

Free Market Economy, Dispute Duration, and Its Implications for the Cross-Strait Relations*

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Abstract

As democratic peace theorists demonstrate the importance of democratic institutions in shaping and promoting the global order, the effects of liberal economic institutions on interstate conflict behavior have also been introduced, tested, and eventually found positively associated with the lower probability of dispute onset. Yet while democratic peace theorists assume the characteristics of democratic political processes determine why the conflict tends to be shorter among democracies if it has already begun, whether economic institutions play a similar role is underdeveloped. This paper aims to offer an economic account for conflict duration. By using all militarized disputes from 1970 to 2001, the paper empirically confirms that militarized disputes tend to be shorter if countries share similar free market institutions. Such finding further confirms that to ensure the militarized dispute between Mainland China and Taiwan would be as short as possible, the Chinese government would not withdraw its military deployment along the Taiwan Strait.

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... without free exchange in capital and consumer goods, there is no market; that without a market there are no prices; and that without prices there can be no economic calculation (Richman 1981, 90)

1 Introduction

After decades of debates on whether democratic institutions bring peace—and a generally supportive answer is statistically confirmed—scholars now turn to test the pacifying effect of liberal economic ones.¹ For example, the positive effects of economic institutions, say, institutional similarity or capitalism, on the likelihood of alignment choices and reduction of conflict onset have been introduced theoretically and tested empirically by international relations theorists (See Gartzke 2005, 2007, Gartzke and Hewitt 2010, Mousseau 2009, Souva 2004, Weede 2005, Werner and Lemke 1997). Moreover, both policy practitioners and academia address the importance of free market economy in preserving peace, making democracy and capitalism the fundamentals of a peaceful global order. As what former United States President Clinton highlighted at the 49th Session of the United Nations General Assembly, democracy and free market economy would be two pillars that mark the life after the end of the Cold War: “The Cold War is over; we must secure the peace ... After all, the walls that once divided nations in this very chamber have come down. More countries have chosen democracy than ever before; more have chosen free market and economic justice” (Clinton 1994, 2). Students of international relations also have started investigating empirically how democracy, together with the development of market mechanism, reinforces the prospect of global and civil peace (Mousseau 2009, de Soysa and Fjelde 2010).

We recognize that in the social sciences, any phenomenon can hardly be a rule. Exceptions exist. As Weede outlines, “almost no theory in macroeconomics, macrosociology,

¹In this paper the terms liberal economy, free market, capitalism are used interchangeably, though free market economy is the most preferable term.

or international relations delivers deterministic propositions. Instead we have only probabilistic statements . . .” (2005, 6). Any theory, even it is law-like, found in the field of political science can only be established in relative statements. Hence, though democracies (and free market economies) are *much less likely* (but apparently not low enough to a negligible level) to use force against each other, such probability still cannot be ruled out.² These exceptions then lead us to ask and answer the next crucial question: Given that the likelihood of conflict for institutionally similar dyads might be low but not zero, when countries eventually resort to arms to solve their disputes, why do some conflicts end earlier while others do not?

To this, recently democratic peace theorists extend the argument to the tie between democratic institutions and conflict duration (Bennett and Stam 1996, Bueno de Mesquita, Koch and Siverson 2004, Bueno de Mesquita et al. 2003, Maoz and Russett 1993) based on the institutional characteristics of democratic processes. For example, the selectorate theory proposed by Bueno de Mesquita et al. (2003), Bueno de Mesquita, Koch and Siverson (2004) demonstrates that a democratic leader will not go to war with other democracies easily in order to avoid the risk of losing power. Once a democratic state decides to join or start the war, she will choose the target which is easily being defeated. In other words, a shorter militarized dispute is ensured through the deliberative selection of targets,³ because a lengthy conflict process endangers its leaders’ political

²See notable refutations of the democratic peace theory in Rosato (2003, 2005). The “technical” absence of militarized conflicts among democracies is bolstered by normative and institutional characteristics of democratic processes, as argued in Maoz and Russett (1993), Russett (1993). Yet in especially Rosato (2003), the author challenges these two characteristics. For example, political accountability determined by surrendering her power to the opposition party or intra-party rivalries prevents democratic leader from choosing the war option. Yet, the consequences of losing war are more severe for autocratic leaders. In addition to be removed from office, autocracies leaders usually face extra risks of going to jail, exile, and/or the death penalty. Empirically, militarized inter-democratic disputes prevail. Consider the conflicts occurred between Israel and the United States, and between Japan and South Korea as coded in the Militarized Interstate Conflict (MID) dataset: <http://correlatesofwar.org> (accessed April 29, 2010).

