

# **Economic Warfare: A Study of U.S. and China Strategy Using the Economic Element of National Power**

**A Monograph  
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## Abstract

Economic Warfare: A Study of U.S. and China Strategy Using the Economic Element of National Power, 43 pages

Following the fall of the Soviet Union in 1991, the United States stands alone today as the only global superpower remaining. Many political scientists have speculated that our nation will enjoy this status for many years to come with only China as a possible near peer competitor in the next 25 years. Today, China is rising—peacefully so far. Its focus remains on economic development and winning acceptance as a great power.

The U.S. military forces dominate the battlefield today, but recent operations have demonstrated that victory cannot be achieved through the traditional annihilation of enemy forces alone. The United States can only achieve victory through the quiet synchronization and integration of all elements of national power. Current operations in Kosovo, Afghanistan, and Iraq provide poignant examples of the future nature of warfare. This change in warfare requires the United States to shift from a 20<sup>th</sup> century annihilation approach toward a full spectrum approach which engages all elements of national power.

America has at its disposal the elements of national power (diplomatic, information, military, and economic) to support the U.S. National Security Strategy. The use of these elements of national power protects and allows the United States to remain the lone superpower in the world today. The efficient and effective use of America's assets is critical in support of the National Security Strategy. One element of national power that is of critical importance because of the recent explosion in technology and globalization is the *economic* arm. This monograph will compare the economic arm of national power for both the U.S. and China.

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## INTRODUCTION

Economic power has helped shape American foreign policy for decades. This element of power is very flexible. If used wisely in conjunction with the political, military, and informational elements, it is extremely effective. Whether our nation has a large or small military, our leadership does understand economics, but not necessarily in the same manner the Chinese do as a weapon of warfare. Economics is a great tool to create conditions for further action or to coerce a nation to change its behavior. As the world further embraces globalization, economics as an element of power will only gain greater influence in the United States and around the world. This monograph will look at how China and the U.S. use this element of national power to shape their world. The question is whether we are truly using economics to *our* advantage as a weapon of warfare to shape the world of tomorrow.

### **The World of Tomorrow – 2050**

I want to take you forward in time to the year 2050 for a fictional snapshot of the United States and the world at large if current international economic policies continue. The top six economies in the world (in order) in the year 2050 are: China, United States, India, Japan, Brazil, and Russia. European countries are not within the top six as the European Union imploded due to infighting amongst its members. The United Kingdom sided with the United States as its economy continued to spiral as part of the European Union. The value of one U.S. dollar buys only 2.5 Chinese yuan. The U.S. dollar is no longer seen as stable currency due to the tremendous international debt accrued from overspending and lack of fiscal economic policy.

The United Nations has been replaced by the World Trade Federation (WTF) with 7 permanent members (the top six world economies and additionally the United Kingdom, which the U.S. insisted as a member). The balance of power within this organization is tipped to the east with China, India, Japan, and Russia on one side, with United States, United Kingdom, and Brazil on the other.

Manufacturing and production is now primarily based in the East, as U.S. companies in the past 40 years, continued to move their factories overseas and outsourced technical expertise to Eastern professionals in China, India, and Japan. General Motors and Ford were bought by Toyota in 2042.

The United States is in debt of over 10 trillion dollars. China owns over half of this debt with China continuing to buy our Treasury bonds (albeit it at much lower rates) to keep our interdependent market regulated and the value of their currency stable. Prices in America have spiked in the past 10 years due to lack of foreign investment as the dollar value has declined. China's integrated economy has been affected, but in comparison China's domestic prices have steadily increased with inflation and production, while the U.S. prices have spike in the last 10 years. China now dictates the price of their exports to the United States (the price of foreign controlled debt).

The average American home was \$400,000 in 2040, but those prices have fallen in the past 10 years to \$250,000. Americans have no savings and owe more than their homes are worth. Credit cards and bank loan interest rates are so high that the average American cannot afford to get a loan and owes more than they can pay on their credit cards. The government is allowing the American family a one time bankruptcy in an attempt to generate domestic economy. American families are now forced to live within their means for the first time in almost 100 years.

The U.S. government has cut many programs to attempt to balance the budget and become fiscally responsible. Currently, the President is an Independent that was voted into office on a fiscal reform campaign promoting economic responsibility and accountability. Over 90% of voters believe that the U.S. economic policy needs improvement.

Although the world of 2050 is fiction, one can agree that it is certainly not "shaped" for United States success. The questions raised are how did this happen?; why did this happen?; and what can we do today to prevent this future from coming to fruition? As the United States implements economic policy today, it must realize that it is shaping the world we must live in

tomorrow. The United States is shaping both our own and China's destiny through its own policies, but is China an innocent player in this game or is China also shaping its own destiny?

## **Present Day**

Following the fall of the Soviet Union in 1991, the United States stands alone today as the only superpower remaining in the world. Many political scientists have speculated that our nation will enjoy this status for many years to come with only China as a possible near peer competitor within the next 25 years. Today, China is rising—peacefully so far. Its focus remains on economic development and winning acceptance as a great power. Is China's economic focus out of necessity or rather is it a calculated plan to gain power against the United States?

China is already emerging as an economic power in Asia. In 2006, China stood as the second-largest economy in the world after the US.<sup>1</sup> U.S. strategy with China focuses on economic engagement, with the hope that increasing wealth within China may eventually lead to democratic reform. China and U.S. economies are interdependent upon one another. It is because of this interdependence coupled with U.S. economic policy that both countries will engage in economic conflict within the future. This paper will analyze both China and U.S. economic policies and determine where the conflicts are. China's true economic strategy will be determined using the published Chinese concept of "Unrestricted Warfare." An analysis of trade alliances and currency devaluation will determine current Chinese methodologies and strategies in the global market.

China has two very important upcoming world events: the 2008 Olympic Games and the 2010 World Expo. These international gatherings are extremely important to China. No longer

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<sup>1</sup> CIA World Factbook, Updated 15 Mar 07, available at <https://www.cia.gov/cia/publications/factbook/geos/ch.html>; Internet; accessed 15 March 2007.



will China focus internally alone, as it must now engage the world to quench its desire for resources for its “ever growing” middle class.

As recently as 1850, China was the world’s largest economy. However, by 1950, China and India together had declined to about 8 percent of global GDP while Europe and North America had become 75 percent of global GDP.<sup>2</sup> This imbalance is changing in Asia’s favor where China and India account for over 15 percent of the global economy and are growing at phenomenal rates. By 2025, China is likely to become the world’s biggest economy and after 2050. Asia will resume its historical position as the global economic leader.<sup>3</sup>

The words *Made In China* have become synonymous with American children’s toys, clothes, and shoes. No other nation sews more clothes, stitches more shoes, or makes more toys than China. China exports more electronics (TVs, DVDs, and cellphones) than any other nation. No other nation has ever made such a run at climbing the economic ladder, and no other country plays this economic game better.<sup>4</sup>

Beyond China’s economy is its large population. China is home to close to 1.5 billion people equal to the populations of Germany, France, and the United Kingdom combined. Currently, a large urban migration is occurring in the peasant countryside. This migration to the cities is due largely to a lack of government support to rural farmers and the rise of capitalism in urban areas. By 2010, almost half of all Chinese will live in urban areas.<sup>5</sup> This change in China’s populous has led to a search for resources to quench the thirst of this new emerging middle class. How the world chooses to quench this appetite will shape not only the U.S. economy, but every other economy in the world much in the same way that American industrialization and expansion influenced the world over the last hundred years.<sup>6</sup>

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<sup>2</sup> Clyde Prestowitz, “The Return to Asia”, *Economic Strategy Institute* (October 3, 2006), 1.

<sup>3</sup> *Ibid.*

<sup>4</sup> Ted C. Fishman, *China Inc.* (New York: Scribner, 2005), 1.

<sup>5</sup> *Ibid.*, 2.

<sup>6</sup> *Ibid.*, 7.

