

Can Enemy Become Friend?: the Impact of Security on Bilateral Economic Relations

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1. Introduction

Today, the economic dimension of globalization is becoming ever more significant. Countries are interconnected and interdependent. Some argue that economic interdependence helps countries avoid conflict (Rosecrance, 1986; Mansfield, 1994; O'Neal and Russett, 1997). Others argue that economic interdependence has the potential to create conflict or the need for security in international systems before trading can take place (Buzan, 1984; Blanchard and Ripman, 1995; Lieberman, 1996). It is an important issue at a time of globalization, and has been a focus of considerable interest for some time. Is security or the economy more important in determining how countries behave? (Blanchard, Mansfield and Ripsman, 2000; Mansfield and Pollins, 2003).

This article analyzes U.S. export control policy for dual-use technology, to examine whether security factors have had a more significant impact on it than economic factors.

Although some research has been conducted on the impact of security on intra-alliance trade (Gowa, 1994), few studies have examined its effect on cross-alliance trade.

Previous research has categorized trade between countries as either intra-alliance or cross-alliance trade. However, this categorization makes no distinction between non-allied states in terms of trade. The present research therefore analyzes this situation by comparing U.S. policy toward China and the Soviet Union, neither of which were allied to the United States.

The objectives of this article are twofold. The first is to examine the impact of security on trade policy. The second is to examine differences in trade policy toward non-allied states.

2. The impact of security on trade

To what extent do security considerations influence a country's economic activities? To explain economic relations between states, previous research has focused on (1) whether or not the countries involved are allies, (2) political factors and (3) the structures of the international system.

(1) Alliance and trade

Trade generates wealth, and increased security is an externality of wealth. Countries are concerned about this externality when they begin to trade with others, so they introduce export controls or

embargos to try and prevent their enemies from becoming wealthier than themselves. For instance, during the Cold War, western countries developed a multilateral institution (the Coordinating Committee for Multilateral Export Controls, or COCOM) to control East-West trade. Countries therefore seek to build less hostile economic relations with other countries by developing inter-alliance trade (Gowa, 1994).

(2) Political relations and trade

Even when countries are not formal allies, as in Gowa’s research, political relations can affect trade policies. Research has shown that bilateral diplomatic relations (international cooperation or conflict) may be closely related to economic relations. The importance of politics is exemplified in the expression, “Trade follows the flag” (Pollins, 1989; Keshk, Pollins and Reuveny, 2004).

(3) International structure and trade

Firstly, the externality of trade is a difficult issue because of the question of relative or absolute gain. From the late 1980s to the mid 1990s, there was a debate about whether international cooperation between states was feasible. Proponents stressed that countries seek absolute gain, and as the world operates on the principle of positive-sum logic, cooperation between countries is possible. Opponents, on the other hand, argued that countries always compare their own gains to those of other countries, so relative gains matter more, and cooperation between states is difficult to achieve (Baldwin, 1993). The latter school, with its roots in realism, provides a basis for considering the impact of security on trade issues. Comparative analysis shows that states are concerned with relative gain more in bipolar international structures than in multipolar ones. Trading with the enemy is more of a possibility under a multipolar structure (Lieberman, 1996).

(4) Commodity, security relationships and trade

The prior research mentioned above considers trade a concept in its own right. However, it can more accurately be described as a combination of trade commodities and security relationships. Three types of trade commodity can be identified, depending on their fungibility and relevance to military capability, as shown in Table 1: (1) munitions, (2) dual-use and (3) civilian goods (Takagi, 2010). In

Table 1 Trade Commodity and Externality

Trade Commodity	Fungibility and pace in military capability
Munitions	High
Dual-use technology/goods	Medium
Civilian goods	Low

(Takagi, 2010)

terms of export, countries will be sensitive about trading munitions with enemies and non-allied states, and may even be reluctant to trade arms with its allies. On the other hand, there is less externality in exporting civilian goods than in exporting other commodities, and they are indirectly fungible over time, so that states are not concerned about them. Dual-use items come somewhere in between, and are less easy to categorize because they can be used for both munitions and civilian purposes, and they are directly and quickly fungible. This means that the export of these goods simultaneously raises issues of national security and economic interest, and export policies will therefore be vulnerable to changes in the bilateral political situation. In deciding whether to export or to prohibit the export of dual-use technology/goods, a country faces the dilemma of whether to give priority to economic interests, which focus on gain, or to national security, which focuses on preventing the other country from developing its capabilities.

