Economic Engagement Strategies: Theory and Practice

Michael Mastanduno
Department of Government
Dartmouth College
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Much of the renewed attention in political science to the question of interdependence and conflict focuses at the systemic level, on arguments and evidence linking the expansion of economic exchange among states on the one hand to the exacerbation of international conflict or the facilitation of international cooperation on the other. The approach taken in this contribution focuses instead at the state level, on the expansion of economic interdependence as a tool of statecraft. Under what circumstances does the cultivation of economic ties, i.e., the fostering of economic interdependence as a conscious state strategy, lead to important and predicable changes in the foreign policy behavior of a target state? Students of economic statecraft refer to this strategy variously as economic engagement, economic inducement, economic diplomacy, positive sanctions, positive economic linkage, or the use of economic "carrots" instead of sticks. Critics of the strategy call it economic appeasement.

Whatever one calls it, this strategy has profound policy significance as well as being the subject of renewed academic interest. During the first decade following the Cold War, economic engagement proved to be the centerpiece of U.S. foreign policy towards its two most important potential competitors, Russia and China. In both cases, U.S. officials relied heavily on economic instruments in an effort to integrate would-be challengers into a U.S.-centered international order. The United States has also relied on economic incentives, since 1994, in an attempt to dissuade North Korea from breaking out of the nuclear nonproliferation regime. For at least a decade the Washington policy

community has been debating seriously whether economic engagement toward Cuba would serve U.S. interests more effectively than the economic isolation strategy that has been carried out by nine presidents across more than forty years. Similar arguments over the utility of economic incentives as opposed to economic sanctions inform contemporary U.S. policy debates about Iran and Iraq.

The policy appeal of economic engagement is not limited to the United States. For quite some time "civilian" great powers such as Germany and Japan have placed heavy emphasis on economic instruments in their foreign policy strategies. For both states, historical experience and the long memories of neighboring states have circumscribed the utility of traditional diplomatic and especially military instruments. Japanese officials have turned to economic incentives as a substitute means to promote foreign policy interests in relations with the states of Southeast Asia. Germany has long relied on economic diplomacy to serve its objectives in relations with Eastern Europe and the former Soviet Union.

Policy makers seem increasingly eager to resort to strategies of economic engagement. Is the appeal of these strategies justified by scholarly research, or is this an example of practice preceding theory? Put another way, does there exist a sound social scientific basis for the pursuit of economic engagement to serve foreign policy objectives?

An examination of the scholarly literature on economic engagement as an instrument of statecraft reveals a striking pattern. Albert Hirschman's 1945 study, *National Power and the Structure of Foreign Trade*, is widely acknowledged today as a starting point for analysis (Hirschman, 1945/1980). Hirschman argued that the conscious

cultivation of asymmetrical interdependence, if conducted strategically by the government of a powerful state, would lead weaker states to reorient not only their economies but also their foreign policies to the preferences of the stronger state. He developed a systematic framework for analysis and applied it to the trading and political relationships between Nazi Germany and its central and southeast European neighbors during the interwar period.

Hirschman's study did not generate much of a research program in the decades following World War II. The reason, perhaps, had to do with the general lack of interest among political scientists in the substance of international political economy at the height of the Cold War. Political scientists concentrated on the "high politics" issues of warfare and diplomacy, and left the "low politics" issues of economic interaction to the field of economics (Mastanduno, 1998). Scholars who did focus attention on economic instruments focused more on negative sanctions than on positive inducements. David Baldwin observed in an important article in 1971 that "it is not that political scientists have said the wrong things about the role of positive sanctions in power relations; it is just that they have said little." (Baldwin, 1971, p. 19).

Baldwin's remark remained fairly accurate until the end of the Cold War. Over the last decade, however, there has been a sharp increase in the scholarly attention devoted to economic engagement. (Many of these recent works are cited below, and in the bibliography.) In a recent issue of *Security Studies* on the theme of economics and national security, for example, half of the articles focused on the analysis of economic engagement (Blanchard, Mansfield, and Ripsman, 2000).

The end of the Cold War has much to do with this revival of interest. The superpowers of the Cold War were, for the most part, economically independent of each other. Relations among major powers after the Cold War promise to be characterized by economic interdependence rather than independence. Once again, economic interactions are, and will continue to be, an important part of great power politics. In this sense the Cold War is likely to prove to be an anomaly, a break in the "normal" pattern of strategic interaction among politics, economics, and security.

