CHAPTER 6

ECONOMIC GLOBALIZATION AND PEACE: HOW ECONOMIC INTEGRATION CAN REDUCE THE INCIDENCE OF INTERNATIONAL CONFLICT

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Introduction

I used to think that if there was reincarnation, I wanted to come back as the president or the pope. But now I want to be the bond market: you can intimidate everyone.

Clinton administration political strategist James Carville (1995: 3).

The collapse of the bi-polar world order in the early years of the last decade encouraged students of world politics to broaden their conceptions of the fundamental precipitants and processes of international relations. Rejecting traditional claims about imperatives imposed by international anarchy, researchers have increasingly come to regard domestic political variables as major determinants of variation in the foreign policies of states. Similarly, distinguishing the high politics of diplomats from the low politics of merchants appears hackneyed in light of the rising political salience of global markets. Efforts to divine political consequences of global economic integration are now a cottage industry. Advocates from a diverse spectrum of perspectives seem largely to agree that globalization matters, that economic integration is bound to influence state behavior. Yet, there remains profound disagreement about the nature and significance of global economic change.

Our focus here is on the consequences of economic integration for world peace. We argue that globalization can reduce dispute behavior for reasons that have been largely missed in the current debate. To influence interstate conflict, changes in global economics must alter the incentives that impel states to fight. Existing arguments pose diametrically opposed claims about the effect of globalization on peace. Liberals argue integration makes war more costly and less likely whereas realists and radicals believe it can make war more frequent. Though existing claims bracket the realm of possible consequences, we argue that contrasting conventional accounts fail to speak to a coherent logic of war. States fight over distributional issues, but this is not the same as saying that wars result from the distribution of power, threat, or interests. Instead, wars and other contests can best be said to result from disagreements over the status of distributional issues. Beginning with the growing literature on the informational nature of international disputes, we argue that globalization creates an alternative to military violence as a means for states to unravel the uncertainty surrounding global political competition. In addition to better responding to a coherent theory of war, our argument emphasizes intuitive and dynamic features of the interaction of state and market. We briefly review existing debates about globalization and peace. We then offer an interpretation of globalization that seems to us to be more consistent both with basic insights of the theory of economic markets and with new thinking about the causes of international contests. After presenting the argument, we offer as an illustration a case study of the 2000 Taiwan Straits crisis. We then conclude with an extensive discussion of some of the theory’s implications.
Defining Our Terms

Economic globalization implies an international market of goods and factors of production, financial capital moving across national borders with relatively little friction, production networks spread over several states, and elaborate communication networks linking people around the globe. We define globalization for the purposes of this essay as the increasing integration of cross-border markets, as well as the increasing ease with which a variety of non-state economic actors can intervene in the national economic markets of integrated states. Researchers are interested in globalization for many reasons, but of particular interest is the impact of globalization on the conflict (dispute) behavior of states. Can global integration promote world peace, if only modestly? For many, peace is not simply the absence of war. Wars and lesser military contests constitute a small portion of the frequent and widespread contentious interaction of states. Still, wars and disputes are quite reasonably the subject of the keenest normative concern, because of their harm to individuals, groups, and societies. We define ‘peace’ as the absence of militarized dispute behavior. While one might consider other definitions, it seems most important here to distinguish ‘peace’ from ‘amity’. Peace may be a more reasonable objective if political actors are still expected to disagree, but to more often seek to realize their differences through non-violent methods of competition. While differences of interest exist to a greater or lesser degree in almost all circumstances, we are most concerned here with why states appear to vary in how differences are managed, with how integration can alter the need for costly and harmful interstate warfare.

The Literature on Economic Globalization

Globalization involves the interaction of states and markets. It is peculiar, then, that standard treatments of globalization in the security studies community ignore, or at least fail to emphasize, certain basic properties of markets. The fundamental structural change that results from economic globalization concerns the state-market relationship, rather than the state-state relationship. If integration changes politics, it does so because first and foremost the interaction of markets and states is changed by globalization. Yet, it is the interaction of political actors that captures the core of interest in standard approaches to globalization in the security studies literature. Though markets appear as entities that change the rules of interstate politics, researchers are quick to move to the analysis of new political conditions without giving much further attention to how markets and states interact. We are concerned that markets are poorly conceived in security studies of the pacific effect of globalization, and that this inattention to the interaction of states and markets leads to errant claims about the effects of market changes on interstate political interactions.

Inadequate treatment of the nexus linking states and markets can be explained away by the interests of students of international politics, who reasonably care more about their own subject than that of another discipline. Still, while researchers must typically simplify issues, items, or processes based on the proximity of these factors to topics of interest, markets are both proximate and relatively easily described when it comes to the topic of globalization and its consequences for international conflict. The problem appears to be that the significance of markets to states can take several forms and that the form most appropriate to interstate political conflict has yet to be clearly identified. Since a focus on politics is not synonymous with a focus on the political consequences of economic globalization, one needs to use relevant aspects of theory and context to ensure that the aspects of markets that are said to impinge on state behavior do indeed carry some weight.