In turn, the security relationship can also be divided into three elements: (1) ally, (2) non-ally and (3) enemy. Combined with the three types of trade commodity, there are nine types of export policy, as shown in Table 2 (Takagi, 2010).

In trading with an ally, a state has common security interests which make export less harmful (①–③). The only factor which may need to be taken into consideration in making decisions is the export of munitions involving military secrets. On the other hand, there is very little trade with the enemy (⑦–⑨). For instance, in the United States, the Trading with the Enemy Act prohibits all trade of munitions, dual-use technology/goods or civilian items with an enemy state. An example is the US embargo on exporting goods to China since the Korean War in the 1950s. The theoretical rules on trading with allies or with the enemy are therefore relatively easy to understand. However, trade policies with non-allied states are more complicated (④–⑥), as non-allied countries can be considered neither friend nor foe. In addition, exporting dual-use technology/goods to non-allied countries involves a more fluid situation (⑤). In other words, there may be some hesitation about exporting munitions to non-allied states, as there is a possibility that they could become an enemy in the future (④). However, the export of dual-use technology/goods is more common. Unlike munitions, dual-use items only indirectly contribute to another country’s military capability, and export brings economic gain, so it is easier to grant permission for it. From a long-term point of view, however, it contributes to the other country’s military force. There is therefore an inherent contradiction in export policies for dual-use items.

Table 2 Trade Commodity and Security Relationship

	Ally	Non-ally	Enemy
Munitions	①	④	⑦
Dual-use	②	⑤	⑧
Civilian	③	⑥	⑨

(Takagi, 2010)

In the next section, we shall examine ways in which export policies are determined for dual-use items.

3. Trading with the Enemy under *Détente*

To examine the impact of security on bilateral trade, it may be useful to evaluate an export policy for dual-use technology/goods to non-allied countries, as the policy, which is categorized ⑤ as shown in Table 2, is likely to be influenced both by security concerns and economic expectations. Analyzing the policy helps to understand which of the two factors has been given priority. In this section, we shall examine the case of U.S. policy on exports to the Soviet Union and China. Neither country is an ally of the U.S., and until the 1970s they were, in fact, enemies.

(1) Tensions relax, and export can begin

During the Cold War, the Soviet Union had been an enemy of the United States. The USSR was classified as a communist country and export was heavily restricted at first. COCOM was formed by a number of western states to regulate exports of strategic goods to communist countries.

However, both sides had recognized the importance of economic exchange despite security requirements. In 1972, when tensions had eased between East and West, the U.S. made a formal decision to develop U.S. economic and trade relations with the Soviet Union and China.¹ It began to transfer dual-use technology (the sale of one of the largest and most advanced computer systems in the world) to communist countries, under certain conditions and with some exceptions.²

Restrictions on trade with China were more severe than with other communist countries because of the Korean War. When the People's Republic of China was established, the U.S. had missed an opportunity to recognize it as a state, calling it "China lost". In other words, they had no diplomatic relations with China, and the Korean War exacerbated this situation until the late 1960s. In consequence of the war, China was treated as an enemy in terms of economic relations, and U.S. export control policy classified it in Country Group Z, the strictest category.

Détente changed the situation with China. When the Nixon administration began, the President and his National Security Advisor, Henry Kissinger, tried to rebuild international politics in a more flexible form. Recognizing a confrontation between China and the Soviet Union, the President and his advisor sought to reestablish good relations with China to give the U.S. leverage with the Soviet Union. In the wake of the so-called "Nixon Shock", the President eased restrictions by transferring China from Country Group Z to Group Y.³ Following this decision, the President approved the export of eight inertial navigation systems to China.⁴