President Hu Jintao has provided China remarkable success in engaging the world in search of market economies. President Hu spent more time in South America in two weeks in 2004 than President George W. Bush spent on the continent of South America during his first four-year term as president.<sup>7</sup> President Hu pledged billions of dollars in investments to Brazil, Argentina, Cuba, and Chile during his visit. During a three-week period at the end of 2006, President Hu hosted leaders of over 48 African countries in Beijing, visited Vietnam for the annual Asia-Pacific Economic Cooperation summit, Laos, and India and Pakistan. Hu promised to double aid to the African countries by 2009, train 15,000 professionals, provide scholarships to over 4,000 students, and help Africa's health care and farming sectors.<sup>8</sup>

As China becomes more globally focused, it still remains a country that does not wish to engage in other nation's internal affairs. According to the Council of Foreign Studies report regarding China-African foreign aid, "These aids are attractive to countries within Africa because they come with "no conditionality related to governance, fiscal probity, or other concerns of Western donors."<sup>9</sup>

In December 2006, China signed a \$16 billion natural gas contract with Iran and partnership to develop oilfields for China in Iran. This contract may explain why China consistently joins with Russia (also dependent on Iran for oil) to refuse tough sanctions against Tehran which have been sought in 2006 by both Europe and the U.S.<sup>10</sup>

China's military spending is up 300% in the past decade.<sup>11</sup> Noted China watcher at the Johns Hopkins School of Advanced International Studies, James Mann in his recently published book, *The China Fantasy*, states that the U.S. has less leverage over China than it did over the Soviet Union because China holds billions of dollars in U.S. government assets. American

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<sup>7</sup> Michael Elliott, "The Chinese Century," *Time* (January 22, 2007), vol. 169, no. 4, 35-44.

<sup>8</sup> Ibid.

<sup>9</sup> Ibid.

<sup>10</sup> Ibid.

<sup>11</sup> Ibid.

consumers now rely on China's cheap labor to ensure low prices at American stores such as Wal-Mart. Mann states that, "this lack of leverage over China may make for an uncomfortable future."<sup>12</sup>

Although U.S. military forces dominate the battlefield today, recent operations have demonstrated that victory alone cannot be achieved through the traditional annihilation of enemy forces. The United States can only achieve victory through the quiet synchronization and integration of all elements of national power. Current operations in Kosovo, Afghanistan and Iraq provide poignant examples of the future nature of warfare. This change in warfare requires the United States to shift from a 20<sup>th</sup> century annihilation approach toward a full spectrum approach which engages all elements of national power: diplomacy, intelligence, military and *economic*.

America has at its disposal the elements of national power (diplomatic, information, military, and economic) to support the U.S. National Security Strategy. The use of these elements of national power protects and allows the United States to remain the lone superpower in the world today. The efficient and effective use of America's assets is critical in support of the National Security Strategy. Although the United States remains focused on the military element of national power, one element that is recently emerging, once again, because of the recent explosion in technology and globalization is the *economic* arm.

## **Economic Theory**

Economics originated in the West with the publication in 1776 of *Wealth of Nations* by political economist Adam Smith.<sup>13</sup> According to Smith, trade between two nations is based on

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<sup>12</sup> James Mann, *The China Fantasy: How Our Leaders Explain Away Chinese Repression* (New York: Viking, 2007), 19-25.

<sup>13</sup> Adam Smith, *Wealth of Nations*, (New York: P.F. Collier & Son: 1909), 1.

absolute advantage.<sup>14</sup> Absolute advantage theory asserts that individuals or nations trade because they have superior productivity in particular industries. Nations should produce and export goods for which they have an absolute advantage and import goods by which other nations have an absolute advantage of producing. Governments can attempt to counter absolute advantage through trade barriers<sup>15</sup>

Smith's theory was superseded by the comparative advantage theory in 1817. Political economist David Ricardo's comparative advantage theory suggested that international trade was not governed by absolute advantage in price but by comparative advantage.<sup>16</sup> A country can still gain from trading certain goods even though its trading partners can produce those goods at a cheaper price. The comparative advantage comes if each trader has a product that will bring a better price in another country than it will at home. If each country specializes in producing the goods in which it has a comparative advantage and more goods are produced. The wealth of both the buying and the selling nations increases.<sup>17</sup>

Economic interdependence theory posits that "reducing barriers among countries to transactions and to movements of goods, capital, and labor, including harmonization of laws, regulations, and standards" leads to linked economies that trade together in harmony.<sup>18</sup> The liberals have highlighted economic interdependence in order to show how prevalent cooperation is, and can be, in international relations. Liberals argue that economic interdependence lowers the likelihood of war by increasing the value of trading over the alternative of aggression: interdependent states would rather trade than invade.<sup>19</sup> The argument was first made popular in

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<sup>14</sup> Dominick Salvatore, *International Economics, 5<sup>th</sup> Edition* (New Jersey: Prentice Hall, 1995), 28.

<sup>15</sup> Ibid 28-29.

<sup>16</sup> Ibid 30-31.

<sup>17</sup> Ibid.

<sup>18</sup> Deardorff's Glossary of International Economics, available from <http://www-personal.umich.edu/~alandear/glossary/i.html#integration>; Internet, accessed on 26 Mar 07.

<sup>19</sup> Keohane, Robert O. "International Liberalism Reconsidered," in John Dunn, ed., *The Economic Limits to Modern Politics* (Cambridge: Cambridge University Press, 1990), pp. 165-194.

the 1850s by Richard Cobden, who asserted that free trade "unites" states, "making each equally anxious for the prosperity and happiness of both."<sup>20</sup>

Interdependence falls short from a realist perspective regarding state's interests. Realists dismiss the liberal argument, arguing that high interdependence increases rather than decreases the probability of war. In anarchy, states must constantly worry about their security. Accordingly, interdependence - meaning mutual dependence and thus vulnerability - gives states an incentive to initiate war, if only to ensure continued access to necessary materials and goods.

For political scientist, John Mearsheimer, nations that "depend on others for critical economic supplies will fear cutoff or blackmail in time of crisis or war." Consequently, "they may try to extend political control to the source of supply, giving rise to conflict with the source or with its other customers." Interdependence, therefore, "will probably lead to greater security competition."<sup>21</sup>

According to realist international relations theory, states are primarily motivated by the desire for military and economic power or security, rather than ideals or ethics.<sup>22</sup> A realist perspective views the international world whereby states can never be sure about the intentions of other states; the basic motive driving states is survival or the maintenance of sovereignty; states are instrumentally rational and think strategically about how to survive.<sup>23</sup>

The modern version of a realist "economic" perspective in international relations can be found in Neo-realism Theory. Neo-Realism takes a more international realist perspective toward economics. Neo-realism is a modern day reactionary approach to current international relations

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<sup>20</sup> Richard Cobden, *The Political Writings of Richard Cobden* (London: T. Fischer Unwin, 1903), p. 225.

<sup>21</sup> John J. Mearsheimer, "Disorder Restored," in Graham Allison and Gregory F. Treverton, eds., *Rethinking America's Security* (New York: W.W. Norton, 1992), p. 223.

<sup>22</sup> Martin Dunn, *Virtual War College, 1998-2000* available at [http://www.geocities.com/virtualwarcollege/ir\\_realism.htm](http://www.geocities.com/virtualwarcollege/ir_realism.htm); accessed on 27 March 2007.

<sup>23</sup> International Relations Theory (Realism defined), available at <http://www.irtheory.com/know.htm>; accessed on 28 March 2007.

and specifically globalization occurring in the world today. Neo-realism became popular in 1979 with the release of *Theory of International Politics* by Kenneth Waltz. In his book, Waltz states that the fundamental "ordering principle" of the international system is anarchy and individual state actors lack "relations of super- and subordination that are distinguished only by their varying capabilities."<sup>24</sup> Waltz argues in favor of constraint on state behavior, so that different states behave in a similar rational manner, and outcomes fall within an expected range.<sup>25</sup>

Neo-realism is not the current economic theory in place today within America's National Security Strategy (NSS). Currently, the NSS strategy using economic means is a more liberal approach using economic enablers to allow democracy to flourish in developing countries. Is this the right economic strategy for us? This monograph will compare the economic arm of national power for both the U.S. and China and how each nation uses or fails to use this important element of national power.

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<sup>24</sup> Kenneth Waltz, *Theory of International Politics* (New York, NY: McGraw-Hill, 1979), 88-97.

<sup>25</sup> Ibid.