As even our cursory review of the literature will show, profound differences in conclusions about the impact of globalization for world politics follow in large part from differing views of the relationship of states to markets, not due to differing views of the interaction of states. Paradoxically, we see this consensus about the state-state relationship is the origin of confusion in the literature. Studies fail to carefully assess the nature of the political interaction on which the state-market nexus is said to impinge. For markets to affect violent competition globally, it must be the case that features of economic exchange alter the logic of contests. On the other hand, to correctly identify politically significant implications of the state-market relationship, one must capture critical features of the state-state relationship. Globalization research comes to contrasting conclusions because researchers begin with the same flawed premise, that war is a consequence of material variables. If so, then shifts in material variables
lead to shifts in the probability of war and a debate can (and does) occur about how globalization shifts the distribution of power, threat or interests. Though our reading of the literature suggests that market consequences are more often assumed than demonstrated, consensus about how states interact provides the foundation for confusion about the political consequences of markets. If war is instead a consequence of informational, rather than material, conditions, then research on the effects of globalization on conflict has been looking in the wrong place even as the consequences of globalization for peace are less ambiguous. We extend our discussion of the informational view of state-state and state-market interactions below. First, however, we relate elements of the two main existing debates in the literature.

Economic Globalization and the State-Market Relationship

The consequences of changes in the state-market relationship are widely debated in the globalization literature. One view claims the death of nation states as either an economic unit or as sovereign entities (Kindleberger, 1969; Strange, 1996). Accompanying such death notices are assertions about a loss of meaning of state territoriality and the coming of a borderless world (Cohen, 1998; Mathews, 1997; Ohmae 1996; Ruggie 1993). The trend toward an increasing number of states, as well as the apparent desire of many to form new, autonomous entities (French Canada, Scotland, etc.) suggests that state sovereignty and the politicization of territory have yet to be reduced to insignificant commodities.

A second view is that, far from being dead, states are simply severely constrained in the scope of their capacity and policy autonomy (Andrews, 1994; Drucker, 1997; Evans, 1997; Reinicke, 1998; Rodrik 1997). The presence of increasing capital mobility, the adoption of flexible exchange rate regimes, and the rise of global trade mean that states have lost their monetary and fiscal policy sovereignty and are left with a heavily eroded ability to provide a domestic social safety net. Authors in this category of argument seem to concede that total state eclipse is unlikely, but that globalization limits state options to repressive methods of avoiding economic collapse (Evans, 1997) or to acquiescing to global policy regimes orchestrated by supranational entities (Drucker, 1997; Reinicke, 1998).

A third view argues that states remain the single most important international actors (Kapstein, 1994; Krasner, 1999; Waltz, 1999, 2000). According to this argument, the market has played a submissive though expanding role in interstate competition. National borders continue to define the boundaries of systems of capital accumulation (Wade, 1996). States created international regulatory structures based on home-country control, within which the world economy develops (Kapstein, 1994). They still retain much room for effective macroeconomic management while limitations on the welfare state are exaggerated (Garrett, 1999).

At the center of the controversy is the status of the market relative to the state, a topic of significant debate even before Adam Smith. In each of these arguments, the state is seen as involved in a competitive relationship vis-à-vis the market. Juxtaposing state and market in this manner ignores key differences in their roles. While each incurs on the other, both have distinguishable functions that encourage cooperation as well as conflict. States require the productive efficiency of markets for their rents and for the political survival of leaders while markets need states for regulation and for addressing market failures. The magnitude of market constraint on the state continues to be debated, but the emerging consensus is that the state is relatively less autonomous than in the past and thus that there has been transfer of power from the state to markets (Held et al., 1999). Globalization increases financial capital mobility across borders and facilitates the relocation of means of production from country to country. States, in their competition with other states, are more often forced to construct their economic policies to please global investors and transnational firms, ceding de facto state sovereignty and reducing control over trade and capital flows. It is this new structural constraint upon the state that we apply to analyze the impact of economic globalization on interstate political relations.

The Political Consequences of Economic Globalization: Realists versus Liberals

Traditional interpretations of international relations privilege analysis of sovereign states. The interaction of sovereign states (‘high politics’) is said to command the leader’s agenda while state-market relationships (‘low politics’) are merely means to high political ends (Morgenthau, 1958). This perspective continues to be voiced by prominent figures in the study of international relations. As Ken-
neth Waltz puts it, ‘The most important events in international politics are explained by differences in the capabilities of states, not by economic forces operating across states or transcending them’ (2000, 52). Globalization is simply not relevant to the conduct of high politics. Other realists are even less sanguine about the pacific consequences of economic integration. Mearsheimer (1990) argues that if globalization creates interdependence between states, it also reduces the ability of states to act as autonomous political agents. States under globalization are no longer free to pursue international politics (through balancing, etc.), and stability in world politics is threatened.3

Liberals praise the economic benefits of globalization, but treat the political implications of global integration with suspicion. Kant (1795/1957) argued that commercial interests are naturally inimical to the goals of warfare. Trading states avoid war because fighting is bad for business. Woodrow Wilson was so convinced of the Kantian claim that he made free international markets one of his fourteen points (Wilson, 1918). The Great Depression and World War II battered liberal ideas, but the potency of liberalism as an intellectual force revived with peace and prosperity. While acknowledging the power of power politics under anarchy, neoliberals such as Keohane and Nye (1989) returned to the notion that markets inhibit political conflict and emphasized the decreasing divide between ‘high’ and ‘low’ politics in international relations. The benefits of economic linkages were thought to deter military violence for fear of lost economic opportunities. Statistical evidence marshaled to support the liberal notion continues to increase the research community’s confidence in the correlation of trade interdependence with peace (cf. Oneal and Russett, 1997, 1999).

