Improvement and Rectification” embodied a conservative critique of Zhao’s management of the economy. A marked shift was taking place in the direction

⁴⁷ Ibid. pp. 26-32

⁴⁸ *Selected Works*, vol. 3, pp. 303-304

⁴⁹ President Bush’s suspension of high-level exchanges, including a visit by the Commerce Secretary, were designed to deter Congress from pursuing harsher measures. Thomas Friedman, “U.S. Suspends High-Level Links to China as Crackdown Goes On,” *New York Times* (June 21, 1989)

⁵⁰ *Financial Times*, December 14, 1989, 16

of Chen Yun's more conservative thought.⁵¹ From the outside looking in, it was unclear who was commanding the vehicle. When the question was put to Secretary of State Baker, he replied that the "situation is too clouded now...there is an internal power struggle going on in China."⁵² China was at a crossroads. The outcome of the internal contest would decide whether China would turn left, or continue to flash its turn signal left but drive right.

Deng was caught between domestic and international crosswinds. The dilemma: how to cool down the domestic situation while warming up relations with the West. In December 1989, Deng condemned the West charging that "Countries that play power politics are not qualified to talk about human rights...Since the Opium War, when they began to invade China, how many Chinese people's human rights have they violated!"⁵³ During the same month, he sent the following message back with special envoy Brent Scowcroft: "...tell President Bush that there is an old retired man in China who is concerned about the improvement of Sino-US relations."⁵⁴ On the domestic side, Deng could not be seen as weak and supine in dealing with the West, nor could he afford to be too confrontational lest he burn major bridges with key commercial partners. This political juggling act was not a simple one.

An interest in not disrupting market access helps explain Deng's subdued response to the West's political onslaught. In a July 1990 conversation with Pierre Elliott Trudeau, Canada's former Prime Minister, he explained that "...despite the sanctions imposed by seven Western countries, we adhere to one principle: to maintain contacts and build good relations with the

⁵¹ For a useful discussion of this see Joseph Fewsmith, *China Since Tiananmen*, pp. 35-37

⁵² Quoted in Ross, "China" p. 14

⁵³ *Selected Works*, vol. 3, p. 336

⁵⁴ Excerpt from a talk between Deng Xiaoping and Brent Scowcroft on December 10, 1989. *Selected Works*, vol.3, p. 338

Soviet Union, with the United States, and also with Japan and the European countries.”⁵⁵ Despite perceptions of foreign “attack” and “interference,” Deng was eager to expand commercial ties.

Second, Deng was concerned about China’s long-term relative competitiveness. Speaking to the Central Committee in March 1990, Deng explained that “If our economy grows at the rate of only four or five per cent a year, it will be all right for a couple of years. But if that rate continues for a long time, it will represent a decline compared with the growth in the rest of the world, especially in the East Asian and Southeast Asian countries and regions.” Thus, a slowing economy would mean that China would again be losing the global race. “If China wants to withstand the pressure of hegemonism and power politics and to uphold the socialist system,” Deng insisted, “it is crucial for us to achieve rapid economic growth and to carry out our development strategy.”⁵⁶ “[T]he State Council...should stoke up its courage and let the banner of opening fly high.”⁵⁷

The lessons of history weighed heavily. The reason why China was bullied during the Century of Humiliation was because she was weak. She was weak because Western powers had grown relatively stronger. But perhaps most significantly, in contrast to Japan’s Meiji Restoration, China had refused to open up, learn from the West, reform and adapt. To avoid a repetition of history, the CCP had to guide the country along the Westward road to modernization and Great Power status. Party leftists threatened the national interest by pursuing a policy whose long-term effect would be to weaken China’s relative power position. Isolation and economic mismanagement, Deng feared, would cause China to fall behind.

⁵⁵ *Selected Works*, vol. 3 p. 346

⁵⁶ *Selected Works*, Vol. 3, p. 341-43

⁵⁷ Minutes from a June 16, 1989 meeting. Andrew Nathan and Perry Link, eds. *The Tiananmen Papers* (New York: Public Affairs, 2002) p. 429

By 1992 the political climate had changed such that Deng would make his decisive move against the Left. He was no longer talking about Western imperialism, interference, and subversion. The principal enemies of China's national interest were rank and file Marxists intent on putting the brakes on reform. "China should maintain vigilance against the Right," Deng explained, "but primarily against the Left."⁵⁸

Frustrated with leftist intransigence, the ageing and diminutive Paramount Leader reentered the limelight in a final political act whose weight and significance is difficult to exaggerate. In January and February of 1992 he hit the road, in what is known as the Southern Tour (*nanxun*). The epic tour, which included stops in Shenzhen and Shanghai, was designed to influence the political agenda in the 14th Congress and the National People's Congress later that year. Deng was holding no punches: "The economies of some of our neighboring countries and regions are growing faster than ours," he trumpeted to an audience. "We must not act like women with bound feet" he told another. "Anyone who is against reform" he warned, "will be put out of his office."⁵⁹ The Southern Tour had the decisive effect of shifting the debate and reviving the reform agenda. When the 14th Congress of the Communist Party convened in October it endorsed the concept of a "socialist market economy."