In 1976, the Ford administration issued permission for the U.S. computer company, the Control Data Corporation (CDC) of Minneapolis, Minnesota, to export Cyber 73 to the Soviet Union on September 30th and Cyber 172 to China on October 12th.⁵ Prior to the decision, CDC had been asked

to accept government conditions, and the company conveyed its intention to do so.⁶ China had, in fact, been attempting to buy the system a year before, but this had not happened for several reasons.⁷ Opponents of the trade deal, the Energy Research and Development Administration (ERDA) and the Department of Defense, continued to criticize the decision on the basis of security. They were concerned that both computer systems were capable of calculations which could result in nuclear weapons, anti-submarine technology, large phased-array radar to track enemy ICBMs and other military applications.⁸

The export agreements described above were part of an attempt to treat the Soviet Union and China equally, and not to antagonize the Soviet Union by treating China preferentially.⁹ The Presidential Review Memorandum/NSC24 notes that the President issued a directive to investigate the implications of the transfer of defense-related technologies to the People's Republic of China in terms of Soviet perceptions.¹⁰ In the 1970s, China and the Soviet Union had the same relations toward the United States. They were enemies, were both communist countries, and were both eager to acquire western technology. U.S. policy was influenced both by the security situation, which had become less tense, and economic interests in industries which produced dual-use items. It therefore agreed to export rather than embargo.

(2) Tension still relaxed, but export banned

Policy changed quite suddenly, however. On June 24, 1977, when Cyber 76 was exported, the Carter administration prohibited its sale on the basis that it did not incorporate satisfactory safeguards.¹¹ Cyber 76 is a "super-computer", used as the "brain center" of the Pentagon, the U.S. Air Force, the super-secret National Security Agency, the ERDA and the National Aeronautics and Space Administration (NASA).¹² Decisions about the transfer had to take into account a wide range of factors. A supercomputer was useful in a number of defense applications, such as satellite imaging, acoustic intelligence and nuclear weapons design.¹³ This made it one of the most critically strategic technologies.

Of course, CDC criticized the decision as "essentially political".¹⁴ Six high-technology trade associations also disagreed with the government position because they were international competitors of computer companies like Japan and France in the Soviet market.

In a domestic context, this short period contrasted with the previous one. Although the Cyber computer system was criticized on the grounds of national security, Cyber 73 and 172 were approved for transfer, yet the sale of Cyber 76 was prohibited. In an interview, William C. Norris, CDC's chairman and Chief Executive, noted, "The main reason is that government agencies believe that the safeguards for smaller machines aren't valid for larger machines. This isn't true." He believed the decision was essentially political, and was not based on sound technical grounds.¹⁵

(3) *Tension again, followed by a diversification of exports*

Under the same strategic environment, the relationship between the United States, China and the Soviet Union was, however, treated differently in the late 1970s. On February 9, 1978, the U.S. government approved the export of Japanese computers to China.¹⁶ Moreover, on May 16, 1979, the Department of Commerce and COCOM gave approval for the Digital Resources Corporation to export computers to China.¹⁷

These deals seemed to be favoring China, and were influenced by the matter of Soviet troops in Cuba, but Secretary of State Cyrus R. Vance denied that there would be any change of policy. In reality, a number of events appeared to negate his attempts to treat China and the Soviet Union equally. For instance, a secret Pentagon study recommended selling military equipment to China on the one hand, and on the other, the Defense Department was reconsidering the sale of Cyber 73 to the Soviet Union.¹⁸

In the meantime, the situation had been gradually changing, and a new state of affairs was unfolding. In September of 1980, the United States agreed to sell the Chinese a highly sophisticated computer designed for oil exploration, but which also had military uses. At the same time, the Commerce Department relaxed export controls against China but tightened controls on exports to the Soviet Union.¹⁹ In fact, U.S. policy toward communist countries had changed following the Soviet invasion of Afghanistan on Dec 24, 1979. In January 1980, it was announced that the United States would sell non-lethal military equipment to China. On the other hand, the administration gave the go-ahead for the sale of sophisticated computers and other high-technology products for both military and civilian uses. Some officials called it "from détente to entente".²⁰

Debate continues about the Reagan administration's policy toward China.²¹ Proponents insisted on using the *China Card* as leverage with the Soviet Union, while opponents feared the Soviet response and that Taiwan would be affected.