Modern advocates of the liberal view are often so convinced of the value of globalization on purely economic grounds, and so concerned about political intervention in markets, that they seek to justify the pursuit of free markets independent of political consequences (Bhagwati, 1998; Krugman, 1996). Indeed, the liberal position is largely normative, rather than positive (a position akin to the US drug policy that pleaded for citizens to ‘just say no’). By abstaining from optimistic assertions about the behavior of political actors in the face of growing market power, liberals have effectively acquiesced to the political claims brought by critics of globalization, that the growing power of markets is a net threat to the pursuit of high politics by states. While international liberals continue to argue that integration promotes peace, interaction with realists has affected the liberal view. As Moravcsik (1997) has pointed out, domestic liberals advocate the protection of markets from the encroachment of political institutions while international liberals are willing to advocate the use of institutions to protect states from markets. The liberal position seeks to treat state-market interactions as non-interactive. States and markets do not interact to bring relative international peace. The only direct political value in markets in bringing peace is that they create wealth that in turn is said to deter recourse to political violence.

There is thus nothing inherent in the interaction of states and markets in either realism or liberalism that is thought relevant to state-state relationships. Markets affect state power and states can in turn regulate markets, but markets are not seen as responding to politics any more than politicians are thought to respond to the status of market conditions. We believe this view of globalization is incorrect, that neither realists nor liberals are capable of satisfactorily explaining the impact of economic globalization on interstate violence. The problem with current conceptions is two-fold. First, most studies on the topic of globalization and peace ignore key insights about why states fight. Recent thinking about the origins of costly interstate contests has begun to emphasize that an important cause of wars is informational, rather than material conditions (Fearon, 1995; Gartzke, 1999; Morrow, 1999; Wagner 2000). Second, liberals and realists treat markets as exogenous, ignoring strategic interactions between state and market. Our argument differs from the above approaches. For the class of contests that are informational in nature, if markets are valuable to states because of capital and informative to states as aggregators of information, then globalization can change the frequency with which states fight by changing the informational conditions under which states compete. The integration of global markets provides a new venue for states to settle competition short of military violence by allowing states to credibly communicate information about relative resolve through costly but non-violent means. We extend our discussion of the argument that war and markets interact informationally to bring peace below
Our Argument

To accurately gauge the effect of globalization on interstate dispute behavior, one must do two things. First, one must see the state-market relationship as interactive, not merely as a directional process whereby markets develop and threaten states. Market behavior can affect states, but states can also affect markets. It is in the interdependence of state and market that we are most likely to identify behavior that can transform, or at least moderate, global politics. Second, discussion of the impact of the state-market relationship on global conflict must involve an explicit treatment of the process generating interstate disputes. Too often, students of world politics identify modifiers of conflict behavior without mapping a causal logic underlying contests. Accounts of how globalization affects the frequency of interstate contests require a clear enunciation of what can lead states to fight. We explore these two elements below, beginning with the state-state relationship.

The State-State Relationship: Logic of Costly Contests

One of the readily discernable features of interstate conflict is its episodic nature. Wars begin, last for some period of time, and then end.5 A second discernable feature of interstate contests is that they typically terminate in some settlement (tacit or overt). Finally, disputes appear costly. States may profit from war and may even derive psychic benefits from fighting or victory. However, the contest itself involves positive costs in the form of expenditures of gold, blood and equipment that are forfeit to the contest itself. These features of warfare lead to the conclusion that disputes result primarily from informational asymmetries (plus incentives to compete).

States that disagree often settle disagreements diplomatically. Indeed, states seem to prefer to settle disagreements when and where settlements seem to offer terms comparable to those that are likely to be obtained from fighting. War is costly. Contests consume resources that are otherwise available for use in furthering other objectives. At the same time, wars almost invariably terminate in some form of settlement. The task in explaining disputes is not, as many have presumed, in identifying conditions under which states may be able and/or willing to fight. Rather, given that some settlement eventuates, a logic of disputes explains why it is that states sometimes settle ex ante and at other times require violence to identify terms.

Disputes most often occur because competitors are unable to arrive at the bargains ex ante that settle contests ex post. To see why this is so, imagine that two states (A and B) compete over some disputed issue, territory, etc. Suppose that the states have the option of engaging in some contest at a cost c, in which the probability of victory is equal to a for state A and equals (1 – a) for state B. If the stakes in the contest equal x, and if all the spoils go to the victor, then the expected value of fighting for a state is just the product of a state’s odds of victory multiplied by the stakes [ax – c; (1 – a) x – c]. If either player (state) is allowed to make a proposal to its opponent, and if we assume that the issue space is infinitely divisible, then there always exists some offer both parties prefer to fighting. The inevitability of some settlement, as well as the positive cost of a contest, mean that obtaining an ex ante settlement is always a Pareto-improving move, if actors can identify the proper bargain.