## CHAPTER ONE

### U.S. ECONOMIC STRATEGY

The National Security Strategy recognizes the importance of strengthening our economic security, expanding trade and investment, and promoting economic development. We are working to achieve these goals through diplomacy and by sharing the experience of our own development, based on our political and economic freedoms. Success in achieving these economic policy goals is a core part of our National Security Strategy.

*Under Secretary of State, Alan P. Larson<sup>26</sup>*

"Our Nation's cause has always been larger than our Nation's defense. We fight, as we always fight, for a just peace—a peace that favors liberty. We will defend the peace against the threats from terrorists and tyrants. We will preserve the peace by building good relations among the great powers. And we will extend the peace by encouraging free and open societies on every continent."

*President George W. Bush<sup>27</sup>*

America's current way of thinking is skewed toward the military element of national power. The United State has at its disposal many elements of national power (diplomatic, information, military, and economic) to support the U.S. National Security Strategy. The economic arm is a core part of the NSS as articulated in the quote above. Prior to getting to this core element of the NSS it is important to discuss and understand the basic design of the National Security Strategy.

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<sup>26</sup> Alan P. Larson, "Economic Priorities of the National Security Strategy," available from <http://usinfo.state.gov/journals/itps/1202/ijpe/pj7-4larson.htm>; Internet; accessed 21 December 2006.

<sup>27</sup> President George W. Bush speech to West Point Class of 2002. West Point, New York, June 1, 2002.

## National Security Strategy (NSS)

According to Deputy National Security Advisor J.D. Crouch, the NSS is “based on the proposition that peace and international stability rest on a foundation of free nations.”<sup>28</sup> The current administration’s NSS document released in 2006 is an updated version of NSS 2006. This document states that the United States will continue to help nations develop their own democratic institutions and prosperous societies. By using the elements of national power, the United States proposes to remain the lone superpower in the world today. The efficient and effective use of America's assets is critical in support of the National Security Strategy. Some of these elements of national power are more important than others but all work together to support the National Security Strategy objectives.

The National Security Strategy contains five essential themes:<sup>29</sup>

1. Preserving and enhancing America’s political, economic, diplomatic, and military strength against those who would harm the United States and its allies;
2. Defeating terrorism by promoting a positive vision of freedom and democracy as the alternative to the terrorists’ negative ideology of hatred and repression;
3. Working to defeat tyranny and promoting effective democratic institutions;
4. Encouraging nations that pursue effective democratic institutions by supporting their efforts to promote prosperity, open markets, and integrating developing countries into the world economy; and
5. Leading the growing community of democracies to face cross-border threats, such as pandemic diseases, the spread of weapons of mass destruction, terrorism, human trafficking and natural disasters.

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<sup>28</sup> Press interview with Deputy National Security Advisor, J.D. Crouch, “New National Security Strategy Charts U.S. Foreign Policy Course” outlining the new U.S. National Security Strategy March 2006. Available from <http://usinfo.state.gov/mena/Archive/2006/Mar/20-242143.html>; Internet, accessed 17 January 2007.

<sup>29</sup> George W. Bush, *National Security Strategy 2006*, 36-37.



According to Deputy National Security Advisor J.D. Crouch, the first strategy is really premised on preserving our national, economic, diplomatic, and our military strength. He states that the President has articulated what we need to preserve these elements from and that is terrorism.<sup>30</sup> The second theme describes a long-term strategy to defeating terrorists, focused on defeating their hateful ideology. The third theme recognizes that freedom and democracy are not just a means to an end. This means the U.S. works to end tyranny and to promote effective democracies. The fourth theme of the NSS emphasizes a development strategy that focuses on outcomes.

The NSS articulates an economic strategy or “way forward” approach focused on achieving a spread of democracy throughout the world. The NSS even states the theory behind this approach in the context of the document, “over time, as people gain control over their economic lives, they will insist on more control over their political and personal lives as well.”<sup>31</sup>

Regarding U.S. relations with China, NSS 2006 states that engagement with China is fundamental to our influence on their political future. “As economic growth continues, China will face a growing demand from its own people to follow the path of East Asia’s many modern democracies, adding political freedom to economic freedom. Continuing along this path will contribute to regional and international security.”<sup>32</sup>

According to Deputy National Security Advisor Crouch, the U.S. “needs to encourage nations and reward nations that govern well and invest in their own people, and that we will work

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<sup>30</sup> Press interview with Deputy National Security Advisor, J.D. Crouch, “New National Security Strategy Charts U.S. Foreign Policy Course” outlining the new U.S. National Security Strategy March 2006. Available from <http://usinfo.state.gov/mena/Archive/2006/Mar/20-242143.html>; Internet, accessed 17 January 2007.

<sup>31</sup> George W. Bush, *National Security Strategy 2006*, 4.

<sup>32</sup> *Ibid*, 1

with them to promote prosperity, open markets, integrating developing countries into the world economy through the WTO, free trade agreements, and the like.”<sup>33</sup> The fifth and final theme explains the importance of growing a “community of democracies” to deal with catastrophes such as pandemic disease, the proliferation of weapons of mass destruction, terrorism, human trafficking, natural disasters (ie tsunami). “Effective democracies are better able to deal with these challenges than are repressive or poorly governed states.”<sup>34</sup>

### **NSS-Economic Components**

One element of national power that is of critical importance because of the recent explosion in technology and globalization is the economic arm. There is no one document alone to find an all encompassing economic strategy which supports the National Security Strategy (NSS) and provides the U.S. government, corporations, small businesses, and every American individual an economic strategy for maintaining our global economic strength. However, economic strategic themes are present throughout the NSS and make up the core underpinnings of the strategy. The NSS provides a clear vision to spread economic prosperity through democracy, globalization, and free trade.<sup>35</sup>

The National Security Strategy states that economic freedom is “a moral imperative...that also reinforces political freedom.”<sup>36</sup> “It creates diversified centers of power and authority that ultimately limit the reach of government. It expands the free flow of ideas; with increased trade and foreign investment comes exposure to new ways

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<sup>33</sup> Press interview with Deputy National Security Advisor, J.D. Crouch, “New National Security Strategy Charts U.S. Foreign Policy Course” outlining the new U.S. National Security Strategy March 2006. Available from <http://usinfo.state.gov/mena/Archive/2006/Mar/20-242143.html>; Internet, accessed 17 January 2007.

<sup>34</sup> Ibid.

<sup>35</sup> Alan P. Larson, “Economic Priorities of the National Security Strategy,” available from <http://usinfo.state.gov/journals/itps/1202/ijpe/pj7-4larson.htm>; Internet; accessed 21 December 2006.

<sup>36</sup> George W. Bush, *National Security Strategy 2006*, 27.

of thinking and living which give citizens more control over their own lives.”<sup>37</sup> In short, the NSS articulates our economy as central to the spread of democracy, also a theme throughout the NSS.

The economic element of national power is extremely important to the overall strategy for the United States abroad. The economic “way forward” strategy as articulated by the NSS is:

1. Opening markets and integrating developing countries.
2. Opening, integrating, and diversifying energy markets to ensure energy independence.
3. Reforming the International Financial System to Ensure Stability and Growth.

According to Under Secretary of State, Alan Larson, the economic dimension of the National Security Strategy focuses on three distinct priorities<sup>38</sup>:

1. Economic security by making the U.S. and global economies more resilient to economic shocks.
2. Advance a global prosperity agenda by expanding trade and investment between nations.
3. Ensure poor nations participate fully in the rising tide of prosperity.

### **National Economic Council**

The National Economic Council was established in 1993 within the Office of Policy Development and is part of the Executive Office of the President. It was created to advise the President of the United States on matters related to U.S. and global economic policy. The NEC has four principal functions: to coordinate policy-making for domestic and international

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<sup>37</sup> Ibid.

<sup>38</sup> Ibid.

economic issues, to coordinate economic policy advice for the President, to ensure that policy decisions and programs are consistent with the President's economic goals, and to monitor implementation of the President's economic policy agenda.<sup>39</sup> Allan Hubbard is Assistant to the President for Economic Policy and Director of the National Economic Council (NEC). The NEC is comprised numerous department and agency heads within the administration, whose policy jurisdictions impact the nation's economy. The staff is composed of two Deputy Assistants to the President, whose responsibilities are divided between domestic and international economic issues. The Deputy Assistant concerned with international economy reports directly to the National Security Adviser. The other members of the NEC coordinate and implement the President's economic policy objectives on the following economic policy issues: agriculture, commerce, energy, financial markets, fiscal policy, healthcare, labor, and Social Security.<sup>40</sup> Interestingly, there is no one document that has been produced by the United States NEC to outline the economic strategy of the United States of America in the global, international environment. The NEC continues to focus on overriding domestic issues.