The Reagan administration had considered amending U.S. policy to liberalize export controls on dual-use technology to China.²² It intended to suspend China from the list of embargoed destinations for arms transfers.²³ Before making the decision to treat China as a friendly nation and relax controls on exporting dual-use technology, the U.S. administration consulted allies as well as its domestic legislature and embassies.²⁴

Finally, President Reagan made the decision to liberalize U.S. technology transfer policy toward China by placing the People's Republic of China in the "free world" category, i.e. Country Group V.²⁵ At the same time, the United States, the NATO countries and Japan jointly agreed to impose new, broad export controls on computer sales to the Soviet bloc countries.²⁶

In the late 1980s, U.S. policy supported the transfer of technology to China, but within certain limits based on national security considerations. The fundamental rationale for this policy was that assisting the modernization of China would serve U.S. interests.²⁷ However, U.S. controls on exports to China really only affected a few key advanced technology sectors such as computers, telecommunications, precision instruments and advanced manufacturing equipment.²⁸

Dual-use technology has implications for both security and economic opportunity, so its export policy expresses sender's intention obviously.

4. Conclusion

The aims of this article were twofold. The first was to examine the impact of security on trade policy. The second was to examine U.S. policy on the export of dual-use technology to two non-allied countries.

In summary, we find clear evidence that security factors affected trade policy. Around the 1970s, the international political environment had become more relaxed. This international factor affected U.S. policy on the export of dual-use technology to communist countries, i.e. enemy countries. At first, the United States treated China and the Soviet Union equally for the strategic purpose of maintaining the balance of power. Both countries were able to import advanced computers with U.S. approval. U.S. domestic opinion was sharply divided on the issue. Proponents favored export on the grounds of economic gain, and opponents were concerned about security. However, as soon as political tensions eased, economic considerations prevailed.

Nevertheless, the U.S. prohibited the export of these computer systems to the Soviet Union. On the other hand, China was allowed to continue to import dual-use items. A country's technological ability to transform dual-use technology into military capabilities was another security factor which influenced policy. China had long ago closed its borders, and alleged that it was incapable of using the technology for military ends. This was before China modernized. The Soviet Union was more advanced than China, and had the potential to make use of the technology to improve its strategic capabilities. Moreover, the behavior of each of the two countries was quite different. China shared with the U.S. a concern about the Soviet threat, while Soviet foreign policy raised questions about its military intentions, such as its presence in Cuba.

These differences were exacerbated by the Soviet invasion of Afghanistan, which once again raised security concerns. Sales of computers to the Soviet Union were banned, but sales to China increased under a more relaxed export control policy. China finally became a 'friendly nation' to the United States. This led to an opportunity to use China as leverage with the Soviet Union.

As described above, in the 1970s and 1980s, security factors took priority over economic factors and formed the basis for policy mechanisms. Moreover, the U.S. operated different policies toward non-allies and enemies. During the 1970s, the U.S. treated China and the Soviet Union 'even-handedly', but China gradually moved toward the status of "friend", while the Soviet Union moved back toward enemy status. Policy was affected accordingly.

Previous hypotheses had explained these differences in terms of: (1) alliance and trade, (2) political relations and trade and (3) international structure and trade. Firstly, countries were more likely to trade with allies, but there were also variations in cross-alliance trade. There are more specific

explanations for these differences. Secondly, the cases illustrated above show that political relations affected trade. In these cases, trade definitely followed the flag. Thirdly, despite the fact that there had been no changes in the bipolar international structure, the U.S. nevertheless traded with its enemies. However, this hypothesis should be examined by comparing trade in a bipolar and a multipolar world.

One further hypothesis is worth consideration (4): the concept that commodity and security relationships decide trade policy. This analytical framework may help to understand export policy for dual-use technology. This type of policy is affected by whether priority is given to security or to the economy. Case analysis showed a subtle change in these policies according to the political climate. Each change in policy was precipitated by a change in relations between the countries concerned. The Soviet Union and China were primarily enemies of the United States, but in other cases, both were treated as non-allied states, and later on as enemy and friend. These shifts can be explained within the framework of a combined trade commodity and security relationship.