The most general explanation for why states sometimes disagree on settlements ex ante that resolve contests ex post is that states often differ in their predictions about the consequences of a contest. In order for states to fight, at least one party must be overly optimistic about its own prospects in a dispute. Blaney (1988) argues that states irrationally misperceive, but actors can err simply by being uncertain about strategic variables (capabilities, resolve, etc.). Fearon (1995) notes that uncertainty (and incentives to compete) then constitute the necessary conditions for a rationalist theory of dispute behavior. To see why this is so, imagine that the states discussed above (A and B) on the brink of a dispute are suddenly able to see into the future and anticipate the terms that will eventually settle a given contest. If we assume that there is some positive cost to fighting, then competitors are always better off accepting the terms that eventuate from a contest prior to the contest itself. In a world of omniscient states, wars would seldom happen.6 Obviously, states do fight. It follows that states are most often at war because they are unable to anticipate, or at least to agree upon, the settlements that eventually terminate contests prior to the onset or continuation of fighting.

Costly contests involve at least two elements. First, there is a zero-sum competition for excludable goods.7 Conflict is a difference of interest over issues, territory, etc., that two or more states cannot
possess simultaneously. Second, a contest is a negative-sum interaction that may be used as a mechanism to settle a conflict (threat, dispute, sanction, etc.). The transaction costs associated with contests deprive ‘winners’ of benefits and increase the burden for ‘losers’ so that all are better off selecting contests that minimize the cost involved in obtaining settlements. Since war is costly, fighting is only efficient if comparable agreements are unobtainable through other, cheaper methods. A theory of contests thus explains, not just why states differ in a manner that sustains a conflict of interest, but why states pursue a particular (and particularly costly) method for addressing such differences. Put another way, a theory of disputes explains why ex ante settlements are unobtainable to competitors that will settle ex post.

The bargaining literature on costly contests argues that wars result from uncertainty about conditions likely to influence eventual settlements as well as the incentives states have to misrepresent private knowledge about conditions. States often possess private (asymmetric) information about strategic variables (capabilities, intent, etc.). Efficient ex ante bargains are obtainable if states can credibly share asymmetric information. Unfortunately, asymmetry gives weak or unresolved states an opportunity to conceal weakness even as competition provides weak or unresolved states with the incentives to deceive (to bluff) other competitors. A state can ‘pool’ with other states, claiming to be resolved or capable regardless of its true status. ‘Cheap talk’ claims make it difficult to distinguish resolved or capable opponents from weaker types. Only by imposing contests can states ‘separate’, or distinguish resolute opponents from those seeking to bluff. Thus, states fight in large part because they cannot determine bargains that each prefers to what each expects to obtain from fighting. If states can agree on the content of eventual settlements, then mutually preferred bargains typically exist ex ante. Thus, uncertainty about the allocation of spoils from the contest accounts for the contest itself.

The State-Market Relationship: Costly Signaling Through Markets

Markets are informational devices. The simplest description of a market involves exchanges between buyers and sellers and the price mechanism for market clearing. Markets embody consensus beliefs about factors affecting the value of goods and services. Since political decisions affect the value of goods and services, decision making on the part of political actors influences markets. Similarly, since market behavior increasingly affects the wealth of nations, state actions that threaten market welfare also harm states.

Costly contests occur because states in competition are sometimes thwarted from obtaining efficient ex ante settlements. States have incentives to make self-serving claims about strategic variables (to bluff) and thus competitors have difficulty identifying the true nature of eventual settlements. States must sometimes fight to demonstrate capability or resolve, something that is difficult to credibly communicate through talk alone because of states’ incentives to bluff.

The interdependence of state and market makes leaders’ talk costly and hence, more credible. Leaders engaged in political competition must choose between making competitive political claims and appeasing market concerns about stability and profitability. Some state leaders will prefer to pacify global markets by moderating their political demands. Other leaders will decide that the value of political issues is too great to ignore, preferring possible political gains to certain economic losses. To the degree that leaders (or states) differ in their subjective valuation of potential political benefits and economic costs, observers learn about the true value of strategic variables from the actions of leaders confronted with globalization. Signals transmitted through global markets distinguish or ‘separate’ resolved or capable leaders from those less capable and less resolved, the interaction of state and market serves to inform the political process. The rise of global markets offers politicians an opportunity to learn through the interaction of states and markets.

Students of globalization emphasize that economic integration causes a loss of policy autonomy for states. Markets become increasingly able to avoid or counteract attempts by states to impose regulation or restrictions. This structural change in the state-market relationship does limit the ability of states to pursue preferred policies, but only in realms directly relevant to markets. In fact, because states that are confronted by global markets are better able to signal resolve short of military violence, integrated states are also better able to pursue a wider variety of political competition. Under autarkic conditions, states are free to compete over any issue. However, the limited range of mechanisms avail-
able to states in seeking to pursue competing interests means that autarchic states must often choose between cheap talk and risking war as the only means available. Many contentious issues are just not of sufficient importance for a state to consider the recourse to military force. Economic integration provides an alternative means of political competition, one that is less costly because of the reduced risk of war. This means that some issues that autarkic states are deterred from pursuing by economically integrated states. In other words, at least according to some measures, globalization increases the ability of states to pursue political competition in some aspects of international interactions.

Global markets thus serve to arbitrage information about strategic variables, enhancing the ability of states to obtain ex ante settlements and reducing the need for military violence. In a world of high capital mobility, profit-driven investors respond to political risk by exiting states at risk or else by imposing higher rents on capital. Leaders who contemplate military threats must consider the economic consequences of contentious politics in a global economy. Globalization makes the otherwise cheap talk by leaders more expensive and thus more credible.