³Bueno de Mesquita, Koch and Siverson (2004) criticize Maoz and Russett (1993)’s bargaining argument because according to Maoz and Russett, the lengthy nature of the democratic decision-making process makes the war longer, since democratic countries need to achieve a consensus among domestic groups, and this consensus is unlikely to be obtained without numerous rounds of talks and negotiations

tenure.

Surprisingly, when democratic peace theorists have started investigating the relationship between regime type and conflict duration, “capitalist peace” (as Gartzke 2007, Weede 2005 put it) scholars are either unaware of this topic or if they are, they misinterpret the pacifying effect of free market institutions.⁴ The paucity of the discussion of free market economy and conflict duration largely rests on “over-”emphasis on single economic institution. For example, how does trade (inter)dependence (Krustev 2006) or overseas direct investment (Bussmann 2010) impacts conflict behavior have been explored extensively but *separately*. Second, commercial exchange measured in currency does not tell us the effect of economic institutions. Lacking a whole picture discourages us from advancing a free market world, if a liberal economic order cannot persuade sovereign states it is the most effective means through which a shorter dispute can be guaranteed.

This paper serves as the first piece to develop the argument about free market economy and dispute duration, and to test it empirically. Augmenting to the argument that the unbearable cost generated by armed conflict inhibits mutual economic exchange and thus reduce the likelihood of conflict among liberal economies, I propose that it also pushes them to solve the dispute faster if they are experiencing some sort of militarized actions. The wartime economic system characterized by the command economy, state interventionism, infringement of private property rights, and so on dampens long-term economic growth. In order to pursue economic recovery and development, free market economies will conclude their disputes quicker to resume a liberal market order.

among domestic parties and interest groups.

⁴I am not aware of any paper discussing this topic. The only possible exception is the tie between conflict duration and trade interdependence examined empirically by Krustev (2006). Yet trade interdependence (as the percentage of gross domestic product, GDP) is not equivalent to economic institutions, since trade interdependence basically reflects no underlying definition and function of institutions as given by North (1991, 97), respectively: “Institutions are the humanly devised constraints that structure political, economic and social interaction. They consist of both informal constraints (sanctions, taboos, customs, traditions, and codes of conduct), and formal rules (constitutions, laws, property rights). Throughout history, institutions have been devised by human beings to create order and reduce uncertainty in exchange.”

This essay is developed in the following order. Although previous studies do not inquire extensively into the effect of free market institutions on conflict duration, a generally positive effect of capitalism on conflict still can be located. In the next section I briefly review the current literature on conflict and capitalism or economic institutional similarity. I then ask how regulation during the wartime affects conflict parties' economic performance. Then I conduct empirical tests after describing variables, data sources and the way of operationalization. Model choice gives the reason of my selection of econometrical skills. A case study of the China-Taiwan relations will be given to confirm that after both political entities open domestic markets, the length of militarized conflict reduced greatly. I will in the conclusion part provide policy implications.

2 The Capitalism-Conflict Nexus

Recently students of international political economy and conflict studies connect economic institutions with a lower likelihood of conflict statistically, with more emphasis on capitalism. In terms of economic institutional similarity, Souva (2004), Werner and Lemke (1997), for example, test the impact of it on conflict onset and alignment choice and find a positive association, respectively. In general, similar institutions adopted by states reflect their choices of partners in the international system, and their means toward conflict resolution. Similar institutions allow countries to identify "in-group" and "out-group" members (Werner and Lemke 1997, 532). Because the adoption of domestic institutions are a reflection of their policy preferences, "in-group" members tend to adopt a more cooperative attitude toward each other. In addition, domestic institutions are also a reflection of international behavior. In dealing with international affairs, it is institutionally similar states that will seek possible nonviolent solutions that they all agree. Such agreements will reduce the possibility of using violent means. Incompatible institutions will lead to different foreign policy preferences, and eventually leads two in-

stitutionally dissimilar countries to go to war.