Several important conclusions can be drawn from the findings of this study. First, security factors always take priority over economic interests. Regardless of domestic requirements, the same kinds of trade deal were approved or disapproved, depending on the security environment. This has implications for the issue of economic interdependence and international conflict, and further studies are required.

Secondly, the concept of trade should be redefined. In this paper, it was classified into three categories: munitions, dual-use items and civil goods. The export of each commodity has different security implications, so the relationship between economic interdependence and security should be examined separately in each case.

There are several limitations to this study. Official documents used in the paper are still partially declassified because of their importance for security. It could be years before the justification for these policies is fully understood. Despite these data limitations, the issue is clearly important in understanding the relationships between security and the economy, economic interdependence and international conflict, and export policy on dual-use technology.

Notes

1. "Next steps with Respect to U.S. Soviet Trading Relations," National Security Decision Memorandum 151/ Council on International Economic Policy Decision Memorandum 6, February 14, 1972; "Relaxation of Restrictions on Trade with People's Republic of China," National Security Decision Memorandum 155, February 17, 1972; Garthoff, 1994, p. 106.
2. "U.S. Policy on the Export of Computers to Communist Countries," National Security Decision Memorandum 247/ Council on International Economic Policy Decision Memorandum 22, March 14, 1974.
3. "National Security Decision Memorandum 155. (As fn1, above)
4. "Sale of Inertial Navigation Systems to the People's Republic of China, National Security Decision Memorandum 204, February 6, 1973. This document still contains classified sections.
5. "Press report on computer sale to PRC," Department of State, October 30, 1976; "U.S. did not bar computer-system sale to Soviet," *New York Times*, Oct 30, 1976.
6. "CDC Computer for PRC," Department of State Telegram, October 1976; "CDC Computer for PRC," Department

- of State Telegram, October 16, 1976.
7. "China seeking advanced U.S. computer," *New York Times*, Oct 4, 1975.
 8. Costick, 1977, p. 2.
 9. On the debates about policy toward China, and the question of "Evenhandedness" (treating China and the Soviet Union equally) or "China Preferential" (using policy toward China as a card in negotiations with the Soviet Union), see Yuan, 1995, pp. 50–51.
 10. "People's Republic of China," Presidential Review Memorandum/ NSC 24, April 5, 1977; "U.S. study sees peril in selling arms to China," *New York Times*, June 24, 1977.
 11. "Big-computer sale to Soviets is barred," *New York Times*, June 24, 1977.
 12. Costick, 1977.
 13. Congress of the United States, Office of Technology Assessment, *Technology Transfer to China*, June 1987, p. 23.
 14. "Big-computer sale to Soviets is barred" (As fn.11, above).
 15. Control Data Corporation, 1977.
 16. "U.S. approves Hitachi sale of 3 computers to China," *New York Times*, Feb. 9, 1978.
 17. "Applied devices sale to China approved," *New York Times*, May 16, 1979.
 18. "Vance affirms ban on arms for China," *New York Times*, Oct 5, 1979.
 19. "Talks set on China trade ties," *New York Times*, Sept. 16, 1980.
 20. "U.S. and China forging close ties; Critics fear that pace is too swift," *New York Times*, Dec 8, 1980.
 21. *Ibid.*
 22. "Presidential Decisions on U.S. policy toward China," Memorandum from the President's Assistant for National Security Affairs, Richard V. Allen, June 6, 1981. The document is partially declassified.
 23. *Ibid.*
 24. "Personal Message from the Secretary to Foreign minister Sonoda," June 17, 1981; "Letter to Congressman Zablocki from the Secretary," June 17, 1981; "Letter to Senator Baker from the Secretary," June 17, 1981; "Letter to Senator Percy from the Secretary," June 17, 1981; "Talking points for background briefings on confidential confidential," June 19, 1981.
 25. Letter from Secretary of Commerce to Caspar W. Weinberger, Secretary of Defense, Aug 12, 1983. The document is partially declassified.
 26. "Allies curb computers for Soviet," *New York Times*, July 17, 1984.
 27. Congress of the United States, Office of Technology Assessment (As fn.13, above), p. 20.
 28. *Ibid.*, p. 21.

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