Mobile capital can anticipate and react to political shocks. The resulting economic harm damages rents from office and may even threaten leader tenure. Therefore, leaders who pursue policies harmful to investors reveal a willingness to accept economic burdens in the pursuit of political goals. Those leaders willing to endanger domestic prosperity distinguish themselves from the less determined ones via the rational market response. The strategic economic behavior of the ‘invisible hand’ of global markets thus informs interstate political interactions by communicating credibly about political variables and reduces the need for military violence.

The globalization of markets allows market actors greater ability and autonomy in their anticipation of and response to political conditions. Because autonomous markets can convey credible information about political variables, economic integration offers states a cheaper means to pursue competing political goals. While state liberalization of restrictions over trade and capital flows is generally interpreted as a loss of state autonomy, more robust markets in turn allow states to exploit markets as efficient and effective instruments of statecraft. States integrated into the world market are actually blessed with a greater degree of freedom to act competitively in the political arena through costly economic signaling. The ominous consequences of seeking to change status quo conditions under autarky can only be interpreted as autonomy in the same way that a starving man on a desert island is ‘free’ to dream of food. Economic integration feeds the economic needs of states, but it also frees states to pursue a broader set of political objectives. This counterintuitive conclusion contradicts the conventional wisdom of both proponents and critics of economic globalization. Proponents of globalization emphasize economic benefits while critics assert that integration heightens political tensions. In contrast to both, we identify important positive political externalities of globalization, showing that integration can reduce the advent of militarized violence even as it enhances the ability of states to compete. We illustrate our argument with a case study of the Taiwan Straits crisis involving China, Taiwan, and the United States.

**A Case Study: The Taiwan Election Crises**

In March 2000, the People’s Republic of China (PRC) and the Republic of China (ROC) seemed on the verge of converting a war of words into a military contest. A crisis over the previous election in 1995–96 had brought threatening military action in the form of Chinese missile tests. All participants in the previous crisis had learned something of the nature and intensity of the competing demands. Thus, the tensions were not a surprise. In addition, China sought concessions intended to cement the future of Taiwan firmly to the mainland while Taiwanese voters contemplated converting de facto autonomy into de jure independence. Yet, the crisis quickly subsided after each side moderated incompatible demands. Why? Had the nations involved been limited in their competition to cheap words or costly war, it is possible, even likely, that China would have resorted to force. While several factors contributed to a tacit settlement, we argue that an important mechanism averting the need for military action to demonstrate resolve was the presence of valuable economic linkages.

When the Communists took power on the mainland in 1949, Nationalists under Chiang Kai-shek fled to Taiwan, where the fiction of a greater Republic of China was maintained, 90 miles off the Fujian coast. A cold war continues between the ROC and the PRC. The PRC considers Taiwan to be a
renegade province and has consistently demanded reunification. For decades, Taiwan also sought re-
unification, though under Nationalist rule. The US and the PRC adopted the ambiguous ‘one China’
principle as part of the Sino-US rapprochement in 1972. Leaders in Beijing, recognizing the impracti-
cality of invasion, could bide their time as long as ruling parties on both sides of the Taiwan Strait fa-
vored ‘eventual’ reunification.

Ironically, while conflicting visions of reunification helped in the past to stabilize tensions between
the ROC and the PRC, a lessening of political tensions since the 1970s contributed to the crisis. Opening
of the mainland to Taiwanese goods and investments in recent years had helped to build Taiwan-
ese prosperity that in turn fostered democracy and nationalism on the Island even while KMT legiti-
macy declined. Many Taiwanese began to contemplate a course independent of the mainland. Inde-
pendence was a key objective of the main opposition Democratic People’s Party (DPP), dominated by
majority indigenous Taiwanese (as opposed to KMT mainland ex-patriots). Increasingly, China now
perceives a need to stem the ebb tide of enthusiasm for the ‘one China’ principle. The March 1996
elections in which DPP candidates figured prominently were overshadowed by PRC war games and
missile tests intended to intimidate Taiwanese voters. The strategic situation became more complex
as the US rushed two carrier battle groups to the area. The PRC learned that it had underestimated US
intentions, while citizens on Taiwan learned that the issue of the status of the Island remained impor-
tant to leaders in Beijing. The fact that a second crisis occurred in 2000 demonstrates that the parties
involved continued to differ in their expectations about the nature of an eventual settlement. The fact
that the second crisis did not involve war (only threats of military violence) suggests that the parties
had a unique means of competing unavailable to most states throughout history.

During the first few months in 2000, a new crisis broke out with Taiwan scheduled to hold its sec-
cond direct presidential election on 18 March. The election posed a three-way race among the pro-
independence Democratic Progressive Party (DPP) candidate Chen Shui-bian, incumbent Kuomintang
(KMT) candidate Vice President Lien Chan, and the independent candidate James Soong. Among the
three parties, the DPP most favored independence. As a candidate, Chen Shui-bian symbolized the
independence movement, having advocated Taiwan’s independence from both the KMT and from the
mainland throughout his career.

On 21 February, fearing the prospect of Chen’s victory in the March election, China’s State Coun-
icil issued a policy white paper warning of a possible military attack if Taiwan declared independence,
if outside forces ‘meddled’ in China’s internal affairs (a not-so-veiled threat aimed at the United
States), or if Taiwan persisted in dragging its feet over reunification. The first two conditions are con-
sistent with earlier statements by the PRC, but the last condition appears to reflect China’s fears that it
can no longer afford to bide its time, that China may be ‘losing Taiwan’. Finally, just three days before
the election, Chinese Premier Zhu Rongji raised tensions to a fever pitch by warning that election of a
pro-independence candidate could bring war.