However, in discussions of economic institutions, it is free market institutions that receive more attention. In Gartzke (2005), Hall and Lawson (2009), de Soysa and Fjelde (2010), economic freedom characterized by five areas of economic exchange and activities⁵ has been recognized as the prominent factor in promoting the prospect of global and domestic peace. Gartzke (2005, 32–33) outlines two key effects economic freedom can bring to the likelihood of conflict onset. First, free flows of capital, labor, goods and services prevent a free market economy from using force with each other because such militarized action discourages investment. Declaration of war means capital flight and a deteriorated investment environment. The state leader therefore must consider if means other than guns and missiles are feasible when facing possible conflicts. Second, a mature liberal economy relies on ideas to attract foreign investment, and this is hardly achieved through the pursuit of foreign territory occupation and war. Conquering and colonizing foreign territories to secure the source of wealth is outdated and costly.

Second, the emergence of globalization in recent decades encourages scholars to consider its link to conflict (de Soysa and Fjelde 2010, Weede 2005). In a series of papers Weede (2005) adds globalization as another crucial factor of conflict prevention. Globalization in his argument promotes free trade and therefore idea and interest exchange among sovereign states. de Soysa and Fjelde (2010) tries to link globalization with state autonomy. In their examination of whether a more economically integrated world will lead to the loss of the state capacity in dealing with domestic issues, leading to a higher frequency of civil conflict onset. Globalization means not just capital and trade flows. Most important of all, it represents a country's economic environment expressed in forms of economic institutions, such as private property rights, judicial independence, and fiscal freedom, etc. A sound economic institutional environment means globalization brings

⁵Hall and Lawson and their colleagues investigate five measurable areas of economic freedom, including size of government, monetary policy, trade freedom, property rights protection, and credit, labor and business regulations Hall and Lawson (2009, 6).

economic competition and opportunity to a country's citizens, not inequality and exploitation by foreign states. Citizens in capitalist states therefore are more unwilling to use force abroad or rebel domestically.

Third, conflict incurs cost, and this cost is especially too high for capitalist states to bear (Krustev 2006, de Soysa and Fjelde 2010). When capitalist economies resort to arms, then most economic activities must be halted and available resources mobilized to ensure they will at least not lose in the battle. Capitalist states develop economically by attracting foreign capital and encouraging domestic demand. Therefore, it would be too unrealistic for a free market economy to run the risk of waging and joining the war by compensating its economic prosperity.

3 Why Capitalism Tend to (and Should) Shorten Disputes?

Most scholars agree that the costs-benefit analysis is crucial in determining a country's decision of initiating or joining a war (Bennett and Stam 1996, Fearon 1995, Krustev 2006, de Soysa and Fjelde 2010). In general, a rational state leader will start the war if, in his calculation, the benefits of conducting conflict behavior outweigh the costs of it. Similarly, when countries are involved in conflicts, then they will continue fighting if such costs is lower than the benefits. Otherwise the fight stops. So far most studies on conflict duration and domestic institutions pay attention to political institutions. In terms of economic institutions, the wartime economic system transformed from free market economy and deteriorated macroeconomic performance

Intuitively, the longer the war duration the severer the damage caused by it to economic performance. Yet historians and economists find an inverse relationship between duration and economic performance. In some Koubi (2005)'s investigation, war duration

is positively associated with postwar economic recovery, with an increase of economic growth rate by 22%. Further, Great War historians and economists also suggest that it is the Second World War that dragged the US economy out of the quagmire of the Great Depression. However, in my investigation, at least two reasons support my argument that why a free market economy should conclude their disputes earlier.

CONSTRAINTS ON ECONOMIC INSTITUTIONS

There is no denying that war at times has positive impacts on a state. In Herbst (1990, 119–122), the author explains why the statehood was formed in Europe and East Asian countries but not in Africa, and the very fundamental reason is most African states became independent without the “help” of conflict.⁶ Conflict allows a state to develop the capability of extracting financial resources. A modern state through war reinforces the capacity of tax collection, and the public must also agree to be taxed to a much higher level than usual to ensure the financial support for war will be enough. Those that fails to do so lose the opportunity of building a modern state and lead to the resulting demise.

Once the war begins, the government must mobilize all possible resources to ensure that it will not at least lose in the battle, if negotiations is not possible. In addition, the government will also add economic and political constraints on its subordinates to make sure resources could be effectively mobilized.