### **Economic Element of National Power**

The most potent and flexible ability of the United States to influence events worldwide may not be military, but economic.<sup>41</sup> Increasingly, national leadership may find exercising military power difficult to use in this complex world. One way to think about national power is “the capacity to create capabilities that a nation can use to undertake actions to achieve its

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<sup>39</sup> The White House, *The National Economic Council*, available from <http://www.whitehouse.gov/nec/>; Internet, accessed 21 January 2007.

<sup>40</sup> Ibid.

<sup>41</sup> Clayton K. S. Chun, “Economics: American element of Power or Source of Vulnerability?” available at <http://www.au.af.mil/au/awc/awcgate/army-usawc/strategy2004/11chun.pdf>; Internet, accessed 21 March 2007, 157.

national interests. In this light, a strong economy provides the means to allow national leaders the ways to attain desired ends.”<sup>42</sup>

The economic element of national power is a mechanism that can be used to shape international activity through United States government spending and taxation. Economic policy on money supply and interest rates, trade agreements, trade policy, and other negotiated trade arrangements in addition to U.S. Government policy to promote international trade activity, and sometimes American Trade Interests. Although boring and mundane compared to the other elements of National Power—this element especially the money supply and interest rate aspect—is critical for stability both domestically and overseas.<sup>43</sup>

A government can use economic means to deter or compel another to take certain actions. The United States can use its economic power to deny essential goods or services from a potential adversary. The nation can simply refuse to sell certain items to a country, outbid rivals for the sale of the items so that the targeted country cannot purchase the items, deny adversaries the ability to sell goods and services that would reduce their ability to buy certain resources, or get other countries to act against the state in question. A strong economy has a great say among producers and consumers around the world. In some respects, even if the nation is concerned about buying a product from another country, the United States can influence adversaries behavior. Suppose the seller of a raw material decides to export that product to an American adversary.<sup>44</sup>

A nation can also use its economy to try to defeat another power. The nation can use its economic power in an attempt to destroy an adversary’s capability to take certain actions or destroy power projection. Although the physical defeat of an enemy is usually associated with

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<sup>42</sup> Ibid, 159.

<sup>43</sup> John Mills, “All Elements of National Power’: Re-Organizing the Interagency Structure and Process for Victory in the Long War,” *Strategic Insights*, volume V, issue 6 (July 2006), available at <http://www.ccc.nps.navy.mil/si/2006/Jul/millsJul06.pdf>; Internet, accessed 21 March 2007.

<sup>44</sup> Ibid, 159-160.

military operations, economic means are also viable to support the elimination of a nation's ability to take certain actions.<sup>45</sup> The United States, with the world's largest economy, has many options it can use to influence, coerce, and defeat a foe with economic means.<sup>46</sup>

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<sup>45</sup> Ibid, 160.

<sup>46</sup> Ibid, 160-161.

## CHAPTER 2

### CHINA'S ECONOMIC STRATEGY

In general, the strategy for employing the military is this: If your strength is ten times theirs, surround them; if five, then attack them; if double, then divide your forces. If you are equal in strength to the enemy, you can engage him. If fewer, you can circumvent him. If outmatched, you can avoid him.

Sun Tzu, *Art of War*<sup>47</sup>

For centuries China stood as one of the world's leading civilizations, outpacing the rest of the world in the arts and sciences. As recently as 1850, China was the world's largest economy. Although by the early 20th century, China was besieged by civil unrest, major famines, military defeats, and foreign occupation. After World War II, the Communists under Mao Zedong established an autocratic socialist system that, although ensured China's sovereignty, imposed strict controls over everyday life and cost the lives of tens of millions of people.<sup>48</sup> By 1950, China and India together had declined to about 8 percent of global GDP while Europe and North America had become 75 percent of global GDP.<sup>49</sup> This imbalance is changing in Asia's favor where China and India account for over 15 percent of the global economy and are growing at phenomenal rates.

After 1978, Mao Zedong's successor Deng Xiaoping and other leaders within China began to focus on a market-oriented economy, and by 2000 output had quadrupled. In 2001, China was accepted to the World Trade Organization (WTO) with support and encouragement from the United States. By 2006, China stood as the second-largest economy in the world after

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<sup>47</sup> Sun Tzu, *Art of War*, Translated by Ralph D. Sawyer (Colorado: Westview Press, 1996), 51.

<sup>48</sup> CIA World Factbook, available from <https://www.cia.gov/cia/publications/factbook/geos/ch.html>; Internet; accessed 15 March 2007.

<sup>49</sup> Clyde Prestowitz, "The Return to Asia", *Economic Strategy Institute* (October 3, 2006), 1.

the only the U.S.<sup>50</sup> By 2025, China is likely to become the world's biggest economy and after 2050. Asia will resume its historical position as the global economic leader.<sup>51</sup>

The economic strategy enacted by Mao Zedong in 1978 sent China on an economic pace that within the past two decades has China growing at a phenomenal rate of 10% annually.<sup>52</sup> During 2004, the Chinese government tightened down on macroeconomic policies. The People's Bank of China (PBC) took steps to reduce overall liquidity in the banking sector and slow overall lending growth, intensified open market operations, increased bank deposit and lending interest rates, and eliminated the ceiling on lending rates.<sup>53</sup>

China, like the United States, uses all of its elements of national power within its strategy that the Chinese refer to as their "grand strategy." China's grand strategy consists of a combination of political, *economic*, informational, and military means that Beijing has adopted over the past ten years actively embracing multilateralism and improving bilateral relations with the world's major powers to conduct a "peaceful rise." This strategy emerged in 1996 after a thorough analysis regarding the post-Cold War world.<sup>54</sup>

Chinese grand strategy is the first level of warfare. This level can be somewhat compared to our own strategic level of war, but focused solely at the international level. This is

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<sup>50</sup> CIA World Factbook, available from <https://www.cia.gov/cia/publications/factbook/geos/ch.html>; Internet; accessed 15 March 2007.

<sup>51</sup> Prestowitz, "The Return to Asia," 1.

<sup>52</sup> Stanford University China Economic Overview 2007, available at [http://www.gsb.stanford.edu/library/programs/faculty\\_china\\_study\\_trip/pdf/Economic%20Overview.pdf](http://www.gsb.stanford.edu/library/programs/faculty_china_study_trip/pdf/Economic%20Overview.pdf); Internet; accessed 18 March 2007.

<sup>53</sup> Ibid.

<sup>54</sup> Avery Goldstein. "China's Grand Strategy and U.S. Foreign Policy," available from AmericanDiplomacy.org at [http://www.unc.edu/depts/diplomat/item/2005/0709/gold/gold\\_china.html](http://www.unc.edu/depts/diplomat/item/2005/0709/gold/gold_china.html); Internet; accessed 11 January 2007.



the level of war that we will focus on for the remainder of this monograph. The following are the Chinese 4 levels of warfare<sup>55</sup>:

1. Grand War-War Policy
2. War- Strategy
3. Campaigns-Operational Art
4. Battles-Tactics

The first level is “grand war-war policy.” In this level of war, the Chinese use military and non-military actions of warfare, but mainly focused on the non-military. Often referred to as “grand strategy,” this level of warfare is focused internationally using non-military means.<sup>56</sup> The second level is “war-strategy” which focuses on the national level using again using both military and non-military actions or warfare, but with the military playing a much larger role. The third is “campaigns-operational art” which is warfare in between the war and battle levels of Western warfare. This level of warfare can be compared to the Western operational level of war. The fourth and final level of warfare focus on military action at the tactical level and is comparable to the tactical level of Western warfare.

## **Grand Strategy**

China’s current grand strategy focuses on a peaceful rise to generate economic growth to allow China to establish itself as a global power. This strategy has emerged as a reaction to China’s global position as a weak but potentially powerful state. This strategy will allow China to grow for several decades into a truly great power.