How the Cold war ended is also relevant. Economic engagement proved to be a key factor in Gorbachev's calculation that the Soviet Union should accept the risks and consequences inherent in the significant reform of its economy. Although Gorbachev eagerly anticipated the expansion of economic ties with the United States, the Cold War endgame was shaped even more profoundly by German economic statecraft. The West German government spent twenty years using economic incentives to build political confidence and trust in its relations with the Soviet Union. This enabled Germany, at the crucial moment, essentially to buy Soviet acquiescence to German unification on favorable terms with the current provision and future promise of expanded trade and generous credits and loans. The German government agreed to pay, among other things, to move Soviet troops from East Germany and house them back in the Soviet Union (Newnham, 2001).

Now that political scientists have rediscovered economic inducement strategies, what is the state of our knowledge? The first point to make is that we are still in the very early stages of scholarship – we don't yet know all that much. Other contributions to this volume demonstrate advances that have taken place in the overall scholarship on

interdependence and conflict. Over several decades, the work has become more nuanced theoretically and has made extensive use of both case-based and quantitative techniques in linking cause and effect. The literature on negative economic sanctions has progressed in a similar fashion. A large collection of case studies is now complemented by analysis of a large-N data base (Hufbauer, Schott, and Elliott, 1983). The fact that the utility of that data base is the subject of scholarly debate (Pape, 1997, Elliott, 1998) should not deflect us from appreciating its importance in providing a foundation for analysis of whether economic sanctions work. In the area of positive economic statecraft, no comparable data base exists. Scholars don't yet agree on even the basic question of how common or widespread the practice of economic engagement actually is (compare Baldwin, 1985 and Drezner, 1999). Careful case-based research is only beginning to accumulate. It is fair to say at this point that sticks have been studied far more extensively than carrots.

This is problematic in the sense that even a cursory examination suggests that positive economic measures have the potential to be as effective, if not more so, than negative ones. Threats and coercion usually inspire resentment and resistance in a target state; rewards and inducements are more likely to prompt a willingness to bargain. Negative sanctions tend to produce the "rally around the flag" effect: as Fidel Castro's Cuba and Saddam Hussein's Iraq demonstrate, leaders can often mobilize internal political support for their regimes by pointing to the existence of an external threat. Economic engagement strategies do not inspire this type of patriotic coalescence in the target country. Negative sanctions typically require multilateral support in order to be effective; economic engagement can benefit from multilateral support but can also work

unilaterally. Finally, negative sanctions, unlike positive measures, carry the risk of escalation to more costly measures. If sanctions fail, leaders face the choice of accepting failure or escalating to military means of statecraft.

None of this is intended to suggest that economic engagement works easily or without risk. Economic inducement strategies clearly raise a moral hazard problem, particularly when dealing with potential adversaries. No government wishes the reputation of rewarding bad behavior. A state (or a parent) that "pays" for good behavior in one instance may find itself facing payment demands in subsequent instances. Economic engagement also carries to potential to raise political expectations unrealistically at home. As the experience of U.S.-Soviet détente suggested, the transition from economic warfare to economic cooperation can lead the public to expect a similarly rapid transition from political emnity to friendship, only to be disillusioned when conflicts of interest persist. The point here is not that economic engagement has a high probability of success or is risk or problem free, but that as a tool of statecraft it is worthy of the level of attention paid to negative economic sanctions. This point has been emphasized consistently by David Baldwin (1971, 1985), but only recently have scholars responded seriously to his challenge.

The case study work conducted over the last decade suggests that economic engagement can work, and even can allow states to satisfy significant foreign policy objectives. Lars Skalnes demonstrates that economic engagement has been a critical component of the grand strategies of great powers over the past two centuries. His case studies include nineteenth century France and Germany, Great Britain during the interwar years, and the United States after World War II (Skalnes, 2000). Paul Papayounou's

examination of nineteenth century international politics suggests the important role economic inducement efforts played in bolstering the credibility of alliance commitments (Papayounou, 1999). Randall Newnham provides a careful examination of the contribution of German economic statecraft to the Cold War settlement with the Soviet Union (Newnham, 2001). Patricia Davis turns attention to postwar West German-Polish relations to show that economic inducements were crucial to Germany's efforts to reassure its weaker and suspicious neighbor (Davis, 2000). Jonathan Kirshner and Rawi Abdelal apply Hirschman's framework for economic engagement to an array of cases including U.S. diplomacy toward the Kingdom of Hawaii during the nineteenth and early twentieth centuries (Kirshner and Abdelal, 1999). Dale Copeland has taken an effective first cut at why U.S. economic engagement toward the Soviet Union seemed to succeed after 1985 but not during the 1970s (Copeland, 1999). William Long analyzes the effectiveness of economic inducements in cases involving U.S. relations with China (Long, 1996).