Yet in the long run, the measures a government adopts during the wartime basically undermine the market system, especially if it is a capitalist one before the conflict. Consider the war communism implemented by the Bolsheviks during the Russian Civil War between 1918 and 1921, a series of policies aimed at cracking capitalism down was applied. Free and voluntary economic exchange was prohibited, private property and ownership were illegal and punishable by the government, and all agricultural crops were forced to

⁶Of course, Herbst as in his concluding part does not suggest the African states to go to war. Alternatives other than violent means should be sought and used to avoid the tragic use of armed forces.

be sent to the central government for military use. The halt of free market economy produced serious drawbacks to the Russian economy, as highlighted by Richman (1981):

Industrial production by 1920 was 20 percent of the pre-war volume. Gross agricultural output fell from more than 69 million tons in the period 1909-1913 to less than 31 million in 1921. Sown area dropped from over 224 million acres in the period 1909-1913 to less than 158 million in 1921. From 1917 to 1922 the population declined by 16 million, not counting war deaths and emigration. Eight million persons left the towns for the villages from 1918 to 1920. In Moscow and Petrograd, the population declined 58.2 percent (Richman 1981, 90).

Thus, when countries go to war or have internal conflicts, they must try their best to stop the war as quickly as possible to preserve the operation of the free market mechanism. Inversely, there is no big differences between the peacetime and wartime economy to non-capitalist states, leading us to expect a longer conflict among these non-capitalist states.

MACROECONOMIC PERFORMANCE

Some might question that it is the very destruction of the war that shake a country's economic foundation. In countries where their soil is (fortunately) free from destruction, war might bring prosperity. This argument is exactly what some American economists and historians explains the benefits that the second great war brought to the U.S. However, this argument is wrong at best.

In his subsequent papers, Higgs (1992, 1997, 1999) challenges the role the war played in vitalizing the U.S economy during the Second World War period by re-investigating three macroeconomic indicators. First, the very low unemployment rate (roughly 1.2 percent) during the wartime period was caused by increasing military forces. At its height

nearly two-fifths of U.S workers were conscripted (1943-1945), leading to much lower non-military employment. Second, the real output calculated by the Commerce Department included the relative prices of war munitions. This inclusion, criticized by Simon Kuznets, exaggerated the growth to which the Great war contributed (Higgs 1992, 46–47). In fact, it is peacetime that stimulated the U.S economy. Third, real consumption was declined. Then he concludes and finds that “By early 1945, almost everyone expected the war to end soon. The prospect of a peacetime economy electrified investors . . . In just two years the Standard & Poor’s index increased by 37 percent and the value of all shares on registered exchange by 92 percent, despite a decline of current-dollar after-tax corporate profits from their peak in 1944” (Higgs 1992, 58). In addition, war also encroaches private property rights (Tooley 2009). The government for the purpose of winning war sacrifices private property rights, and confiscates individual assets. When war continues or happens frequently, the general public cannot protect their belongings, leading to the decay of individual economic freedom.

In other words, if war brings prosperity, low unemployment, and economic recovery, then it is predictable that first, every country will join or start the war more frequently. Second, once war starts, belligerent states will try every effort, mobilize all resources to keep it alive, rather than end war. Yet this argument is hardly true, and contradicts the expectation of the general public and the government, and more important economic performance.

4 Data and Methods

4.1 The dependent variable

The dependent variable in this study is conflict duration (*DURATION*), measured in the number of day(s). Data are retrieved from the Militarized Interstate Dispute

(MID) dataset, version 3.01 (Ghosn and Bennett 2003, Ghosn, Palmer and Bremer 2004, Jones, Bremer and Singer 1996) of the Correlates of War (CoW) project. The period of investigation covers 32 years (1970 to 2001), and 1,423 dyads in this period were involved in certain levels of conflict, from threat to use force to show of force to limited militarized conflicts to full-scaled wars. Conflict duration ranges widely, from 1 day to 4,764 days.⁷

4.2 Independent and control variables

LIBERAL MARKET INSTITUTIONS

Scholars measure domestic economic institutions in a variety of ways. Souva (2004) uses property rights protection as the proxy of economic institutional similarity and finds that even when countries are dissimilar in political institutions, economic institutions help reduce the likelihood of conflict. Werner and Lemke (1997) use the degree a state intervenes in economic and social activities retrieved from the Polity II project as the determinant of alignment choice, along with polity scores (Werner and Lemke 1997, 535). In addition, life insurance contracts is applied in Mousseau (2009)'s study to supplementing the argument of democratic peace through social market dimensions.