Four distinct factors contributed to China’s current grand strategy: U.S. strength, China weakness, nervous international reaction, and Taiwan tensions. In the mid 1990s, China realized

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<sup>55</sup> Col Qiao Liang and Col Wang Xiangsui. *Unrestricted Warfare: China’s Master Plan to Destroy America* (Panama: Pan American Publishing Company, 2002), 169-171.

<sup>56</sup> Ibid,

that the world was not going to be multi-polar, and that they would face a foreseeable future where the U.S. could potentially frustrate China's international ambitions. China witnessed a strong U.S. military in 1991 during Operation Desert Storm. They clearly recognized just how far they would have to go to compete militarily. In the mid 1990s, this weakness was once again confirmed as the U.S. Navy conducted a show of force operation off the Taiwan Strait to ward off Chinese intimidations of Taiwan pursuing independence.<sup>57</sup>

China's grand strategy using economic power is ultimately causing geopolitical power. China is gaining political soft power by becoming everyone's largest customer.<sup>58</sup> China has surpassed the United States as the largest export market for South Korea, Taiwan, Japan, Thailand, and Indonesia.<sup>59</sup>

### **BRIC Economic Report**

In a fascinating study, conducted by the investment house Goldman, Sachs and Co. in 2003, the company compared the BRIC economies (China, Brazil, Russia, and India) to the G6 economies (United States, Japan, Germany, United Kingdom, France, and Italy) over the next 40 years in comparative GDP growth. The report concluded that China would become the largest economy in the world and the BRICs together would surpass the 7 leading industrialized countries of the world.<sup>60</sup> The BRIC report used information from demographic projections, capital accumulation, productivity growth, GDP growth, income per capita, and currency

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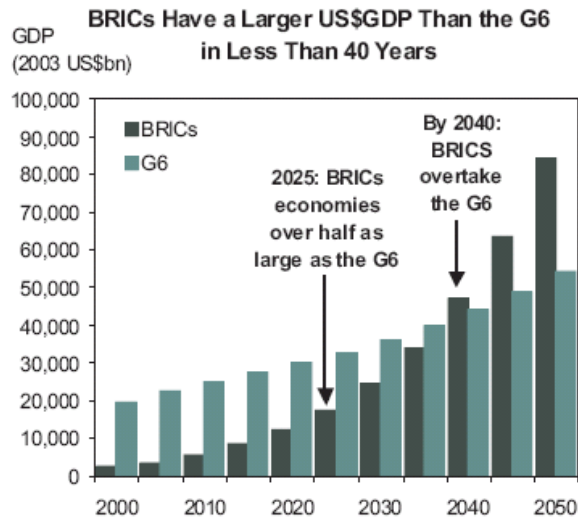
<sup>57</sup> Avery Goldstein. "China's Grand Strategy and U.S. Foreign Policy," available from AmericanDiplomacy.org at [http://www.unc.edu/depts/diplomat/item/2005/0709/gold/gold\\_china.html](http://www.unc.edu/depts/diplomat/item/2005/0709/gold/gold_china.html); Internet; accessed 11 January 2007.

<sup>58</sup> Clyde Prestowitz, *Three Billion New Capitalists: The Great Shift of Wealth and Power to the East*. (New York: Basic Books, 2005), 226.

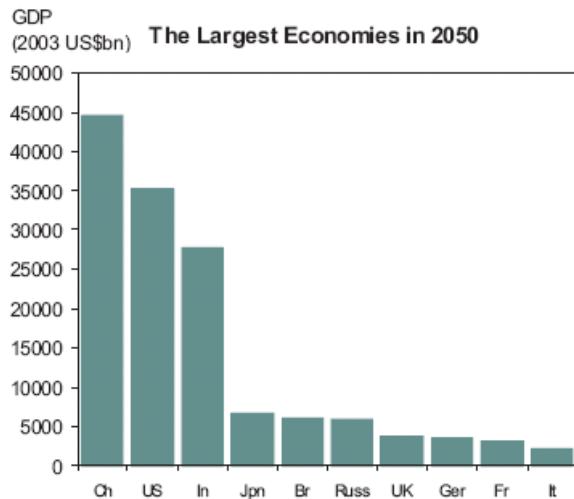
<sup>59</sup> Ibid.

<sup>60</sup> Dominic Wilson and Roopa Purushothaman, "Dreaming With BRICs: The Path to 2050" *Global Economics Paper No: 99*, Goldman, Sachs & Co. Economic Report, 1 October 2003,

movements projected to the year 2050.<sup>61</sup> Today, the BRIC countries account for only 15% of the combined GDP of the G6 (in current U.S. dollar term), but by 2050, only the U.S. and Japan will still be in the top 6 economies in the world.<sup>62</sup> In terms of purchasing power, the BRICs pass the G6 by 2020.<sup>63</sup>



**Figure 1 and 2: BRIC GDP Report**



available at <http://www2.goldmansachs.com/insight/research/reports/99.pdf>; Internet, accessed 21 March 2003, 1.

<sup>61</sup> Ibid.

<sup>62</sup> Ibid.

<sup>63</sup> Ibid.

The BRIC report was very enlightening and projected a very different future political landscape in world politics. This different political landscape was not commented on within the report, and no projections were made within the report to describe this new global political dynamic other than stating it would be very “different” than today. This is where the report falls short. One major point of analysis can be drawn from this report regarding the future of the United Nations. Of the countries within the study, there were five which are currently serving as permanent members of the United Nations Security Council (UNSC): United States, Russia, France, United Kingdom, and China. Of the five nations on the UNSC, only China and Russia are members of the BRIC nations, with China depicted as the largest economy by 2050. The point to draw is that the world will be different indeed if the BRIC report is correct in the future.

In a recent interview conducted by *Business Week* magazine, both noted economists and authors of the BRIC report, Wilson and Purushothaman, were asked a few questions regarding this report and stated that “in the future the largest economies in the world are no longer necessarily the richest countries.”<sup>64</sup> The economic engagement of these countries and the strategies implemented today will be critical to shaping the world of tomorrow.

### **Quest for Resources**

China has an insatiable consumption rate with little end in sight. This consumption rate is directly effecting the world markets. Between 1990 and 2003, China’s oil consumption increased 81 percent. The direct effect on the global oil market was an increase of 13 percent. China’s consumption of cement doubled in that 13 year span, the world market demand for

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<sup>64</sup> Dominic Wilson and Roopa Purushothaman, “The BRICs Are Coming—Fast,” *Business Week Online*, 27 October 2003, available at [http://www.businessweek.com/magazine/content/03\\_43/b3855187\\_mz035.htm](http://www.businessweek.com/magazine/content/03_43/b3855187_mz035.htm); Internet, accessed 21 March 2007.

cement grew 52 percent. Global demand for stainless steel increased by 48 percent, while demand in China increased eight-fold.<sup>65</sup>

On December 11, 2001, China was admitted into the World Trade Organization (WTO). According to Mike Moore, WTO Director-General, this was truly a defining moment in international economic trade relations. “With China's membership, the WTO will take a major step towards becoming a truly world organization. The near-universal acceptance of its rules-based system will serve a pivotal role in underpinning global economic cooperation,” said Mike Moore.<sup>66</sup>

In a September 2001 press release, China made the following commitments prior to acceptance into the WTO<sup>67</sup>:

1. China will provide non-discriminatory treatment to all WTO Members. All foreign individuals and enterprises, including those not invested or registered in China, will be accorded treatment no less favorable than that accorded to enterprises in china with respect to the right to trade.
2. China will eliminate dual pricing practices as well as differences in treatment accorded to goods produced for sale in China in comparison to those produced for export.
3. Price controls will not be used for purposes of affording protection to domestic industries or services providers.
4. The WTO Agreement will be implemented by China in an effective and uniform manner by revising its existing domestic laws and enacting new legislation fully in compliance with the WTO Agreement.
5. Within three years of accession all enterprises will have the right to import and export all goods and trade them throughout the customs territory with limited exceptions.

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<sup>65</sup> Admiral Alejandro Kenny, Argentine Navy, “China’s Presence in Latin America: A View on Security from the Southern Cone, *Military Review* (September-October 2006), 60-61.

<sup>66</sup> WTO Press Release, “WTO successfully concludes negotiations on China's entry,” 17 September 2001, available at [http://www.wto.org/english/news\\_e/pres01\\_e/pr243\\_e.htm](http://www.wto.org/english/news_e/pres01_e/pr243_e.htm); Internet, accessed on 28 March 2007.

