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What can economic interdependence do for Asia?

*Rohan Mukherjee**

In a short essay published in 2000, Aaron Friedberg noted that for the first time in the modern era, Asia is emerging as “a cluster of strong, prosperous, independent nations dealing intensively and continuously with one another in diplomatic, strategic and economic matters.” Did this mean that Asia would follow pre-1945 multipolar Europe’s path to war and self-destruction? Or would Asia—fundamentally different from Europe—somehow discover the basis for lasting peace?¹

History provides sufficient reason for pessimism about future conflict in Asia. Between 1946 and 2007, Asia—including East, Central (minus Russia), South, and the Middle East, or West Asia—was home to 66 percent of interstate wars and 95 percent of combat deaths in such wars.² This statistic presents a stark contrast to the century prior to 1945, when Europe and the Western hemisphere dominated the war ledger. The record in the case of intra-state or civil wars is similar. Between 1946 and 2007, Asia accounted for 43 percent of such wars and 56 percent of the combat deaths in these wars.³ It becomes evident that the locus of geopolitical competition and great-power politics has shifted steadily eastward in

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¹ Aaron L. Friedberg, “Will Europe’s Past Be Asia’s Future?” *Survival*, 42:3, Autumn 2000, 147-159.

² Computed from the Correlates of War project. Data available at www.correlatesofwar.org.

³ These figures exclude the Chinese and Taiwanese civil wars of 1947-49, which alone account for 52 percent of battle deaths if included.

the course of the 20th century. Indeed all of the United States' wars since 1945, with the exception of Kosovo in 1999, have been fought in Asia.

In some respects, Asia's place as a site of considerable military conflict in the late 20th century is an artifact of the Cold War, a time that saw more wars on average per year and more external interference in Asian politics compared to the post-1989 world.⁴ It is possible, therefore, that the world today is fundamentally different in the ability of countries to enjoy relatively peaceful relations. Less optimistic observers point out that China's late 20th-century "calculative" grand strategy⁵ designed to facilitate a peaceful rise is giving way to a more assertive stance.⁶ Others highlight the potential for the United States to make missteps in Asia that might lead to war.⁷ Many analysts have thus predicted conflict between the United States and China, China and Japan, or China and India in coming years.

The actions of great and rising powers will undoubtedly be critical for Asia's future, but there are other material factors operating between countries that might mitigate the impetus for future conflict. Prominent among these factors is economic interdependence, or the manner in which economic relations between countries ensure that events in one country become contingent on events in another country, and vice versa, thus limiting the

⁴ Between 1990 and 2007, Asia's share of wars—44 percent—was the same as Europe and the Western Hemisphere combined.

⁵ Ashley J. Tellis and Michael D. Swaine, *Interpreting China's Grand Strategy: Past, Present, and Future* (Santa Monica: RAND, 2000).

⁶ For a summary of this debate, see Alastair Iain Johnston, "How New and Assertive Is China's New Assertiveness?" *International Security*, 37:4, Spring 2013, 7-48.

⁷ Steve Chan, *China, the U.S., and the Power-Transition Theory: A Critique* (New York: Routledge, 2008).

policy autonomy of both countries.⁸ All else being equal, military conflict between two countries is likely to severely attenuate their economic relations. The less substitutable these relations, the more likely countries are to try and avoid military conflict. The logic of interdependence suggests that the future of Asian stability hinges on the ability of countries to develop the types of economic relations that are costly to disrupt.

There are broadly four modes of inter-state economic engagement in Asia: trade, investment, aid, and cross-border production. These channels vary in the strength of the interdependence they foster. Aid is clearly the least likely to create any sort of binding commitment between nations. Although interdependence may exist between recipient and donor, both parties are generally able to replace aid with other policy instruments in a pinch. Nonetheless, aid often constitutes an expression of diplomatic interest, friendship, or support; the channels of collaboration and communication that accompany a thriving aid relationship can be useful in times of crisis. It bodes well then that Asian countries have steadily increased the amount of aid they provide to other Asian countries. Between 2000 and 2011, this figure amounted to USD 167.3 billion.⁹

Trade is more likely to promote interdependence between nations and thereby constrain them toward peace in times of crisis. This is particularly the case if the products and services traded are specialized to a degree that makes them difficult to replace. The Asian economic

⁸ For an extensive treatment of this concept, see Robert O. Keohane and Joseph S. Nye, *Power and Interdependence* (Boston: Addison-Wesley, 1977).