A primary achievement of this new literature is to showcase the past utility and future potential of economic engagement. Thus far the literature has tended to "select on the dependent variable," i.e., to choose cases in which economic inducement was an effective foreign policy instrument. This is understandable in light of the research bias in favor of negative sanctions and, perhaps, the tendency among international relations practitioners as well as students to associate concessions to adversaries with appeasement. The useful next step will be to develop systematic comparisons of cases of success and failure to illuminate the conditions under which economic engagement is likely to be effective.

Along those lines, the recent literature has served a second important purpose – to clarify the underlying logic of economic engagement strategy and to point to some of the likely determinants of success or failure. In a striking convergence, virtually all of the recent studies highlight the linkages between domestic politics and foreign policy strategy as the key factors driving the potential effectiveness of economic engagement.

The basic causal logic of economic engagement, and the emphasis on domestic politics, can be traced to Hirschman. He viewed economic engagement as a long-term, transformative strategy. As one state gradually expands economic interaction with its target, the resulting (asymmetrical) interdependence creates vested interests within the target society and government. The beneficiaries of interdependence become addicted to it, and they protect their interests by pressuring the government to accommodate the source of interdependence. Economic engagement is a form of structural linkage; it is a means to get other states to *want* what you want, rather than to *do* what you want. The causal chain runs from economic interdependence through domestic political change to foreign policy accommodation.

In an intriguing way, the logic of negative sanctions similarly suggests a central role for domestic politics. In the standard logic, external economic pressure deprives the target population of economic welfare benefits. The population, in turn, pressures the government to relieve the pain. The governing coalition, faced with a discontent population on one hand and its foreign policy preferences on the other, becomes internally divided, and, if the external pressure is sufficient, eventually capitulates. The problem, of course, is that target societies and governments do not always or even often react in the anticipated fashion. Over thirty years ago Johan Galtung, reflecting on

Rhodesian defiance of international sanctions and isolation, termed the above account the "naïve" theory of economic sanctions (Galtung, 1967). Even strategic bombing did not easily lead to popular or governmental capitulation; it was all the more naïve to think economic sanctions would have that effect.

If economic pressure does not easily lead to capitulation, should we expect economic engagement to lead easily to foreign policy accommodation? It obviously would be imprudent to make that assumption, i.e., to expect a simple or predictable relationship between economic expansion, domestic transformation, and foreign policy change. Before assuming that economic engagement will have the predicted (for scholars) or desired (for policy makers) effect, we need to pay particular attention to the following four analytical (and, for policy makers, political) challenges.

The first is the inherent unpredictability of target domestic politics, and the difficulty of using economic exchange as an instrument to manipulate it. Scholars usefully distinguish nationalist from internationalist coalitions in the domestic politics of a target state (Solingen, 1998, Papayounou and Kastner, 1999). These coalitions cut across the state and society. Nationalists are more conservative and inward-looking defenders of the status quo. Internationalists, from the perspective of the outside world, are more progressive; they embrace political and economic reform and the integration of the national economy into the global economy. Economic engagement is intended to strengthen the internationalists at the expense of the nationalists, and eventually to tip the balance of domestic political power in favor of the former.

It may in fact turn out that way. But it may not – there is no reason to assume the internationalists will always win. Economic engagement threatens the interests of the

nationalist coalition. If that coalition prevails, it is likely to lash out against what it perceives as intrusive external influences. Depending on the configuration of target domestic politics, engagement could lead to a more confrontational, rather than more accommodating, foreign policy. In international relations theory terms, the potential exists for a security dilemma – the unintended and counterproductive consequences of a strategy designed to increase a state's security.

The experience of the United States in relations with Russia during the 1990s is sobering in this regard. Economic engagement and the integration of Russia into the global capitalist economy was intended to reinforce the position of the reformist coalition led by Boris Yeltsin. By the middle of the decade, it became clear that the balance of political authority in Russia had tipped from the reformers to the nationalists. U.S.-Russian relations soured in the latter part of the decade for numerous reasons, but critical among them was the feeling in Russia that international economic integration had been painful and exploitative. Nationalists, rather than internationalists, seem to have used the experience to consolidate their political position; from the perspective of the United States, Russian foreign policy over time has become less rather than more accommodating.