<sup>67</sup> Ibid.

6. China will not maintain or introduce any export subsidies on agricultural products.

Foreign investment remains a strong element in China's remarkable expansion in world trade.<sup>68</sup> China's quest for resources has led to a global outreach to quench China's thirst for resources. China has received many resources from Latin America, essentially the backyard of the U.S. in the Western Hemisphere. Many in Latin America believe that trade with China provides a "good counterbalance to trade asymmetry with the United States."<sup>69</sup> President Hu spent more time in South America in two weeks in 2004 than President George W. Bush spent on the continent during his four-year first term as president.<sup>70</sup>

China has been making a strong move into Latin American resources over the past 5 years. As the United States remains focused in the Global War on Terror in the Middle East, China is gaining a strong foothold in Latin America. Brazilian exports to China are growing at an alarming rate annually. This strong trade will give China an economic and political hold in Latin America. In 2004, President Lula of Brazil stated that China and Brazil "share similar interests regarding social needs, imperatives of growth, and communal thinking in the United Nations and the World Trade Organization."<sup>71</sup>

Recently, President Bush has tried to reach out to Latin American countries once again during a recent visit in March 2007 to reestablish trade and alliance with these important strategic allies in the Western Hemisphere. President and Mrs. Bush traveled to Brazil, Uruguay, Colombia, Guatemala and Mexico from March 8-14, 2007. The trip was suppose to reestablish the United States commitment to the Western Hemisphere and highlighted common agenda to

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<sup>68</sup> CIA World Factbook, available from <https://www.cia.gov/cia/publications/factbook/geos/ch.html>; Internet; accessed 15 March 2007.

<sup>69</sup> Admiral Alejandro Kenny, Argentine Navy, "China's Presence in Latin America: A View on Security from the Southern Cone, *Military Review* (September-October 2006), 61.

<sup>70</sup> Michael Elliott, "The Chinese Century," *Time* (January 22, 2007), vol. 169, no. 4, 35-44.

<sup>71</sup> Ted C. Fishman, *China Inc.* (New York: Scribner, 2005), 144.

advance freedom, prosperity, and social justice and deliver the benefits of democracy in the areas of health, education, and economic opportunity.<sup>72</sup>

Export growth continues to be a major component supporting China's rapid economic growth, and China's current account has been in surplus due to large surpluses in trade balance. In 2005, trade surplus surged from US\$59 billion in 2004 to US\$134.2 billion.<sup>73</sup> The United States accounts for more than 20 percent of China's total exports, while China's imports from the United States account for about 10 percent of its total imports. The large trade deficit by the U.S. with China has strained trade relations between the two countries. In 2005 the U.S. trade deficit with China reached a record US\$202 billion, up from a deficit of US\$124 billion in 2003. The United States believes that China is purposefully undervaluing its currency to keep its manufactured exports inexpensive.<sup>74</sup> According to Stephen Roach, chief economist and director of global economic analysis at Morgan Stanley, "the Chinese economic boom could change the global order and lift Beijing above Washington in economic might and influence."<sup>75</sup>

### **Regional Economic Dominance**

According to the 2006 Annual Report to Congress: Military Power of the People's Republic of China, China remains a committed participant in the Asia-Pacific Economic Cooperation (APEC) and the Association of Southeast Asian Nations (ASEAN) Regional Forum. Both of these institutions, in which the United States participates, form the foundation for East-

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<sup>72</sup> U.S. State Department, *The President's trip to Latin America: March 2007*, available from <http://www.state.gov/p/wha/81535.htm>; Internet; accessed 17 March 2007.

<sup>73</sup> Stanford University China Economic Overview 2007, available at [http://www.gsb.stanford.edu/library/programs/faculty\\_china\\_study\\_trip/pdf/Economic%20Overview.pdf](http://www.gsb.stanford.edu/library/programs/faculty_china_study_trip/pdf/Economic%20Overview.pdf); Internet; accessed 18 March 2007.

<sup>74</sup> Ibid.

<sup>75</sup> Discussion between economists Stephen Roach and Desmond Lachman, "Is China Growing at the United States' expense?", October 2006, available at [http://www.cfr.org/publication/11631/is\\_china\\_growing\\_at\\_the\\_united\\_states\\_expense.html](http://www.cfr.org/publication/11631/is_china_growing_at_the_united_states_expense.html); Internet accessed 19 March 2007.

Asian and Pacific regional architecture.<sup>76</sup> As recently as December 2005, China continues to try to exclude the United States diplomatically was also geared to promoting regional institutions that would exclude the United States, however, such as the December 2005 East Asia Summit and the ASEAN dialogue.

China's growing economic and military power, expanding political influence, diplomacy, and increasing involvement in regional multilateral institutions are key developments in Asian affairs. According to David Shambaugh, Director of the China Policy Program in the Elliott School of International Affairs and Professor of Political Science and International Affairs at George Washington University, China's has a new proactive regional posture, reflected in almost all their elements of national power: economic, diplomatic, and military. This posture in Asia correlates to China's increased activism on the global stage.<sup>77</sup>

According to realist political scientist John Mearsheimer, a theory that explains how rising powers are likely to act and how other states will react to them predicts the future of Asia. "My theory of international politics says that the mightiest states attempt to establish hegemony in their own region while making sure that no rival great power dominates another region. The ultimate goal of every great power is to maximize its share of world power and eventually dominate the system."<sup>78</sup> According to Mearsheimer, China is likely to try to dominate Asia the way the United States dominates the Western Hemisphere.<sup>79</sup> China as a regional hegemon could be the beginning of China's rise to future superpower status. China watchers are monitoring this

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<sup>76</sup> 2006 Annual Report to Congress: Military Power of the People's Republic of China, available at <http://www.defenselink.mil/pubs/pdfs/China%20Report%202006.pdf>; Internet accessed 21 March 2007.

<sup>77</sup> David Shambaugh, "China Engages Asia: Reshaping the World Order," *International Security*, vol. 29, no. 3 (Winter 2004/05), 64.

<sup>78</sup> John J. Mearsheimer and Zbigniew Brzezinski: Q and A discussion forum, "Clash of the Titans," *Foreign Policy*, available at [http://www.foreignpolicy.com/story/cms.php?story\\_id=2740&page=1](http://www.foreignpolicy.com/story/cms.php?story_id=2740&page=1); Internet, accessed on 21 March 2007.

<sup>79</sup> Ibid.



situation closely to determine China's strategy in the East as it shapes itself through its economic element of national power.

## ECONOMIC WARFARE?

“This is to say that there is nothing in the world today that cannot become a weapon...As we see it, a single man-made stock market crash, a single computer virus invasion, or a single rumor or scandal that results in the fluctuation in the enemy country’s exchange rates or espouses the leaders of an enemy country on the Internet, all can be included in the ranks of new-concept weapons...The new concept of weapons will cause ordinary people and military men alike to be greatly astonished at the fact that commonplace things that are close to them can also become weapons with which to engage in war.”

*Unrestricted Warfare*<sup>80</sup>

“He who wants to win today’s wars, or those of tomorrow, to have victory firmly in his grasp, must “combine” all the resources of war which he has at his disposal and use them as means to prosecute the war.”

*Unrestricted Warfare*<sup>81</sup>

The quotations above are from a book by two former Chinese Colonels in the People’s Liberation Army (PLA), Col Qiao Liang and Col Wang Xiangsui, called *Unrestrictive Warfare: China’s Master Plan to Destroy America*. These Colonels view traditional warfare as limited and that future warfare will test the limits of war and develop many more means to achieve victory. Warfare is no longer an activity confined to the military sphere or “domain,” but rather can be decided by political factors, economic factors, diplomatic factors, cultural factors, technological factors, or non-military factors.<sup>82</sup> The domains of politics, *economics*, and diplomacy are the new battlefields of future warfare. These are elements of a new “beyond limits” approach to warfare which combines all the resources of war to achieve victory.

A “beyond limits” warfare approach focuses on the different “means” available to be utilized to achieve an objective. This approach to warfare is described in *Unrestricted Warfare* as

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<sup>80</sup>Col Qiao Liang and Col Wang Xiangsui. *Unrestricted Warfare: China’s Master Plan to Destroy America* (Panama: Pan American Publishing Company, 2002), 16-17.