In spite of PRC intimidation, on 18 March 2000, voters elected pro-independence candidate Chen
Shui-bian as the new president of Taiwan. Obviously, an attack never materialized from the mainland.
One might offer that PRC military forces remain incapable of mounting an amphibious assault on the
island, but this is only a partial explanation. As early as the 1996 crisis, China had prepared plans
and equipment for a sustained bombardment of Taiwanese ports with conventionally equipped short-
to-medium range missiles. Such an attack would clearly devastate Taiwan’s heavily trade-dependent
economy. Roughly 70% of Taiwan’s trade ships through two ports, Kao-hsiung and Chi-lung, both of
which were targeted in war games in 1996.

Another reason for limited escalation was that each side learned about its opponent during the cri-
sis. Before March 2000, observers could plausibly downplay Taiwanese enthusiasm for its evolving
path. While Taiwanese citizens said they favored autonomy, it was not yet clear how much Chinese
pressure they would resist. Issues on Taiwan had evolved since the 1996 crisis. Candidates were no
longer debating autonomy but independence. Even while pace of the independence movement seemed
to increase, the real impetus behind the movement was not yet clear. Was Taiwan moving toward
rapid independence or was this just a ‘fad’ that would soon pass? The position of Taiwanese after the
2000 crisis is much less ambiguous.

In large part, the ability of competitors on both sides of the Taiwan Straits to discern intentions
short of military violence was due to the prevalence of the new global economy. Resolve was tested,
and threats made credible, through currency exchanges rather than through artillery battles. The new
availability of an intermediate step between boisterous talk and military violence made it possible to compete short of war. During the crisis, Taiwan’s stock market suffered sharp downturns that, along with Chen Shui-bian’s victory, signaled Taiwanese resolve. From experience, Taiwanese voters knew that electing Chen Shui-bian was bound to lead to a stock market crash. On 9 February 2000, the market was at a 29-month high, breaking 10,000 points. Yet on 22 February, a day after China’s policy white paper, Taiwan’s Stock Exchange index plummeted 617.7 points (6.6%) to 8,812, the largest drop in Taiwanese history (surpassing a 612.5-point dive on 7 April 1990). The market index continued its decline throughout March, with a 195.6-point drop on 16 March (the day after Zhu Rongji’s warning) to 8,473. It is thus not surprising that after Chen Shui-bian won the election on 18 March (Saturday), the Taiwan stock market again fell sharply the following Monday, losing 254.7 points (2.9%). Knowing the economic consequences, roughly 83% of Taiwan’s 15.5 million voters turned out to cast ballots with Chen obtaining 39.3% of the votes, leading second place candidate James Soong by a 2.5% margin. The Taiwanese voters traded the stock market prosperity for the pro-independence candidate, sending an informative signal about their resolve to withstand potential China military attacks and seek independence or at least greater autonomy.

Throughout the crisis, China used various methods to display its opposition to the Chen Shui-bian candidacy. However, China knew that threats, missile tests and even war games might not appear credible to Taiwan voters. China had attempted to influence Taiwan’s first direct presidential election in 1996. But voters still elected Beijing’s least preferred candidate (Lee Teng-hui). In a time when China placed high priority on trying to develop economically, conflict with Taiwan is costly and thus undesirable. On the other hand, the PRC needed to make Taiwanese voters understand the seriousness with which it viewed the question of Taiwanese independence. Trade politics with the US offered an opportunity for credible communication.

China has long sought accession to the WTO (the World Trade Organization). To gain entry, China first needed to obtain permanent normal trade relations with the United States. On 15 November 1999, after extended talks and the direct intervention of Premier Zhu Rongji, US and Chinese negotiators finally reached an agreement whereby China would open its economy to more extensive competition in exchange for WTO membership. As a follow-up to the agreement, President Clinton needed to obtain congressional passage of the trade bill granting permanent normal trade relations with China. The PRC leadership knew that although the Clinton administration made passage of the China trade bill a priority, its prospect in Congress was not at all certain. Supporters of the bill (Republicans and the business lobby) were opposed by two-thirds of House Democrats together with traditional Democratic constituents (labor, environment, and human rights groups). If China wanted to assure WTO membership, it should have avoided antagonizing a divided US Congress.

Yet, in sharp contrast to their previous relentless efforts at WTO accession, PRC leaders repeatedly provoked the US Congress over Taiwan. In February 2000, China issued the threatening white paper, stiffening opposition to the trade bill even before it reached Congress. On 8 March, President Clinton sent the trade bill to Congress and then launched a major effort to rally congressional support. Once again, on 15 March, with the fate of the bill at a critical juncture in Congress, Premier Zhu Rongji delivered the much publicized threat about the upcoming election in Taiwan, emphasizing that the people of the mainland were willing to ‘shed their blood’ to prevent Taiwan’s secession. Zhu Rongji jeopardized his own considerable efforts on behalf of China’s accession to WTO by delivering this heavy-handed threat against Taiwan. Yet, by doing so, the PRC more clearly demonstrated its resolve to whoever eventually came to power in Taiwan. While the bill eventually passed both houses of Congress, the long delay and the willingness of China to risk its WTO status in an attempt to deter Taiwanese independence is telling. Just as the Taiwanese proved resolved in the crisis, the Chinese leadership also was able to demonstrate strong interest without firing a shot.