To operationalize first and main response variable FREE MARKET, Gwartney and Lawson's *Economic Freedom of the World* (2009) is used as the source of economic institutions in this work. In their work, economic freedom is defined by an overall score composed of five areas of economic activities-government size, international trade, labor, business, and credit regulation, property rights protection, and money flow. On a 0 to 10 continuous scale 0 denotes the least free and 10 the most free.

There are two thing worth noting here. First, Gwartney and Lawson do not code annual data until the year of 2000. Before 2000 economic freedom score was coded on

⁷The total number of conflict dyads is 1426. Yet in case no. 353, there were no military actions between Egypt and Israel, and between Syria and Israel. Meanwhile, in case no. 3957, Kuwait and Jordan did not fight against each other before they joined in or withdrew from the battle. Therefore I exclude these three dyads.

the basis of five-year intervals. I follow de Soysa and Fjelde (2010)'s practice, linearly interpolating the data for missing values between 1970 and 2000. Second, Gwartney and Lawson in their annual survey do not correlate economic freedom with economic regime. To operationalize, I in this paper consider those countries that receives a score of 7.0 or higher as capitalist,⁸ and give them a score of 1. Otherwise 0 is given. A dyad will be considered capitalist if its combined score is 2.

BILATERAL TRADE OPENNESS

Along with the main response variable, I also include several control variables as discussed in Bremer (1992), Oneal and Russett (1999). Whether trade brings peace or conflict to the world, or vice versa lies at the core of discussions of international political economists (see an excellent review by Mansfield and Pollins 2001), yet it shortens or lengthens the conflict is largely underdeveloped. Based on the opportunity cost approach, recently Krustev (2006) formally and empirically finds that higher trade interdependence between two states leads to a shorter dispute, because such interdependence generates unbearable costs for them to fight. I use bilateral trade flow as the percentage of GDP to measure trade openness (OPENNESS), and expect that if the value is high, the conflict in a dyad tends to be shorter:

$$\text{OPENNESS} = \frac{\text{Trade}_{ijt} + \text{Trade}_{jit}}{\text{GDP}_{it} + \text{GDP}_{jt}}, \quad (1)$$

where subscripts ij and ji denote the trade flow from state i to j and j to i , respectively, and t denotes year. Data come from Barbieri, Keshk and Pollins (2008, 2009)'s trade dataset available at the CoW project. GDP is from UNdata.com.⁹

⁸In fact, statistics present similar results when I switch the threshold from 7.0 to 6.5. See Section 5. In addition, using a score of 7.5 will be too high to include all free market economies as we identify today, such as Austria, Belgium, Finland, and Germany.

⁹Taiwan is not a member of the United Nations and its GDP data therefore are not reported. I retrieve its GDP from the Directorate-General of Budget, Accounting and Statistics of the Executive

DEMOCRACY

The argument that democratic dyads (DEMOCRACY) tend to experience shorter disputes has been confirmed in Bueno de Mesquita, Koch and Siverson (2004), Bueno de Mesquita et al. (2003). To operationalize this variable, I use the data from the Polity IV project (Marshall and Jaggers 2009). Each country's democratic performance is measured by its democracy and autocracy scores measured on two 0 to 10 scales that higher values denote higher democratic (autocratic) performance. I obtain a country's polity score by subtracting its democracy score from autocracy score. I then code a country as democratic and give it a score of 1 if it receives a polity score of 6 or higher, and 0 otherwise. Finally, I add two countries' polity scores and code it as a democratic dyad if such combined score is 2.¹⁰

GEOGRAPHICAL PROXIMITY

Sometimes countries are more likely to go to war and then involved in a lengthy conflict process because they are geographically close (PROXIMITY), such as the 8-year Iran-Iraq war between 1980 and 1988. As operated by Souva (2004, 271), geographical proximity is coded with a dichotomous variable: 1 is given if two countries share a land or river border, or if they are separated by less than 24 miles of water.¹¹ 0 otherwise is coded. Data are retrieved from the COW project's Direct Contiguity dataset (Correlates of War Project 2007, Gochman 1991, Stinnett et al. 2002), version 3.1.

POWER RATIO

Countries are considered conflict-prone if they are approximately equal in power, yet

Yuan: <http://www.dgbas.gov.tw/mp.asp?mp=1> (accessed September 19, 2010).

¹⁰Similar results are presented when the threshold is 1 point higher.