The first way to get leverage over the theoretical claims is to see whether and how leaders reacted to markets. The second is to see whether and how markets reacted to political events. The key year is 1992 and the months following the Southern Tour. This was a watershed moment in which Deng succeeded in breaking the levee. His *Nanxun* commentaries were to become the central guidelines as China moved forward along the road to modernity.⁶⁰ As leftists were

⁵⁸ Speaking to a crowd on his Southern Tour. *Selected Works*, vol. 3, p. 363

⁵⁹ Excerpts from talks given in Wuchang, Shenzhen, Zhuhai and Shanghai. *Selected Works*, vol. 3, pp. 358-66

⁶⁰ On the significance of the Southern Tour see John Wong and Zheng Yongnian, eds. *The Nanxun Legacy and China's Development in the Post-Deng Era* (World Scientific Publishing Company, 2001)

marginalized, a decisive political shift had taken place and consequently a dramatic change in investor outlook. A deluge of foreign direct investment poured in. In 1992, gross FDI surged to nearly \$18 billion from just over \$6 billion the year before. In 1993 FDI soared to over \$40 billion. During those years China experienced 14.2 percent and 13.5 percent GDP growth, respectively.⁶¹

The record supports the conclusion that whereas competitive and market pressures operated, sanctions failed to induce policy concessions. Despite a few strategically timed, high profile releases of protestors, the CCPs reaction to the demands of the sanctioning powers was resolute defiance. In early May of 1990, just before the scheduled renewal of MFN status, China released several hundred individuals arrested during the protests. In late June of that year, prominent dissident Fang Lizhi was released and allowed to expatriate to Britain. These and other minor gestures notwithstanding, the CCP refused to admit any wrongdoing, make concessions, or consider meaningful political reform. At a press conference, President Bush admitted what all knew to be true: “there hasn’t been much give.”⁶²

Sanctions failed for three reasons. As predicted by sanctions theory, the CCP used external political pressure to drum-up a unified nationalist front against perceived foreign aggression. As Deng explained confidently: “...the Chinese people will not be intimidated... We have a tradition of defeating the enemy when we are outnumbered and weaker.”⁶³ Indeed, the Party’s very claim to legitimacy in part rests on its strength in foreign affairs. Chinese nationalists expect and demand that the leadership never kowtow to foreign powers or buckle under external pressure. Seen in this way, it is questionable whether the Party could have made

⁶¹ World Development Indicators, 2003

⁶² “Bush Distressed as Policy Fails to Move China,” *New York Times* (March 11, 1990)

⁶³ Excerpt from a talk with Chinese-American physicist Tsung-Dao Lee in September 1989. *Collected Works*, pp. 316-17

concessions even if it wanted to; or whether those concessions would have been desirable in the long run. As Robert S. Ross aptly notes, "...Chinese concessions might have made relations worse, insofar as they might have further undermined Deng's authority and contributed to more adversarial policies."⁶⁴

Second, the pain inflicted by the sanctions was not significant. The main punch of the sanctions involved suspension of arms sales, World Bank loans, and official export credits and other finance. The estimated annual cost of these was a paltry \$322 million, having a negligible effect on GNP.⁶⁵ By contrast, FDI inflows dropped by well over \$2 billion in a single year. Sanctions were mainly symbolic. Meanwhile, the US was willing to make notable exceptions in order to promote non-military trade, including the sale of Boeing aircraft and American satellites. Several World Bank aid projects relating to agricultural development, reforestation, and earthquake assistance were approved. Had the US suspended MFN status, sanctions would have had some real bite. But the threat of suspending MFN was not credible "because Chinese leaders understood that Washington lacked the will to endure the costs of imposing sanctions."⁶⁶ China is not Cuba. The Sino-US relationship was not so asymmetric that the US could have inflicted pain without significant consequence to self.

Third, sanctions can be effective when multilateral.⁶⁷ But in addition to being weak, the multilateral sanctions regime was relatively short lived. While multilateral in important respects, most notably the G-7 Paris declaration and accompanying actions taken in mid July, the sanctions regime began to lose steam before it had gathered very much momentum. From the

⁶⁴ Robert Ross, "China," in Richard Haass, ed. *Economic Sanctions and American Diplomacy* (New York: Council on Foreign Relations, 1998), p. 14

⁶⁵ Gary Hufbauer, Jeffrey Schott, Kimberly Ann Elliott and Barbara Oegg, *Economic Sanctions Reconsidered* 3rd ed. (Washington: Peterson Institute, 2007). See supplemental CD Rom summary of Case 89-2.

