

CHAPTER 1 : THE THREAT OF CHINA'S ECONOMIC COERCION

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This chapter examines the characteristics of China's use of economic coercion and assesses its effectiveness. We use four key indicators: policy changes or other responses to the measures; the trade volume between China and the targeted sector; the total volume of trade between the targeted country and China; the trade volume of the targeted sector with the rest of the world. We find that the effectiveness of Chinese economic coercion depends on a number of factors: power asymmetry; trade dependence; the elasticity of China's demand; and the capacity of the targeted sector or country to swiftly diversify export markets. We argue that trade diversification is the first essential step to avoid economic dependence on China and becoming vulnerable to coercive measures. A collective response by like-minded countries also plays a critical role in helping targeted sectors and countries. Joint action can be undertaken to challenge the legality of China's coercive measures at forums such as the WTO dispute settlement system. The EU's recently adopted countermeasure – the Anti-Coercion Instrument - also serves as a good example for countries considering legislation to deter China.

1.1 Introduction

In the past few decades, the People's Republic of China (PRC) has maximized its efforts to isolate Taiwan from international relations. One of its policy instruments is the use of economic statecraft, which aims to lure Taiwan's diplomatic partners with economic benefits or coerce them to behave in a given manner for diplomatic and strategic purposes. China may offer economic benefits, such as foreign aid and trade preferences, with a view to persuading states that recognize Taiwan to switch diplomatic relations. On the other hand, it may resort to economic coercion in order to change their behavior and shape the direction of policy making. Whether the promise of economic benefits materializes, or whether coercion is effective, demands careful analysis.

This chapter complements following chapters that examine in more depth the economic impact on countries that switch diplomatic relations or establish representative offices in Taipei. It aims to illustrate how China uses its economic might to pursue strategic and diplomatic objectives by shaping the behavior of third countries, and in some cases competing with Taiwan for diplomatic partners. The chapter first examines the policy instruments available for China's economic statecraft in general, and assesses its use of economic coercion in particular, and then highlights their characteristics. The chapter then considers the effectiveness of China's use of economic coercion based on four indicators:

the trade volume of the targeted sector into the Chinese market; the total trade volume of the targeted country with China; the trade volume of the targeted sector with the rest of the world; and finally, the responses of countries that have been targeted in terms of changed behavior. After assessing the effectiveness of China's use of economic coercion and examining the response of the targeted sectors/countries, this chapter offers suggestions on how to ameliorate the impact of Chinese coercion and how to preserve policy autonomy.

1.2 Policy Instruments for China's Economic Statecraft and their Characteristics

1.2.1 China's Evolving Attitude toward Economic Statecraft

Economic statecraft is understood as the use of economic tools or measures by countries to advance their national and strategic interests (Baldwin, 2020). Scholars have illustrated how the expansion of a country's economic and diplomatic power can lead to much more vigorous use of such methods (Norris, 2016; Macikenaite, 2020, pp. 108-109). Economic statecraft can be exercised either to entice targeted countries with incentives, or to employ economic coercion to try to compel a given response. (Blanchard & Ripsman, 2013). The available policy tools, national objectives, and the effectiveness of economic coercion or inducements over targeted countries, are all observed indicators and constitute the primary focus for us to examine China's economic statecraft.

China has been described as a master of economic statecraft. However, its use of such foreign policy tools began relatively recently. (Suettinger, 2000, p. 15). For decades after the PRC was established in 1949, the Chinese government constantly stressed its commitment to "Five Principles of Peaceful Coexistence", which highlighted anti-hegemony as a fundamental foreign policy goal. (Ministry of Foreign Affairs, 2021).¹

During the Cold War, China repeatedly criticized the US and Soviet Union for using their economic and military power to bully the developing world. (Li, 2017; Levine, 1975; Van Ness, 1993). However, since 1980, in line with its growing economic, military and political power, China has increasingly resorted to economic coercion to pursue its national interests (Nephew, 2019). Illustrative examples include an attempt to internationalize the "One China Principle", which requires recognition of Taiwan as an integral part of Chinese territory, and to insist on the principle of non-interference regarding Beijing's control over Hong Kong, Tibet and Xinjiang. (Macikenaite, 2020, p. 118).