¹¹12 miles are the usual practice of a country's territorial sea, and an extra of 12 miles is the contiguity zone, as defined by the 1982 United Nations Convention on the Law of the Sea.

it is not sure if power parity is positively associated with a longer militarized dispute. I expect that when two countries go to war, the conflict process is longer if their power are more equal.

To measure the variable power ratio (RATIO), I use the the Composite Index of National Capability (CINC) score from the CoW project's National Material Capabilities, version 4.0 (Singer 1988, Singer, Bremer and Stuckey 1972). Each country annually receives it CINC score based on its relative share of six indicators, urban population, total population, military budget, military personnel, steel and iron consumption, and energy consumption in the world. I calculate the ratio of the weaker state's CINC score over the stronger state's. Higher values of this calculation denotes more power parity. Therefore, two countries are physically equal in power if the ratio is 1.

4.3 Model Selection

Though the response variable is continuous in nature, the ordinary least squares (OLS) model should not be applied. The OLS skill violates several assumptions of the time-to-event model, such as normality and the expected negative value. In stead, event history models (a.k.a. duration models or survival models) are the most appropriate to study an event from its onset to termination, such as militarized dispute, or if an event transforms, such as democratic transition (Cleves et al. 2008). I primarily use the semi-parametric Cox model but also compare my results with the parametric Weibull model.

5 Statistical Results

Tables 1 and 3 show the statistical results and Tables 2 and 4 shows each variable's hazard ratio. In the first set of models I test the effect of the primary response variable, LIBERAL MARKET INSTITUTIONS, on conflict duration. Then I expand my models to

include all variables identified in this paper.

In the first set of my results, either Cox or Weibull model demonstrates the importance of free market institutions in shortening militarized dispute. For example, in Model 1, the effect of LIBERAL MARKET INSTITUTIONS on conflict duration is significant at 1%, and its hazard rate is 1.364, meaning that the likelihood of ending conflict between two free market economies are 136.4% higher than those conflicts between capitalists and non-capitalists, and between non-capitalists. Across all eight models, LIBERAL MARKET INSTITUTIONS generally show a robust and positive effect on shortening dispute duration. Another example, as demonstrated in model 7, is that the hazard ratio of conflict is 1.214. Though the significance level decreased from .01 to .05, free market institutions still can reduce conflict duration.

Second, TRADE OPENNESS (logged) confirms what Krustev (2006) finds in his work. When two countries's bilateral trade as a ratio of GDP is higher, the likelihood of ending conflict is higher. Through models 5 to 8, such effects are robust and significant at the .01 level. However, the effects of DEMOCRACY are mixed. Models show that democracy dyads tend to experience a shorter dispute but such effects are not significant. Unlike what Bueno de Mesquita, Koch and Siverson (2004), Bueno de Mesquita et al. (2003) demonstrate, the link of conflict length to democracy worth further investigation.

GEOGRAPHICAL PROXIMITY is found positively associated with a longer dispute. If two countries share a land or river border, or they are merely separated by territorial sea and contiguity zone, the hazard ratio of conflict is generally less than 1, meaning that they tend to experience longer conflict. In model 4 where the hazard ratio is .444, for example, its survival ratio is 2.252 ($1/.444 = 2.252$). Such results are robust across eight models. Finally, the results of POWER RATIO are mixed. When two countries are roughly equal in power, the hazard ratios of conflict, from model 1 to model 4, are about 1.100 and significant at the .05 level. When the models are presented in full, POWER

RATIO is not significant.

6 Conflict Duration and Its Implications for Cross-Strait Relations

In the previous section I empirically demonstrated that free market institutions shorten dispute duration. To lend further support to my theoretical argument and empirical findings, an in-depth investigation of the China-Taiwan relations will be provided here. Such investigation centers around a crucial question: If Beijing launches militarized attacks against Taiwan for whatever reasons, would it prefer surprise attack or a gradual escalation and military preparation?

It is now argued that the balance of military power across the Strait is shifting quickly in China's favor, given China's rapid increase in military expenditure and modernization. According to the 2010 *Military and Security Developments Involving the People's Republic of China* report (Office of the Secretary of Defense 2010), Beijing had deployed 490 fighters, 400,000 ground forces, and about 1,000 missiles¹² in three military regions that face directly to Taiwan (2010, 2–4). Moreover, China's overwhelming military advantage is accompanied with its military modernization. In other words, Beijing pursues not only the quantity but also quality preponderance over Taiwan.