<sup>81</sup>Ibid, 155.

<sup>82</sup>Ibid, 164-165.

a new way of Chinese thinking about the means one can use during warfare, and that “there is nothing” that cannot be considered a means when conducting war.<sup>83</sup>

According to the authors of *Unrestricted Warfare*, the United States is locked in a military means of conducting warfare. One example of this approach was during the 1978 Iran hostage crisis, where Iranian terrorists occupied the U.S. Embassy and took American hostage. During this crisis, the U.S. used an instant “rash of military means” which failed miserably. It was not until the U.S. used diplomacy negotiations, froze Iran’s foreign assets, imposed an arms embargo, and supported Iraq in the war with Iran that ultimately led to the end of the Iranian hostage crisis.<sup>84</sup> In the current world of unprecedented complexity, the various application of varying means led to a solution to the crisis.

In the current world of globalization and economic integration, an economically powerful country has at its means much more than economic blockades, arms embargos, trade sanctions, and military threats to coerce another country. Instead, a country could adjust its own financial strategy, using currency revaluation or devaluation as a primary means to gain the upper hand in public opinion and make financial crisis appear within the targeted country, ultimately weakening the country’s overall power as well as military strength.<sup>85</sup>

The Southeast Asian financial crisis is an example which led to the lowering of the arms race in that region of the world. China could use this approach to affect the world economy. Authors, Col Liang and Col Xiangsui, stated that “if China were a selfish country, and had gone back on its word in 1998 and let the Renminbi lose value, no doubt this would have added to the misfortunes of the economies of Asia. It would have induced a cataclysm in the world’s capital markets, with the result that even the world’s number one debtor nation, a country which relies on the inflow of foreign capital to support its economic prosperity, the United States, would

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<sup>83</sup> Ibid, 166.

<sup>84</sup> Ibid.

<sup>85</sup> Ibid, 167.

definitely have suffered heavy economic losses. Such an outcome would certainly be better than a military strike.”<sup>86</sup>

The authors of *Unrestricted Warfare* discuss a new approach to warfare, but this approach could be analysis based on an assessment that China will be disadvantaged in traditional military engagement with the United States, and therefore more innovative and asymmetric approaches are necessary to engage in warfare. This asymmetric warfare focuses on the development of what the authors call “new-concept weapons”.<sup>87</sup>

Colonels Liang and Xiangsui call all weapons in history “old-concept weapons” or weapons focused solely on their mobility and lethal power such as precision bombs and other high-tech weapons. According to these authors, Americans are slaves in their thinking to this technology and invariably often “halt their thinking at the boundary where technology has not yet reached”.<sup>88</sup> New-concept weapons, on the other hand, are not lethal, but arguably still extremely powerful nonetheless. Technology is no longer the main factor, but rather creating weapons that link closely to the lives of the common people.<sup>89</sup>

There are two indicators that China’s economy is part of the component of these “new-concept weapons”. First, China has become economically interdependent with both the United States and other Asian nations. Second, China has engaged in a strategy of economic denial and resource dominance in Asia.<sup>90</sup>

During 2004, the Chinese government tightened down on macroeconomic policies. The People's Bank of China (PBC) took steps to reduce overall liquidity in the banking sector and

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<sup>86</sup> Ibid, 167.

<sup>87</sup> Ibid, 13-14.

<sup>88</sup> Ibid, 15.

<sup>89</sup> Ibid.

<sup>90</sup> Cdr James R. Greenburg “China’s Free Trade Relationship with the United States: Economic Boon or “Unrestricted Warfare”” USAWC Strategy Research Project, Carlisle Barracks, PA: U.S. Army War College, 3 May 2004.

slow overall lending growth, intensified open market operations, increased bank deposit and lending interest rates, and eliminated the ceiling on lending rates.<sup>91</sup>

Upon China's entry into the World Trade Organization (WTO) in 2001, U.S. farmers encountered a sharp decrease in agricultural exports that was not expected by the United States.<sup>92</sup> According to Ron R. Warfield, Illinois Farm Bureau president, China's artificial trade barriers is a real problem for U.S. farmers. "We worked exhaustively to get China into the WTO because it's such a potentially great market, and we expected a good-faith effort to comply with WTO rules, but we've come face-to-face with artificial trade barriers."<sup>93</sup>

According to Ted C. Fishman, author of *China Inc.*, Chinese trade barriers come and go without warning because they are constantly rebalancing domestic farm taxes and subsidies while attempting to give their internal Chinese farmers access to world markets.<sup>94</sup> Other trade barriers arise when China limits imports citing lack of foreign crop standards or genetic makeup.<sup>95</sup> U.S. farmers were surprised when China exports grew after 2001 in many of the American goods, such as corn and soy, that Chinese farmers hoped to export in large quantities to China.<sup>96</sup> Still, the soybean market is linked directly to Chinese consumers as they continue growing and becoming more affluent.<sup>97</sup> Many of these examples, occurring immediately after China's entry into the WTO, do not tell the complete story.

The codependency between the U.S. and China is not sustainable. The U.S. cannot continue to take on larger debts annually due to foreign trade deficits. Today, the U.S. pays out greater dividends to foreign government than taken in annually. The U.S. now lives in the world

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<sup>91</sup> Ibid.

<sup>92</sup> Ted C. Fishman, *China Inc.* (New York: Scribner, 2005), 141.

<sup>93</sup> Ibid.

<sup>94</sup> Ibid, 141-142.

<sup>95</sup> Ibid, 142.

<sup>96</sup> Ibid.

<sup>97</sup> Ibid.

as renters rather than landlords.<sup>98</sup> In 2006, the U.S. had a negative \$233 billion export to import ratio with China.<sup>99</sup> If China pulls out of U.S. markets, American interest rates will climb at an alarming rate and the value of stocks, homes, businesses - almost everything declines.<sup>100</sup>

China has offered incentives to U.S. businesses regarding trade. In April 2004, a group gathered en masse in Washington, D.C. to lobby for a change in relations with China. The group called China's currency actions, "direct violations of their commitments under the World Trade Organization and International Monetary Fund. "China's manipulation of the yuan has had a devastating effect on U.S. manufacturers," said Dan Feinberg, chairman of the IPC Government Relations Steering Committee.

The worldwide competition for Chinese markets means there can be no rule of law, compliance with the World Trade Organization, or sanctions against China. There will be effort to pressure China regarding the environment, labor rights, or even geopolitical ambitions due to financial market interdependence.<sup>101</sup> China is rapidly accumulating an "impressive hand filled with foreign investment dollars, the world's best technology, and new strategic powers. China has little problem setting the rules of the game and no problem breaking them."<sup>102</sup> "In a short period of time, Beijing has proven that it can shift its foreign policy quickly and woo the world, often focusing on countries America has alienated," Joshua Kurlantzick writes in his new book *Charm Offensive*.<sup>103</sup>

China's broken promise to buy more US corn after joining the World Trade Organization in 2001 cost American corn farmers more than \$500 million in losses, causing the US to threaten

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<sup>98</sup> Ibid, 268.

<sup>99</sup> U.S. Census Bureau, U.S. and China Foreign Trade 2006, available at <http://www.census.gov/foreign-trade/balance/c5700.html#2006>; Internet, accessed 18 January 2007.

<sup>100</sup> Ted C. Fishman, *China Inc.* (New York: Scribner, 2005), 269.

<sup>101</sup> Ibid, 293.

<sup>102</sup> Ibid, 294.