Credible demonstrations of resolve on both sides of the Taiwan Strait led to a mutual post-election wind-down. After his electoral victory on 18 March, Chen Shui-bian made a series of conciliatory moves, delivering an acceptance speech without inflammatory reference to independence, retaining the current defense minister, and planning to revise the DDP’s charter regarding Taiwan independence. Meanwhile, China issued the statement that it would ‘observe where [Chen] will lead cross-Strait relations’. The crisis passed without violence, in part because both sides were able to signal through economic rather than military means. The Taiwan Straits crisis was a source of tension and
concern worldwide, but it also offers hope in an increasingly integrated world. Globalization more often makes it possible for states to avoid military contests.

**Implications**

Policy makers acutely feel the presence and impact of global markets. South Korea’s former Prime Minister Lee Hong Koo commented, ‘In the old days we used to say, ‘History dictated this or that’. Now we say that ‘market forces’ dictate this and you have to live within [those forces]. It took us time to understand what had happened. We didn’t realize that the victory of the Cold War was a victory for market forces above politics’ (quoted in Friedman, 2000: 107). That the markets for stocks, bonds and currencies can profoundly influence national economies overnight is no longer an abstraction after financial crises in Asia and Russia. Economic markets, driven by expectations about economic and political fundamentals, can handle evolving information efficiently, resulting in informative market behaviors. It is these properties of the markets that allow economic globalization to affect interstate political relations. As we discuss here and demonstrate elsewhere formally, it is not the benefits of globalization that deter disputes (Gartzke and Li, 2001). States can too easily use the vulnerability of their counterparts to leverage new political concessions. Rather, the size and presence of global assets make it possible for leaders to credibly demonstrate resolve in ways not traditionally available.

States are still asymmetrically integrated into the world economy. Asymmetric integration is often pointed to as a possible precipitant of conflict. The impact of asymmetry in dispute behavior deserves more careful assessment. We conjecture that asymmetry does not directly increase the probability of disputes. Instead, asymmetrically integrated dyads are asymmetrically able to signal. This suggests a useful refinement of policy actions intended to influence interstate violence. Measures that decrease interstate inequality and asymmetry in integration are normatively desirable and can be justified on this basis alone. However, whether such efforts are justified in terms of war reduction is a different question. The informational argument claims that disputes are not generally a consequence of situational variables. States do not fight due to inequality, but because of different perceptions about dissatisfaction and/or resolve. Even if economic integration leads to slightly greater inequality, the advantages of globalization in terms of costly signaling may be justified. The United States and other major economic powers can encourage peace by promoting global economic ties.

The rise of the autonomous market does not necessarily imply a weakened state. The assumption of many students of globalization is that states and markets are in competition, that the state-market relationship is zero-sum. Realists are pessimistic because they see the rising power of markets as necessarily weakening states while liberals are more optimistic because they see international institutions as a remedy for many of the purported problems of globalization and because they value ‘low politics’ more than realists. In some cases, increasing market power does limit state power. For example, the liberalization of tariffs and capital controls is always associated with some loss of state control. In many areas, however, state and market are not direct competitors, but are more appropriately seen as complementary entities.

One consequence of globalization that is clear but that has been ignored in previous studies is that increasing market autonomy opens up new avenues for competition between states. As Friedman (2000: 12) aptly put it, “the Cold War was a world of “friends” and “enemies”. The globalization world, by contrast, tends to turn all friends and enemies into “competitors””. It would not be surprising to find that globalization makes states even more aggressive and interventionist, at least in some policy areas. Proponents of globalization typically advocate the formation of supra-national institutions to conduct essential functions, and eventually superecede, sovereign states. But such a vision, while sufficient, is certainly not necessary for the pursuit of globalization. Nor is it the case that states require protection from the inherently negative repercussions of markets. Negative repercussions are likely to exist, but the balance of consequences for states from markets has not been properly evaluated and may even be positive, as we suggest here. Thus, the need for global institutions to regulate externalities between state and market is an assumption not derived from the structure of state-market relationships. Further, the nature of market externalities may be such that they benefit, rather than harm, the global political arena. Integration stands to facilitate credible interaction among states, but only if institutional mechanisms designed to protect politics from markets do not interfere.
One of the benefits of the globalization debate has been increasing attention to the linkages between international politics and international political economy. Still, studies of the interconnectedness of the two subjects have yet to progress sufficiently. Political economists emphasize the relationship between state and market. IR scholars are typically concerned with inter-state relations. Even when they do appear interested in the effects of economics on international politics, students of international conflict often remain interested only in political consequences of economic change, a preoccupation that has led them to fail to notice how the effect of state behavior affects the state-market relationship, which in turn affects inter-state relations. The emergence of greater economic autonomy means that market actors can shift wealth with greater ease, ironically making the global market more sensitive to political behavior. Traditional international relations focus only on interstate political relations, without looking at the emerging role of market actors, a source of criticism from international political economists (Strange, 1996). Keohane and Nye (1979) make a powerful argument for the inclusion of non-state economic actors, though later research reverts to a more traditional state centrism (Keohane, 1993). In early stages of globalization, where we appear to be now, the continued reification of the state may not be too problematic. However, if global economic integration continues to affect the world economy structurally, it necessitates additional complexity (or at least new actors) in the conduct and analysis of international politics. As Strange (1996) argued, structural changes in the world economy are changing the nature of diplomacy from solely between states to that between states, between firms and between states and firms. States may continue to play a game of power politics, ignoring the interests of market actors. Yet, increasingly states can do so only at a very great price. Liberals argue that international institutions are needed to thwart such market inefficiencies while realists are concerned that states might bow to market inefficiencies and stop playing as robust a game of politics. We offer a more optimistic ‘middle way’, one that appears to us to be far more consistent with the logic of how political conflict evolves. We see the inefficiencies of political competition as virtuous because they provide information to political actors in competition. At least one rationale for protecting the state from the market is removed if markets do not increase the probability of conflict. Similarly, protecting markets from states stands to limit the informational value of signaling through the strategic interaction of state and market actors. Making the threats and demands of political competitors more expensive makes such actions more informative and promises to reduce the need of states to resort to militarized violence.