⁶⁶ Ross, "China", p. 11

⁶⁷ Lisa Martin, *Coercive Cooperation*

very beginning Japan voiced concern about whether sanctions should be imposed at all. By mid August, Japan announced it would resume aid on a selective basis. In December 1989 several European countries decide to resume export credit guarantees to China. In late October 1990, the European Council lifted the remaining economic sanctions. In the years following Tiananmen, China was able to increasingly sidestep US sanctions by turning to third parties for needed technologies. As Nicholas Lardy lamented, "...economic sanctions provide the United States with virtually no leverage since there are alternative sources of supply for all major products American companies sell or might sell to China."⁶⁸ As time wore on, the sanctions succeeded only in making European and Japanese companies more competitive vis-à-vis their American rivals.

Though not leading to changes in policy, sanctions did have two concrete effects. First, they served as a strong signal of Western discontent with China's leadership and political system. This was important because the CCP was and is very mindful of its status in the world.⁶⁹ Leaders were greatly concerned, for example, about widely varying reports regarding the number of dead at Tiananmen, with some reporting the total number as high as ten thousand. Peng Zhen put it bluntly at a Standing Committee meeting: "We need to set things straight, and fast." "The impact is huge," Bo Yibo concurred, "when numbers like these get spread all over the world!"⁷⁰ Moderate leaders also understood that the fallout would complicate China's accession to the General Agreement on Tariffs and Trade (GATT), as it indeed did. From the PRC's perspective, diplomatic isolation and pariah status were politically costly. China would spend years trying to

⁶⁸ "Normalizing Economic Relations with China," in *Promoting US Interests in China: Alternatives to the Annual MFN Review Vol. 8, No. 4* (Seattle, WA: National Bureau of Asian Research Analysis, 1997) p. 19-20

⁶⁹ Yong Deng, *China's Struggle for Status: The Realignment of International Relations* (Cambridge: Cambridge University Press, 2008)

⁷⁰ Minutes from a June 6, 1989 meeting. Andrew Nathan and Perry Link, eds. *The Tiananmen Papers* (New York: Public Affairs, 2002) p. 421

clean up its image and defeat the “China threat” theory. In the final analysis, it is a mistake to think that sanctions and diplomatic isolation were completely irrelevant. They simply failed to lead to desired concessions.

Second, while sanctions signaled discontent and helped isolate China, they also proved counterproductive to Western objectives because they gave leftist elements in the Party much needed political ammunition. Whereas their opposition to reform and opening had been mainly ideological, now they could draw on concrete evidence of internal turmoil and outside interference—and they came surprisingly close to succeeding in their goal of derailing reform. Sanctions and political pressure had the effect of empowering the hardliners and complicating Deng’s goal of renewing the reform and opening agenda. Seen in this way, Western pressure had the unintended effect of buttressing hard-line Marxists while at the same time weakening the more pro-western elements in Chinese politics.

Though sanctions failed to alter the CCP’s policy, the record does lend support to the theory of market and competitive pressure. The CCP’s policy of expanded engagement reflects overriding commercial interests and competitive pressures. The state’s interest in achieving great power status and enhancing relative economic competitiveness converged around an engagement strategy. While the regime felt threatened, the benefits of pursuing a hard-line response were greatly outweighed by the economic and political costs of isolation. Isolation would ensure continued underdevelopment and backwardness. China’s weakness would again invite exploitation and bullying by foreign powers. To remain internationally competitive and to achieve great power status China had no choice but to integrate. Even conservative Li Peng

seems to have understood this when he stated that “Reform and opening are the route to a powerful nation and must be carried out with the firmest resolution.”⁷¹

Conclusion: four lessons for US policymakers

To some observers, the Tiananmen crackdown demonstrated that for Deng Xiaoping and the CCP “politics takes precedence over economics.”⁷² This assessment may have been plausible during the remaining months of 1989. But the record of the Tiananmen interlude as a whole indicates the opposite. Deng would spend the remainder of the interlude, until 1992, trying to reassert the primacy of economics in China’s domestic and foreign policies.

The international structure conditions behavior by rewarding some states and punishing others. The structure selects foolish states by causing them to slip and fall behind. Foolish states pay a price for the mistakes they make. The theory of structure as selector implies that states can and do learn. States learn from the mistakes made by others; states also emulate the successful strategies of more competitive rivals. States can also learn through the mistakes they themselves make. It did not take long for China’s moderate leadership to begin drawing key lessons. As Deng expressed to members of the Central Committee: “The recent events have brought our mistakes out into the open. And yes, we have made some mistakes—some big ones, in fact!”⁷³

The period 1978-1988 represents a time when China emulated the strategies pioneered by more successful neighbors. China’s reform track closely paralleled that of other Asian tigers. The period between 1989 and 1992 represents a time in which China experienced the damaging economic consequences of economic pressure and political isolation.

