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When Trade Leads to War

China, Russia, and the Limits of Interdependence

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Over the past year, the United States has been forced to contemplate a possibility that many have regarded as almost unthinkable since the Cold War: a major military conflict with another great power. For the first time in decades, Moscow has been rattling its missiles to warn Washington about its support for Ukraine. And in early August, following U.S. Speaker of the House Nancy Pelosi's visit to Taiwan, Beijing dramatically escalated its threat of military action over the island.

Almost as startling as the threats themselves are what they seem to suggest about the limits of economic interdependence as a force for peace. Both China and Russia rely to an extraordinary degree on trade for economic growth and to secure their positions on the world stage. China has managed to quintuple its GDP over the last two decades in large measure through the export of manufactured products; more than 50 percent of Russia's government revenue comes from the export of oil and gas. According to an influential strand of thinking in international relations theory, these crucial economic ties should put a much higher price on military conflict for both countries. Yet at least from appearances, neither power seems restrained by the potential loss of such trade.

The picture is not as simple as it looks, however. For one thing, under certain circumstances, trade relationships may serve as an inducement rather than a deterrent to war. Moreover, the assertion of military power or even the threat of adversarial confrontation does not always correlate with a rupture in economic relations. As the contrasting cases of China and Russia have demonstrated over the past year, economic ties often play out in ways that defy expectations. For those who assume that commerce can help prevent great-power conflict, it is critical to examine the complex ways that economic forces have actually shaped strategic thinking in Beijing and Moscow.

AGGRESSIVE COMMERCE

To understand how trade might increase, not reduce, the chance of military conflict, it is necessary to draw on the insights of realist theory. In general, realism focuses on the struggle of great powers for relative military power and position in a world that lacks a central authority to protect them. But realists understand that economic power is the foundation for long-term military strength and that international commerce is vital for building an economic power base. For realists, trade can have two major effects. First, by providing access to both cheap raw materials and profitable markets, trade can bolster a state's overall economic performance and technological sophistication, thus enhancing its ability to support long-term military power. This is the upside to having a relatively open trade policy, and it explains why Japan after the Meiji Restoration and China after the death of Mao Zedong left behind the failed autarchic policies of the past and sought to join the global economy.

But growing commerce also has a second effect. It increases a great power's vulnerability to trade sanctions and embargoes after having become dependent on the import of resources and the export of goods for sale abroad. This vulnerability can drive leaders to build up navies to protect trade routes and even to go to war to ensure access to vital goods and markets.

As long as state leaders expect their trade relationships to remain strong into the future, they are likely to allow the state to become more dependent on outsiders for the resources and markets that drive state growth. This was the situation of Japan from 1880 to 1930 and of China from 1980 to the present day. Leaders in both states knew that without significant commercial ties with other great powers, including the United States, neither could become important members of the great power club.

Yet if expectations of future trade turn sour and leaders come to believe that the trade restrictions of other states will start to reduce their access to key resources and markets, then they will anticipate a decline in long-term economic power and therefore military power. They may come to believe that more assertive and aggressive policies are necessary to protect trade routes and ensure the supply of raw materials and access to markets. This was Japan's predicament in the 1930s as it saw France, the United Kingdom, and the United States retreating into increasingly closed and discriminatory economic realms. As a result, Japanese leaders found themselves compelled to expand Japan's control over its commercial ties with its neighbors. Yet they also came to see that such moves made them only look more aggressive, giving the United Kingdom and the United States new grounds for restricting Japanese imports of raw materials, including oil.

Today, China's leaders understand that they face a similar dilemma—as have the leaders of almost every rising state in modern history. They know that their foreign policy needs to be moderate enough to sustain the basic trust that allows trade ties to continue. But they also need to project enough military strength to deter others from severing those ties. The realist view of how commerce affects foreign policy does much to explain why Chinese leaders have been so hostile over the past year to certain developments in East Asia—particularly regarding Taiwan. In a more limited way, this view can also help explain Russian President Vladimir Putin's obsession with Ukraine.

NOW OR NEVER

By most accounts, Putin's war in Ukraine was driven by his fears about Russian security—a concern that Ukraine was likely to join NATO in the near term—and his desire to go down in history as the man who helped rebuild the Russian empire. But the decision to launch the invasion was likely reinforced in two important ways by something else: Russian energy exports to Europe.

First, Putin certainly understood that Europe was much more dependent on Russia than Russia was on Europe. Before February, the European Union relied on Moscow for approximately 40 percent of the natural gas it needed for its industries and to heat its homes. The Russian economy was, of course, dependent on selling this gas. But given the nature of the commodity, Putin could expect that any significant reduction in the flow of natural gas would cause its price to rise, hurting the EU in two ways—through reduced supply and higher costs—while only marginally affecting the total revenue Russia would receive from its gas exports. As the economist Albert Hirschman pointed out in 1945, in reference to Germany's lopsided relationship with eastern European countries during the 1930s, in a situation of asymmetrical interdependence, the less dependent state will likely feel confident it can browbeat its more dependent counterparts into accepting its hard-line policies simply because they need the trade and are too weak to resist.