⁹ Computed using data from M. J. Tierney et al, "More Dollars than Sense: Refining Our Knowledge of Development Finance Using AidData," *World Development*, 39(11), 2011, 1891-1906.

miracle since the 1970s has largely been based on increasing openness to trade, a phenomenon that has led to a degree of interdependence even between the United States and China.¹⁰ Since the end of the Cold War, Asian countries have steadily expanded their trading relationships with each other. In 2013, Asia's product imports from Asia accounted for 63 percent of Asia's total product imports, and Asia's product exports to Asia accounted for 60 percent of Asia's total product exports.¹¹ In this regard, Asia is second only to Europe, whose corresponding shares were 67 percent and 70 percent respectively.¹² Despite this impressive comparison, the bulk of trade in Asia occurs between countries in East and Southeast Asia. South Asia, Central Asia, and the Middle East remain poorly integrated as stand-alone regions. This is an important disparity that attenuates the effect of trade-induced interdependence when considering Asia as one geopolitical unit.

Trade is still a relatively tenuous channel of interdependence, given the competitiveness of global markets and the mostly low-tech (i.e. substitutable) products traded between developing countries, of which there are many in Asia. In comparison, direct (not portfolio) investment is a surer way of fostering interdependence. When a firm in one country makes greenfield investments in another country or purchases equity stakes in firms of another country, a more concrete interest is created (depending on the size of the investment) that is harder to disrupt in times of crisis. In

¹⁰ Wayne M. Morrison and Marc Labonte, "China's Holdings of U.S. Securities: Implications for the U.S. Economy," *CRS Report for Congress*, RL34314, August 19, 2013.

¹¹ Computed from the Trade Map of the International Trade Centre (based on UN COMTRADE data): www.trademap.org.

¹² *Ibid.*

2012, Asian countries themselves accounted for 45 percent of the approximately USD 5.4 trillion stock of FDI in Asia (the comparable figure for Europe investing in Europe was 73 percent).¹³ Again, regional disparities are hidden in this figure, with East Asia investing significantly more in its own region compared to South, Central, or West Asia in their respective regions.

When compared to aid, trade and investment, cross-border production networks—a relatively new type of economic relationship—constitute one of the strongest forms of economic interdependence in the world today. These networks, operated mostly by large multi-national firms, take advantage of advances in information and communications technologies to horizontally segment their supply chains across multiple geographies, mostly at the regional level, thus profiting from the respective comparative advantages of different economies while also creating less substitutable forms of economic integration between nations.¹⁴ The most obvious example of a state that has benefited from these types of networks, and has also been drawn closer to its neighbors as a result, is China. East and Southeast Asia have benefited as a result, but other parts of Asia remain strangers to this new form of engagement, primarily due to the lack of adequate infrastructure and economic complementarities, and the presence of political obstacles especially in South and West Asia.

Thus if we accept the postulate that growth in *certain forms* of economic interdependence is likely to dampen the impulse toward conflict in Asia (all else being

¹³ The International Monetary Fund's Coordinated Direct Investment Survey (<http://cdiis.imf.org/>).

¹⁴ Devesh Kapur and Manik Suri. "Geoeconomics versus Geopolitics: Implications for Asia," in N. Kaur and N. Singh ed., *Handbook of the Economics of the Pacific Rim* (Oxford University Press, 2014).

equal), then three broad observations emerge from the brief survey above. First, Asia is clearly a variegated geopolitical unit with diverse economic and political constraints. The beneficial effects of interdependence are likely to be felt in some parts earlier and more intensely than others. In order to ensure a more even spread, policymakers must capitalize on opportunities to better integrate regions such as South and Central Asia, and even the Middle East. Second, not all forms of interdependence are equal, and the ones with the most potential also require the greatest public investment in terms of physical infrastructure, human capital, and domestic order (even the rule of law). Thus although trade, investment, and production are driven largely by private actors, the state in Asia has a major role to play by creating the necessary public goods for economic interdependence to emerge.

Finally, economic interdependence is a necessary but insufficient condition for future peace in Asia. There are a host of factors—including territorial disputes, nationalism, and miscalculation—that might lead to war in the future. While deepening webs of economic linkages may not prevent such occurrences, they are a precondition for the type of growth and prosperity that might dampen the impact of crises and under some circumstances even preclude them. As noted by Larry Summers in a recent speech on whether the year 2014 will resemble 1914 in its propensity for a worldwide military conflict, “economic success does not assure peace, but economic failure and disintegration almost assures conflict.”¹⁵ Asia’s leaders have much to gain from

¹⁵ Larry Summers, “Will 2014 end up like 1914?” *The World Post*, April 22, 2014.

building the types of economic relationships that provide the most reliable insurance against conflict.