Students of globalization have restricted their attention to one area of interest (state-state or state-market), such that the interactions between state-state and state-market relations under globalization have yet to be fully explored. Also, students of the state-state relationship have just begun to explore informational, rather than distributional, explanations for interstate contests. As a result, participants to the globalization debates have failed to notice one of the most important positive political externalities of economic globalization, that is, its pacifying effect over interstate political contests through the informational properties of markets. The two fields (international conflict and international political economy) can both benefit from a bridge between them. By looking at the emerging power of the market as a third party, students of international conflict can better understand interdependence and go beyond trade ties. By looking at the implications for interstate political contests, students of international political economy can more appropriately assess the ramifications of economic globalization, beyond the usual debate on state-market relations alone.

References


Notes

1 Waltz (1999) argues that global economic integration will not much change international politics.

2 Sassen (1996) discusses the shift in relative power between states and markets, but also emphasizes the continuing importance of the symbiotic relationship between states and markets (states need markets for rents while markets need states for enforcement of contracts, public goods provision, etc.).

3 It seems to us perplexing to claim both that globalization reduces state autonomy, leading to war and that anarchy is the cause of international conflict. If anarchy is a permissive condition for war (which we contest, note that guerrilla warfare seeks to *cause* anarchy and that domestic conflicts far outnumber major international disputes), then actions that remove or limit anarchy (such as the promotion of international institutions that are associated with globalization) would appear to remove, or at least reduce, one of the conditions that are claimed to precipitate international conflict. An attempt to sufficiently chronicle inconsistencies in the realist position is, however, beyond the scope of this project.

4 ‘The removal, so far as possible, of all economic barriers and the establishment of an equality of trade conditions among all the nations consenting to the peace and associating themselves for its maintenance’, Wilson (1918), Point III.

5 Wars need not end by resolving differences between states. Rather, they resolve uncertainty about the likely consequences of pursuing differences through force. Wars may also end because competitors are no longer physically able to sustain combat, though these contests (total wars) appear to be significantly less common.

6 There are exceptions to this argument involving commitment problems and indivisibility of issues that allow disputes to occur among fully informed actors. We omit discussion of these issues to retain the parsimony of our explanation and because we believe that these other accounts are not modal behavior (see Gartzke 1999).

7 Excludability implies that property rights are enforceable. There are few incentives to fight for what cannot be denied the loser. Relative gains concerns suggest that non-rival goods can still form the basis for contests.

8 As shown in Gartzke, Li, and Boehmer (2001), opportunity costs seldom deter disputes directly, which dispels a conventional liberal conviction. Competitors must have beliefs about what opponents will accept in lieu of fighting. If states are less willing to fight, then opponents have incentives to make additional demands so that the pacifying effects of opportunity costs are subsumed in eventual settlements.


10 ‘The 1996 Taiwan Straits Crisis came as a shock to people in both capitals. Many in Beijing had convinced themselves that the United States would wash its hands of Taiwan or perhaps already had in order to avoid confrontation with China. Many in Washington thought China would not engage in military adventurism and risk relations across the strait and across the Pacific, upon which its rapid economic development depended. Following the 1996 confrontation, those beliefs were less common’. Garver (1997: 5–6).

11 ‘The current tension across the Taiwan Straits has been entirely caused by the perverse acts of some leaders in Taiwan who preach an independent Taiwan’. Shen GuoFang, PRC Foreign Ministry spokesman. CNN Interactive, ‘China Admits Taiwan Intimidation’, 7 March 1996, www-cgi.cnn.com/WORLD/9603/china_Taiwan/07/missiles/index.html.

12 ‘Beijing’s amphibious lift capability is extremely limited at present and there are no indications that China is devoting resources to improve significantly its amphibious assault capability’. (DOD, 1999). Also see Moore (2000).

13 Taiwanese efforts to obtain 2 sea-based Aegis missile systems (aboard Arleigh Burke class destroyers made in the US) are largely motivated by the SRBM and MRBM threat.
Chinese leaders seem to have interpreted market signals in line with our argument. In a warning three days prior to the election, Chinese Premier Zhu Rongji cited plunging Taiwanese stock market prices as evidence of market anxiety about the possibility of war (Xinhua News Agency Xinhua general news service, 15 March 2000).

United Press International. ‘Beijing, watching Taiwan, maintains ‘one China’ policy’ (Beijing, 19 March 2000).