1.2.1 Economic Statecraft with Chinese Characteristics

China has employed ever more diverse economic tools to further its interests as its economic and diplomatic powers have increased. Positive economic instruments were once favored, including the allocation of foreign aid, investment by state-owned enterprises and foreign development assistance programs for the least developed countries (Li, 2017). In 2018, with a view to coordinating its once fragmented foreign aid administration, the

“China International Development Cooperation Agency” was established, representing the first structural change in China’s institutional evolution of foreign aid allocation (Rudyak, 2019). This, combined with the Belt and Road Initiative,² has led to a more systematic use of positive economic statecraft.

Turning to negative economic statecraft, studies find that China is increasingly resorting to coercive measures from its foreign policy toolbox. They are used to retaliate against countries that challenge China’s sovereignty, pose a threat to its national security, or stand against its foreign policy objectives (Li, 2017, p. 18). While being employed more frequently, commentators note that China’s use of coercion is usually not long-lasting and not aimed at crippling targeted countries’ economies; instead, it is designed to express China’s anger and to encourage changes of policy (Macikenaite, 2020, p. 119). China’s ambitious agenda now includes attempts to shape the international system through economic coercion (Economy, 2018, p. 186).³ Its expanding use of such measures can also be understood as a component of a more aggressive foreign policy. China has expanded its self-defined “core interests” and insists on its own interpretations of international law and understanding of international relations.

Beijing’s exercise of statecraft has a number of distinctive features. Much of the economic pressure is not explicitly launched by the Chinese government. Rather, China may rely on its consumer market, one of the largest in the world, as the source of coercive leverage. Specifically, China can manipulate several tools, such as restrictions on tourism, popular boycotts, protests or even riots by Chinese civilians, to increase pressure on the targeted country. (Reilly, 2012, p. 124). Even when economic coercion is employed directly by the government, China rarely acknowledges that the punitive measures are a response to infringements of its national interests. Instead, informal or extralegal measures are used, enabling China to label its actions as legitimate regulatory measures and retain the flexibility to escalate or de-escalate the level of retaliation. For instance, China can selectively apply food safety regulations on products imported from targeted countries. The Chinese government can also suspend targeted companies’ operations on the grounds of public safety concerns (Harrell et al., 2020, p. 23). Most of the countries targeted in this way are democratic states. China has tended to rely on economic inducements to consolidate ties with its authoritarian partners, but such an approach is considered less likely to succeed with democracies. Consequently, China uses measures to target critical products or key enterprises in the hope that the economic damage will sway democratically elected leaders who feel responsible for the welfare of their citizens. (Harrell et al., 2020, p. 23).

1.3 A Review of China's Use of Economic Coercion in Recent Decades

This section uses descriptive statistics to demonstrate quantitatively the effect of economic coercion against other countries. We assess the impact on the following countries that have been targeted in various ways: Norway, Japan, the Philippines, Mongolia, Canada, Palau, Australia and Lithuania. We measure the effectiveness of China's use of economic coercion through four indicators: (1) the value of the targeted product(s) exported to China; (2) the value of the country's total exports to China; (3) the value of the targeted product(s) exported to other countries; and (4) any policy changes undertaken by the targeted country. We aim to offer empirical inputs by displaying the trade effects or policy changes caused by the coercive trade measures.⁴

1.3.1 *Economic Coercion against Norway (2010-2016)*

China is Norway's largest trading partner in East Asia and one of the most important markets for Norwegian salmon (Chen & Garcia, 2016, p.31). However, in 2010, China-Norway relations suffered a severe setback when the Norwegian parliament-appointed Nobel Committee awarded the Nobel Peace Prize to Liu Xiaobo, a human activist detained by China on charges of endangering national security (The Nobel Peace Prize, 2010). After the announcement, the Chinese government condemned Norway for disrespecting its judicial sovereignty and accused Norway of damaging relations (BBC, 2010). China further declared that stricter inspections would be carried out on Norwegian salmon due to food safety concerns.⁵ Lengthy and complicated border inspections resulted in long delays, which were devastating for a fresh product such as salmon. Moreover, in 2015, China announced a full import ban on Norwegian salmon after allegedly detecting infectious salmon anemia, a viral disease. (Xinhua, 2015). Relations finally improved in 2016 after China received a formal apology from Norway and the two countries signed a joint communiqué to normalize their relations.⁶ The salmon trade resumed soon afterwards.