Yet as the same report points out, scholars and policy analysts still not reach the conclusion about the military procedures Beijing might adopt if both sides eventually go to war.¹³ Some argue that China would escalate the dispute level gradually: Beijing

¹²Consider that there were only about 200 missiles when Chen Shui-bian came to power in 2000 (O'Hanlon 2000, 57).

¹³According to the "Anti-Secession Law" promulgated in 2005, the Chinese government reserves the room of applying military means, if "the 'Taiwan independence' secessionist forces should act under any name or by any means to cause the fact of Taiwan's secession from China, or that major incidents entailing Taiwan's secession from China should occur, or that possibilities for a peaceful reunification should be completely exhausted" (Article 8). For the full text of the Anti-Secession Law, see http://www.gwytb.gov.cn:8088/detail.asp?table=Headlines&title=Search&m_id=319 (Accessed September 6, 2010).

would signal its determination to use force first, and then prepare and mobilize troops before going to war, to ensure once war starts Beijing would win quickly. Others hold that to ensure foreign intervention (mainly the United States) would not be able to respond militarily and promptly, Beijing would seek a *Blitzkrieg*. However, if a quick victory is not possible, Beijing would then try to deter foreign involvement or to pursue a possible political solution if a prolonged conflict is unavoidable (Office of the Secretary of Defense 2010, 51).

From the perspective of free market economy, I argue, with China's deepening free market mechanism and market-oriented economic reform, once the Chinese government decides to use force against Taiwan, a surprise attack will be of functional practice. To protect what the Chinese government has in economic performance, such attack assumes no economic structural adjustment is necessary. First, given the market reform in China would go deeper and wider, any protracted militarized action can only daunt foreign investment and also put further constraints on domestic market mechanism. China is now the largest recipient of foreign direct investment. Together with Hong Kong and Macao Special Administration Regions, in 2009 it received direct investment of 145 billion US dollars, compared to the United State's 129.89 billion (United Nations Conference on Trade and Development 2010). Its participation of the World Trade Organization (WTO) in 2001 also marks its acceptance of a global free trade order. China replaced Japan as the second largest economic entity in the second quarter of 2010, and is expected to become the largest by 2027 by replacing the United States.¹⁴ If Beijing cannot win the war quickly, then it must adjust its economic system in order to fight a longer conflict. Economic performance, however, buttresses not only China's growth and modernization but also the Communist Party of China's political legitimacy. As war extends, economic constraints and deteriorations follow.

¹⁴“China Overtakes Japan as World's Second-Biggest Economy,” *Bloomberg News*, August 16, 2010. <http://www.bloomberg.com/news/2010-08-16/china-economy-passes-japan-s-in-second-quarter-capping-three-decade-rise.html> (accessed September 1, 2010).

Thus, if the only goal of China military action is to prevent *de jure* independence of Taiwan, then a protracted standstill could only do harm to its economic performance. Military preparation can only raise the concern of Taiwan, and probably soon of that of the United States and Japan as well, and responds it with military preparation. Beijing would then expect a protracted conflict to ensure they will not at least lose in war, if winning the conflict is not possible. Beijing's action against Taiwan will trigger concerns of domestic and international investors and leads to a deteriorated institutional environment for doing business. Once Beijing cannot quickly conquer Taiwan, it must mobilize all possible resources to support military action. Further, given the possibility of the US involvement, the current dominant power and potential challenger would very likely to mobilize all resources effectively. Beijing will expect a much deeper damage by war to its economy.

Second, China's transformation from a socialist economy in the late 1970s to a free market economy (under the name of "socialism with Chinese characteristics") had certainly increased the role capitalists play in Chinese politics. A clear example is the Communist Party of China (CPC)'s allowance of capitalist party members in early 2002, represented by Jiang's "Three Represents."¹⁵ Take a closer look at this policy change, it means that the CPC started broadening its ruling base by increasing the least welcomed class under the reign of Mao Zedong. The economic success of China over the past thirty years marks an improvement of the role of capitalists in the ruling party. Capitalists's participation into the policy making processes forces the CPC to consider their opinions before military actions. Had capitalists continue their significance in economy and politics, they would not just ask the avoidance of militarized conflict but also a much shorter one if unavoidable.