<sup>103</sup> Joshua Kurlantzick, *Charm Offensive* (New Haven: Yale University Press, 2007), p. 226.

trade sanctions in 2002.<sup>104</sup> After China's entry into the WTO in December 2001, America's \$100 billion trade deficit with China jumped by over 20 percent. Today, American officials remain upset that Beijing continues to drag its feet on many key trade reforms all the while Chinese exports flow into U.S. markets at an accelerating pace.<sup>105</sup>

Trade complaints against China, extend beyond agriculture since China joined the WTO. American companies seeking a larger share of China's market face obstacles ranging from lax copyright enforcement to unfair contract practices, said Bill Reinsch, head of the US National Foreign Trade Council.<sup>106</sup> Chinese violations of U.S. patents, trademarks and copyrights are estimated to cost U.S. firms over \$100 billion a year in lost revenue, with affected products running the gamut from shampoo to aircraft parts and from cell phone batteries to pharmaceuticals.<sup>107</sup>

One of the greatest challenges of China's rise as a global power is their lack of transparency. China's official accountability and rule of law on the domestic front plays out very poorly on the international stage. Current Chinese leaders' inability to be forthcoming and transparent on all matters of international importance -- whether SARS, the Harbin pollution

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<sup>104</sup> Al Santoli, "China's broken WTO pledges hurt U.S., Asian farmers; Nepotism of China's Ruling Elite Challenged," *China Reform Monitor* No. 488 (March 11, 2003), American Foreign Policy Council, Washington, D.C.

<sup>105</sup> Andrew C. Schneider, "More Clashes with China over Trade," Kiplinger Business Resource Center (20 November 2006), available on [http://www.kiplinger.com/businessresource/forecast/archive/more\\_clashes\\_with\\_china\\_over\\_trade.html](http://www.kiplinger.com/businessresource/forecast/archive/more_clashes_with_china_over_trade.html); Internet, accessed on 29 March 2007.

<sup>106</sup> Al Santoli, "China's broken WTO pledges hurt U.S., Asian farmers; Nepotism of China's Ruling Elite Challenged," *China Reform Monitor* No. 488 (March 11, 2003), American Foreign Policy Council, Washington, D.C.

<sup>107</sup> Andrew C. Schneider, "More Clashes with China over Trade," Kiplinger Business Resource Center (20 November 2006), available on [http://www.kiplinger.com/businessresource/forecast/archive/more\\_clashes\\_with\\_china\\_over\\_trade.html](http://www.kiplinger.com/businessresource/forecast/archive/more_clashes_with_china_over_trade.html); Internet, accessed on 29 March 2007.

disaster, or the Chinese missile strike -- erodes whatever goodwill and trust they earn from their tireless sojourns abroad and suggests that they are not ready for prime time.<sup>108</sup>

China's economic rise could surpass the United States as early as 2020. In terms of GDP (nominal dollar terms), by 2050 China will have \$45 trillion versus about \$35 trillion for the United States.<sup>109</sup> China will be a large global creditor and the yuan could be the world's money in the future (or at least its major reserve currencies)<sup>110</sup>

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<sup>108</sup> Elizabeth Economy, "China's Missile Message," *Washington Post* (January 25, 2007), 25.

<sup>109</sup> Clyde Prestowitz, *Three Billion New Capitalists: The Great Shift of Wealth and Power to the East* (New York: Basic Books, 2005), 227.

<sup>110</sup> *Ibid*



## SUMMARY

The year 2006 was not the year of the dog, but the year of the dragon. The Chinese economy grew by 10.7 percent. China surpassed Japan as the world's second largest investor in research and development. It passed Mexico to become America's second largest trade partner. Beijing became the world's largest holder of foreign exchange reserves, much of it invested in U.S. treasury bonds.<sup>111</sup>

China's economic *peaceful* rise is not entirely accurate. On January 25, 2007 China conducted an anti-satellite missile test which sparked a political firestorm.<sup>112</sup> "China's continued fast-paced military buildup, are less constructive and are not consistent with China's stated goal of a 'peaceful rise,'" warns Vice President Dick Cheney (in a statement made immediately following China's missile test).<sup>113</sup> China's rise should be watched closely from all aspects of national power – diplomacy, information, military, an economic to determine what their true global goals are for the future.

By 2025, China is likely to become the world's biggest economy. Asia will resume its historical position as the global economic leader.<sup>114</sup> According to Clyde Prestowitz, director of the Economic Strategy Institute, "this will not be only a matter of size of GDP. It is commonly thought that development occurs in a sequence that begins with labor intensive manufacturing of such things as textiles, shoes, and toys. It then proceeds slowly but steadily up the ladder of increasing sophistication and value added. The developed countries of Japan, North America,

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<sup>111</sup> John Feffer, "China the Indispensable?" *Foreign Policy in Focus* (9 March 2007), available at <http://www.fpif.org/fpif.txt/4070>; Internet, accessed 20 March 2007.

<sup>112</sup> Elizabeth Economy, "China's Missile Message," *Washington Post* (January 25, 2007), 25.

<sup>113</sup> John Feffer, "China the Indispensable?" *Foreign Policy in Focus* (9 March 2007), available at <http://www.fpif.org/fpif.txt/4070>; Internet, accessed 20 March 2007.

<sup>114</sup> Clyde Prestowitz, "The Return to Asia", Economic Strategy Institute (October 3, 2006), 1.

and Europe tend to assume that as this movement takes place, they will also move up the scale to higher technology and sophisticated services, thereby maintaining economic and technological leadership. But this is unlikely to be the case. The advent of the Internet and of express air delivery coupled with the reduction of trade and investment barriers has already demonstrated that the most advanced technology and services can readily be moved and accomplished in developing countries at much lower cost and frequently with better quality. Today, the venture capitalists of Silicon Valley are moving not only the production but also the R&D of their start-ups to Asia. Innovation is becoming as global as manufacturing and delivery of call center services.”<sup>115</sup>

China is growing, but the pace of their growth is definitely worth watching. With over 1.5 billion people today, China’s economic growth is comparable to the growth of the United States during the Industrial Revolution, and ultimately, when we came to present day power in the world. When the United States became the world’s leading industrial nation between 1890 and 1920, it took over 35 years to double real per capita income. China has achieved this same feat in only 9 years.<sup>116</sup>

It is tempting to “mirror image” those from the East, but that would be a mistake. Our elements of national power are “our elements of national power.” We wield these instruments differently than China does. This understanding is the first step in truly understanding just how dangerous the economic interdependence policy of the National Security Strategy can be. Should we continue to promote China’s rise at the expense of the almighty U.S. dollar? The future is definitely uncertain with this economic interdependence strategy and could ultimately lead to U.S. demise.

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<sup>115</sup> Ibid.

<sup>116</sup> Admiral Alejandro Kenny, Argentine Navy, “China’s Presence in Latin America: A View on Security from the Southern Cone, *Military Review* (September-October 2006), 60.

Chinese Colonels in the People's Liberation Army (PLA), Col Qiao Liang and Col Wang Xiangsui in their book *Unrestrictive Warfare: China's Master Plan to Destroy America*, depict Chinese capabilities and willingness to use *all* elements of national power to carry out their grand strategy. The economic element of power is worth watching closely to determine if China's rise is truly peaceful or is it shaping its future using elements of their national power with economic at the forefront?

The way to deal with China is the same way we dealt with the Soviet Union. We must apply the Reagan formula: constrict trade, staunch the flow of high technology and investment, and severely inhibit Chinese ability to continue to acquire hard currency. We must also demonstrate our superiority by building up a military capability they cannot match. Missile defense must occupy the center focus of this effort because missile defense is the center state of Chinese military strategy, just as it was with the Soviet Union.<sup>117</sup> This was evident on January 25, 2007 as China tested its ballistic missile capability as it shot down one of its weather satellites.<sup>118</sup> "If there is a silver lining to this missile strike, it may be that we can finally stop talking about China's peaceful rise or the Washington consensus vs. the Beijing consensus. The only consensus that matters is one rooted in a clear understanding of China's rise and the urgency it brings to the need for real U.S. leadership."<sup>119</sup>

Economic power has helped shape American foreign policy for decades. This element of power is very flexible. If used wisely in conjunction with the political, military, and informational elements, it is hard to beat. Whether our nation has a large or small military, our leadership does understand economics, but not necessarily in the same manner the Chinese do as a weapon of warfare. Economics is a great tool to create conditions for further action or to coerce a nation to change its behavior. As the world further embraces globalization, economics as an element of

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<sup>117</sup> Michael Elliott, "The Chinese Century," *Time* (January 22, 2007), vol. 169, no. 4, 35-44.

<sup>118</sup> Elizabeth Economy, "China's Missile Message," *Washington Post*, January 25, 2007, 25.

<sup>119</sup> *Ibid.*

power will only gain greater influence in the United States and around the world. The question is whether or not we are truly using economics to *our* advantage as a weapon of warfare to shape the world of tomorrow with China possibly at the top.

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