The fact that the Europeans continued to buy Russian gas and oil at high levels after Russia annexed Crimea in 2014 suggested strongly to Putin that they would not put up a fuss if he invaded Ukraine in 2022. He clearly underestimated the ferocity of the European response. But Putin's awareness of Europe's economic dependence on Russia, combined with the common belief that Russia could handily beat Ukraine in a few weeks, helped give him the confidence that his bold attack would succeed.

Second, Putin had reason to fear that Russia's economic leverage over Ukraine and Europe would decline in the future. In 2010, huge natural gas deposits were discovered south of the eastern Ukrainian city of Kharkiv and spreading into the Donetsk and Luhansk Provinces. The field was estimated to hold some two trillion cubic meters of gas, an amount equivalent to the total consumption of the 27-country EU over five years at current usage rates. The Ukrainian government quickly changed state regulations to encourage foreign investment, and in 2013, it signed an agreement with Shell Oil to develop the field, with ExxonMobil and Shell agreeing to work together on deep-water gas extraction off the southeast coast.

Although Putin's invasion of Crimea and the Donbas in 2014 was probably motivated by other concerns, it was certainly clear in Moscow at the time that if the natural gas deposits in eastern Ukraine were developed by Western firms, Ukraine would not only end its dependence on Russian gas but also start to export its own gas to the EU, thereby increasing its bargaining leverage over its contracts with Moscow to allow Russian gas to pass through Ukraine.

Of the three sets of pipelines Russia uses to get its Siberian gas to the EU—including one through Belarus and another through the Baltic Sea to Germany—the most important historically has been the one through Ukraine, mainly because landlocked European countries such as Hungary and Slovakia are especially dependent on Russian gas. By exporting its own gas to the EU and weaning itself from Russian supplies, Ukraine would reverse its asymmetric energy relationship with Moscow. And if Kyiv developed even informal ties to NATO and the EU, let alone joined one or both organizations, Ukraine would become not only a political threat to Moscow but also an economic threat in a position to significantly undermine Russia's long-term economic power.

In short, although Ukrainian President Volodymyr Zelensky's moves in late 2021 to increase his country's political and economic ties with the West certainly upset Putin's sense of Russia's destiny and perhaps heightened Putin's fear that liberal democracy might spread into Russia, they also portended a significant loss in Russia's ability to use the energy card in the future. Expectations in Moscow that Russia might be losing its economic leverage over Ukraine thus contributed to Putin's sense that it was "now or never" to absorb most of Ukraine east of the Dnieper River, an area that holds over 90 percent of Ukraine's natural gas reserves.

SMALLER CHIPS, LARGER STAKES

By contrast, China's economic interdependence with the rest of the world is far more symmetrical than Russia's is. China's economy is driven by the export of manufactured goods, and like Japan's economy was in the interwar period, China is exceedingly dependent on the import of raw materials to keep its economy going—including oil and gas from the Middle East and Russia. China's position as the workshop of the world, supplying a significant percentage of the world's laptops, smartphones, and 5G communications systems, does give the country some leverage with trading partners. It can threaten those partners with selective restrictions on exports and imports when it dislikes their foreign policies. But also like Japan's dependence on imports in the interwar period, China's dependence gives it short-term vulnerabilities that are unknown in Russia. Moscow can certainly be hurt by economic sanctions, but its ability to sell oil and gas—at high prices created by its own actions in Ukraine—cushions the blow quite a lot.

If China faced anything close to the sweeping sanctions now being imposed on Russia, its economy would be completely devastated. In fact, Beijing's awareness of this vulnerability is already acting as a major deterrent to its expansionist desires, including its plans for an invasion of Taiwan. Consider the actual details of China's reaction to Pelosi's visit to Taiwan, despite the threats it made beforehand. Although Beijing demonstrated its anger with robust military exercises and missile launches that passed into Taiwan's airspace, it restricted its economic response largely to sanctions on Taiwanese agricultural exports. Notably, Chinese officials carefully avoided placing any restrictions on Taiwanese semiconductor exports, since China depends on Taiwan for more than 90 percent of its high-tech chips and a large portion of its low-level chips. And, of course, China was careful not to sanction the United States directly for fear of causing a new trade war that would exacerbate an already slowing Chinese economy.