In short, given China's impressive economic performance is built on the basis of market reform, and given free market economy is unlikely (and unwilling) to fight a protracted

¹⁵http://news.xinhuanet.com/ziliao/2003-01/21/content_699933.htm

conflict, it is expected that the Chinese government will prepare the Strait war with a quick solution. Beijing's short- and medium-ranged missiles would still be deployed, regardless of the cross Strait relations worsens or improves.

7 Conclusion

This paper serves as the first to test how free market mechanism determines conflict duration. Through statistical analysis, this paper empirically and robustly confirms that two free market economies tend to fight a shorter dispute if conflict begins. Capitalism, or free market economy, plays an important role in not only reducing the likelihood of conflict (Gartzke 2005, 2007, de Soysa and Fjelde 2010, Weede 2005) but also the length of it. War incurs costs, and such costs are generally too high for capitalist economies to bear. The more fundamental explanation to free market economy leads to shorter disputes is: economic performance is very often associated with politicians' political tenure. If people are not sure whether they can win the war, economic decay and restrictions on free market principles will lead them to think about changing political leaders peacefully (such as in democracies) or violently (as in non-democracies).

Further, this paper also demonstrates why China's deployment of missiles, fighters, and ground forces toward Taiwan is, to Beijing, necessary for the purpose of protecting free market economy and preserving economic growth. After Ma Ying-jeou won the presidential election of Taiwan in 2008, the Cross Strait relations improves rapidly. Both sides now agree to use the 92 consensus: "one China, ". Furthermore, Beijing and Taipei signed the Economic Cooperation Framework Agreement (ECFA) in the year of 2010. However, there is no clear sign showing that Beijing will remove, withdraw, or destroy missiles facing Taiwan. To prepare a possible war and to prevent it from lengthening, such deployment would be unavoidable to Beijing. Such strategy will not have any fundamental change, even if Taiwan now accepts "one China" policy, and since Taiwan

is now democratic in nature.

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Table 1: Duration Analysis: Economic Freedom and Conflict Duration

	(1)	(2)	(3)	(4)
	Cox	Weibull	Cox	Weibull
FREE MARKET	0.311** (3.08)	0.322** (3.17)	0.330** (3.19)	0.338** (3.27)
DEMOCRACY			0.0216 (0.32)	0.0478 (0.70)
PROXIMITY	-0.682*** (-4.12)	-0.801*** (-4.85)	-0.692*** (-4.17)	-0.812*** (-4.90)
ln RATIO	0.0789* (2.39)	0.0862** (2.61)	0.0963** (2.69)	0.107** (2.98)
CONSTANT		-1.410*** (-7.65)		-1.422*** (-7.39)
<i>N</i>	669	669	654	654

t statistics in parentheses

* $p < 0.05$, ** $p < 0.01$, *** $p < 0.001$

Table 2: Hazard Ratios of Models 1 ~ 4

	(1)	(2)	(3)	(4)
FREE MARKET	1.364	1.380	1.391	1.402
PROXIMITY	.506	.449	.500	.444
RATIO	1.082	1.090	1.101	1.113
DEMOCRACY			1.022	1.049

Table 3: Duration Analysis: Economic Freedom and Conflict Duration

	(5) Cox	(6) Weibull	(7) Cox	(8) Weibull
FREE MARKET	0.193* (1.89)	0.197* (1.92)	0.194* (1.86)	0.196* (1.88)
ln OPENNESS	0.136*** (4.51)	0.141*** (4.63)	0.145*** (4.55)	0.151*** (4.69)
DEMOCRACY			0.0498 (0.72)	0.0772 (1.12)
PROXIMITY	-0.454** (-2.55)	-0.570*** (-3.19)	-0.445** (-2.48)	-0.552** (-3.06)
ln RATIO	0.0259 (0.64)	0.0312 (0.77)	0.0313 (0.68)	0.0382 (0.83)
CONSTANT		-0.632** (-2.72)		-0.647** (-2.67)
<i>N</i>	570	570	555	555

t statistics in parentheses

* $p < 0.10$, ** $p < 0.05$, *** $p < 0.01$

Table 4: Hazard Ratios of Models 5 ~ 8

	(5)	(6)	(7)	(8)
FREE MARKET	1.213	1.217	1.214	1.217
ln OPENNESS	1.146	1.151	1.156	1.163
DEMOCRACY			1.051	1.080
PROXIMITY	0.635	.565	.641	.576
ln RATIO	1.026	1.032	1.032	1.039