The second challenge involves the difficulty of controlling the "flow" of economic engagement. Hirschman's theory presumes a steady, gradual injection of interdependence into the target economy, leading to a gradual, almost imperceptible transformation in domestic politics. The medical analogy is apt; economic engagement is akin to the measured doses of medicine administered by a physician to a patient. The problem is that it is difficult to control the flow and effects of economic interdependence,

once a target economy begins to open to international economic exchange. The effects of interdependence are more likely to be shocking and disruptive than incremental and stabilizing. The experience of the "Asian tigers" during the 1990s illustrates the point dramatically. Countries opened their financial markets to find portfolio investment first flood in and then abruptly flood out, leaving collapsing currencies, plummeting growth rates, and beleaguered populations in their wake. China, whose financial markets were relatively unexposed to international movements of capital, managed to evade the detrimental effects of the 1997-98 crisis. If it had succumbed, it is difficult to imagine that the foreign policy consequences would have been salutary.

The third challenge has to do with the malleability of a target state's foreign policy. The theory of economic engagement assumes that foreign policy is susceptible in some meaningful way to external influence. From the perspective of the initiating state, the strategy implies a trade off between capabilities and behavior. Expanded economic interaction will strengthen the capabilities of a potential adversary – an outcome state leaders generally wish to avoid. But they are willing to accept that outcome on the expectation that interdependence eventually will lead to a positive change in target state behavior, i.e., to a more accommodating foreign policy.

For the government of one state to know, with any degree of confidence, the foreign policy intentions of another is a difficult task. Hans Morgenthau observed that the ability to distinguish a status quo state from a revisionist state was the classic problem of diplomacy, and that the fate of nations hung in the balance. The logic of economic engagement presupposes that the target state is not unalterably revisionist, and that if it is not currently a status quo state, it can be transformed into one. That assumption must

obviously be tested on a case by case basis. If it is incorrect, and the target state is in fact embarked on a revisionist path, then economic engagement leads to the worst of both worlds – an uncooperative foreign policy, and an adversary whose capabilities have been strengthened through international economic exchange. Skeptics of the U.S. engagement strategy toward China fear that Chinese foreign policy is less malleable than U.S. foreign policy officials have generally assumed.

The fourth challenge directs our attention from domestic politics in the target state to that in the initiating state. Even if we assume that the target's foreign policy is susceptible to influence, that the flow of interdependence can be effectively managed, and that the domestic politics of the target can be effectively manipulated, there is still the question of whether the initiating state can actually carry out the engagement strategy effectively. Engagement is a long-term strategy that requires consistency, patience and perseverance on the part of the initiating state. Some states are better equipped than others to employ it. West Germany, for example, possessed a national consensus, across political party lines and across state and society, on the desirability of engaging the Soviet Union and Eastern Europe during the twenty years preceding the end of the Cold War. Business and government worked closely together to assure a coordinated approach to foreign economic policy.

The United States, on the other hand, appears less well-equipped. The U.S. political system is fragmented and decentralized. The Executive, when it manages to reach a consensus within its own ranks, has to share foreign policy authority with an often combative and disagreeable Congress. Business is a powerful force in foreign economic policy, but it shares the societal stage with an array of other interest groups.

Interest groups and their representatives in Congress have the potential to "capture" foreign policy to serve domestic or partisan purposes. This is especially true after the Cold War. Domestic actors perceive less at stake in security terms and are less willing to defer to the Executive branch.

The U.S. effort to engage the Soviet Union during the 1970s is illustrative of these problems. Richard Nixon and Henry Kissinger began, in their terms, to weave the Soviet Union into a web of interdependence with the hope of modifying its foreign policy. Congress had ideas of its own, and proceeded through the Jackson-Vanik Amendment, which tied trade and financial benefits to Soviet emigration practices, to undermine the Executive's engagement strategy. Soviet leaders were insulted by what they considered a very public violation of their sovereign autonomy. They abrogated their trade agreements with the United States and subsequently ceased foreign policy cooperation.

It does not require great imagination to anticipate a similar dynamic in contemporary U.S.-China relations. Throughout the 1990s, the U.S. Executive with the support of business interests pursued economic engagement. But critics of engagement – human rights activists, proponents of religious freedom, and those who fear the growth of Chinese economic and military power and are suspicious of Chinese intentions – have increasingly gained strength. As the new Bush administration came to power, these forces gained the upper hand. China's behavior at home and abroad reinforced their position. The simple point is that if economic engagement is a long term strategy requiring consistent application over time, it is fair to question the extent to which the United States has the capacity and will to carry it out effectively.

It is fair to say, in conclusion, that a rich opportunity awaits those scholars who are rediscovering the use of economic inducements as instruments of foreign policy. The expertise of both international relations generalists and area studies specialists is required to operationalize variables, conduct comparative case studies across time and space, and eventually build large-N data bases. This very opportunity for scholarship, however, should suggest caution to policy makers eager to employ economic engagement. The strategy can be effective – yet under conditions that we are only beginning to comprehend.

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