⁷¹ Report to the Fourth Plenum of the Thirteenth Central Committee on June 23, 1989. Andrew Nathan and Perry Link, eds. *The Tiananmen Papers* (New York: Public Affairs, 2002) p. 440

⁷² Charles Krauthammer, “Communist Imperative,” *Washington Post* (June 23, 1989), A27

⁷³ Deng addressing the new Politburo Standing Committee on June 16, 1989. “Minutes of the CCP Central Politburo Standing Committee meeting,” June 16, 1989. *Tiananmen Papers*, p. 428

The Tiananmen interlude reveals important features of China's fundamental foreign policy motivations. These conclusions are very important, but are drawn from the study of a single case and as such should be considered in conjunction with other studies that explore the PRC's foreign policy motives in other contexts. But the study does suggest that even during periods of crisis, China's economic interests had an overriding influence on foreign policy. The above analysis suggests four important lessons for policymakers concerned about managing China's rise.

First, during this important diplomatic crisis, economic imperatives weighed more heavily on the minds of leaders than *realpolitik* strategic motives. Market and competitive economic pressure conditioned and restrained the behavior and thinking of Chinese leaders in important respects. Though moderate leaders talked tough in order counter sanctions and to satisfy nationalists, internationally they also presented a diplomatic and cooperative face designed to bring about a warming of relations. Leaders were very interested in restoring key commercial relationships.

Second, the case suggests that confrontation and pressure are likely to fail under the best of circumstances. It is more likely that they will be downright counterproductive. Strong arming failed when the PRC was weak; coercion is likely to be even more ineffectual now that China is much stronger. In this case, pressure had the unfortunate effect of strengthening hardliners bent on pursuing a confrontational policy toward the West. Moreover, that Chinese nationalism is a powerful and unwieldy force cautions against policies that may alter the domestic balance of political forces in a way that damages Sino-US relations and the American national interest. In China, nationalism is a wildfire that level-headed leaders struggle to control under the best of circumstances—without the added complication of strong winds blowing across the Pacific.

Ultimately, in relations among Great Powers a moralistic foreign policy is unsound because it will fail, and in the process lead to unnecessary setbacks on other important policy fronts.

Third, the US should work to ensure that China's self-interest continues to be tied to the viability and success of the international economic order as a whole. China's fundamental interests require it to be a responsible stakeholder in the system; encouraging the CCP to assume this role and develop itself in this capacity should continue to assume priority in US foreign policy. Today, the PRC is one of the world's foremost trading states; in fact, far more integrated than its more liberal western counterparts. The Party's fate and the country's Great Power ambitions are now vitally tied to the global commercial order. If China's leaders understood this in 1989, they are surely aware of it now that the country is more integrated and less ideological. Though the case suggests that political pressure is likely to fail, appealing to China's economic interests is a far more promising strategy.

Fourth, the economic imperative has a restraining effect in times of international crisis. There are natural barriers beyond which the CCP has no interest in allowing crises to escalate. Because of its fundamental interests—including prosperity, internal stability and single-party rule, and economic competitiveness—China has no incentive to allow crises to over-escalate. Understanding this should help the US appreciate assertive behavior for what it is: a signaling mechanism or brinkmanship game designed to test wills. Revisionism or balancing it is not. Appreciating China's fundamental interest and the economic baseline should help the US manage crises in a more effective way. In situations of crisis, the US can readily appeal to the economic consequences of instability, simultaneously speaking to both Chinese leaders and markets alike. In this way, economic and market imperatives can be creatively referenced as a means to reestablish political stability in tumultuous times.

The tragedy of great power politics is *not* that conflict is inevitable. Rather, in the heat of the moment policymakers may think that it is, and in acting upon these erroneous assessments bring about a self-fulfilling prophesy that benefits no one. Crises will be an inevitable feature of future Sino-US relations, though as Kissinger correctly notes, “The crucial competition between the United States and China is more likely to be economic and social than military.”⁷⁴ In navigating these potentially stormy waters, we are well advised to keep the sagacious words of Deng Xiaoping in mind: “...we should manage our affairs well...take it calmly and not allow ourselves to be provoked.”

⁷⁴ *On China*, p. 525; though there is still much peril in the military-security realm as well. See, Avery Goldstein, “Crisis Instability and US-China Relations: The Present (If Not Clear) Danger,” Paper presented at the APSA Annual Conference, Seattle, WA