Nonetheless, China's economic dependence could lead it to take aggressive action should Chinese expectations of future trade plummet. Take the case of Taiwan's high-tech semiconductors. China now has some capability to produce chips with transistors that are under 15 and even under ten nanometers in size. But to stay on the cutting edge of technological developments in artificial intelligence, self-driving vehicles, and smartphone production, it needs chips measuring under seven or under five nanometers, which only Taiwan can mass-produce at a high level of quality. The latest Apple iPhone, for example, although it is assembled in China, uses an Apple-designed five-nanometer chip that is made by Taiwan Semiconductor Manufacturing Company in Hsinchu, Taiwan.

It is not going too far to say that the whole future of China's ability to catch up to the United States depends on continued access to Taiwanese chips, just as Japan's position in the 1930s was dependent on access to oil controlled by the Americans and the British. And just as in 1941 with the American oil embargo, if Chinese officials suspected that the United States might take steps to cut off Chinese access to Taiwanese chips, they might determine that it is necessary to take the island now to avoid long-term economic decline. This is not some far-fetched scenario. In June 2022, a prominent Chinese economist declared that if Washington placed sanctions on China similar to those imposed this year on Russia, China should invade Taiwan to secure possession of its chip-production facilities.

But here's the good news. Chinese expectations for future trade, as Japanese expectations were in 1941, are a function of American policy decisions. If U.S. officials understand that their policies directly shape the way Beijing sees the future commercial environment, not just in overall trade but in high-tech trade as it relates to Taiwan, they can avoid making Chinese Communist Party leaders feel their economy will collapse unless they act forcefully. The spirals of hostility that can lead to war stem from choices, not given realities. By reassuring Beijing that China will continue to receive semiconductors from Taiwan—even if not the sophisticated machines from the Netherlands needed to make them—the Biden administration can moderate Beijing's concerns about future trade and reduce the likelihood of crisis and war.

Chinese President Xi Jinping and his cohorts will, of course, object to even this U.S. posture, since it leaves China dependent on outsiders for the chips that are the foundation of both a modern high-tech economy and military power. Yet since an attack on Taiwan would not only invoke economic sanctions that would jeopardize China's trade ties with the Western world but might also lead to the inadvertent destruction of the chip-making plants themselves, China has every reason to moderate its behavior, if not its rhetoric, when it comes to the island's status.

MAKING DEPENDENCE LESS DANGEROUS

Putin may have thought the West would roll over on Ukraine given Europe's dependence on Russian oil and gas. But Chinese leaders now know that the Americans, the Europeans, and their global partners have the resolve to punish invaders and that by attacking Taiwan they might destroy everything that the Chinese Communist Party has achieved over the past four decades. History shows that dependent great powers are cautious in their foreign policies when their leaders have positive expectations about future trade, since they know that trade will help build the state's long-term power base and increase the wealth of the average citizen. And Xi needs both to happen if he is to maintain the legitimacy of one-party rule in China and the stability of the state itself.

When great powers seek to use economic interdependence to help maintain peace, they face a difficult balancing act. It is not enough to simply have high levels of trade, since dependent states such as Japan in the 1930s and China today can be pushed into more aggressive policies if they determine that they do not have sufficient access to the raw materials and markets the state needs to sustain its position as a great power. Leaders of less dependent states such as the United States must be careful not to signal that they are seeking to keep the dependent state down—or worse, to push it into absolute and relative decline, as President Franklin Roosevelt's oil embargo did to Japan in 1941. Yet an open trade policy can also be a problem, since it can help the dependent state catch up in relative power and become a long-term threat, as U.S. administrations from Barack Obama's to Joe Biden's have understood in regard to China.

A better approach would be to push rising powers such as China to level the playing field by ending practices such as currency manipulation, subsidies, and the illegal appropriation of foreign technology while assuring these states that if they act moderately in their foreign policies, they will continue to enjoy access to the resources and markets they need for economic growth and domestic stability. Great-power leaders must strive to establish trade relations that allow states to grow in absolute terms and yet ensure that neither side fears a significant future decline in relative economic power that would leave it vulnerable to external threats or civil unrest.

With the current tensions over Taiwan, exacerbated by Xi's continued alignment with Putin, this may be difficult. But as great-power diplomacy returns to a more even keel, Washington can work to remind Beijing that it needs the United States and Western partners in order to achieve its own economic goals—and that Washington will not exploit China's dependence to undermine those goals. Biden can assure Xi that the lesson of 1941—that destroying a state's expectations of future trade can lead to war—has been learned on the American side. But he can also suggest that Beijing learn from Japan's mistakes from the 1930s and avoid the kinds of aggressive policies that destroyed the international trust needed for healthy trade relations. If leaders in Washington and Beijing can improve each other's expectations of both trade and future behavior, many more decades of peace in East Asia should be achievable.

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