In this case, China's coercive measures had a significant impact on Norwegian salmon exports (Chen & Garcia, 2016). The import values of Norwegian salmon to China rose and fell according to the scale of the confrontation. (Figure 1.1). After the Nobel Prize was awarded to Liu, the export value of salmon to China fell sharply from \$145 million to \$84 million in the next quarter. A sharper decrease followed in 2015 Q1 to Q3, while the import ban was in place. While seriously influenced by Chinese economic measures, Norway successfully increased salmon exports to other markets. The huge surge in the export value of Norwegian salmon in 2013, in the midst of the dispute, supports such an observation. Additionally, notwithstanding the tension between the two countries, China did not cut off all trade relations with Norway. Figure 1.2 also shows that the overall value of Norway's exports to China increased from 2013 Q1 to 2014 Q4 while the salmon restrictions were in place. In brief, even though China expressed its dissatisfaction with Norway with punitive

measures on one of its vital exports, the Chinese government did not completely suspend bilateral interaction. However, Beijing's actions were successful since Norway yielded to its demand for an apology, and relations were normalized with the issue of a joint communiqué 2016.

FIGURE 1.1 THE EXPORT VALUE OF NORWEGIAN SALMON TO CHINA

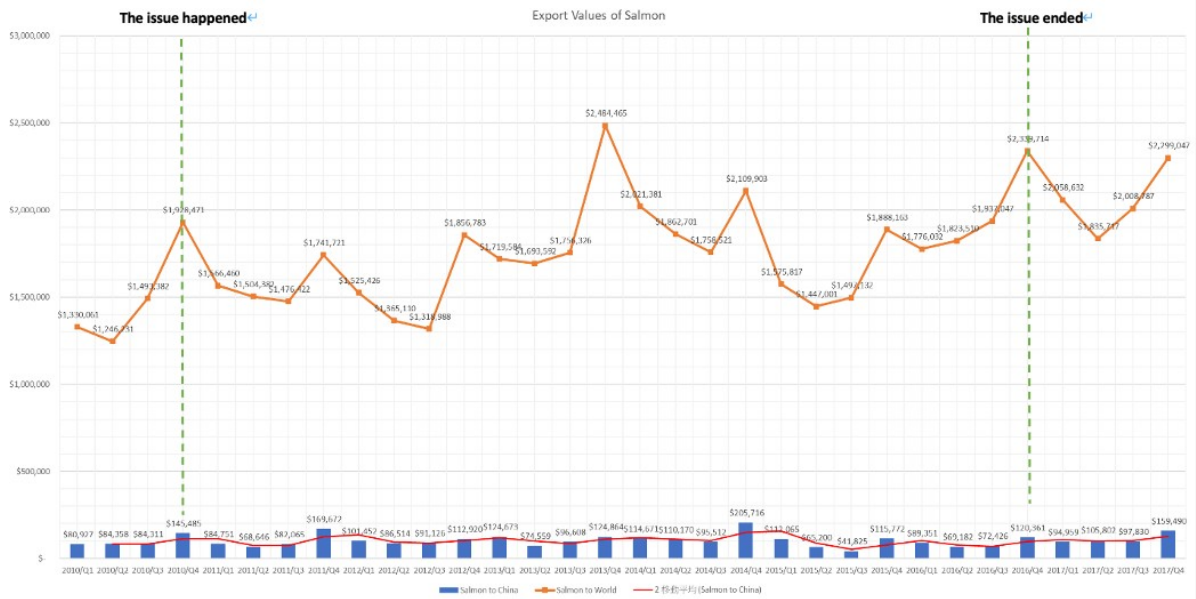
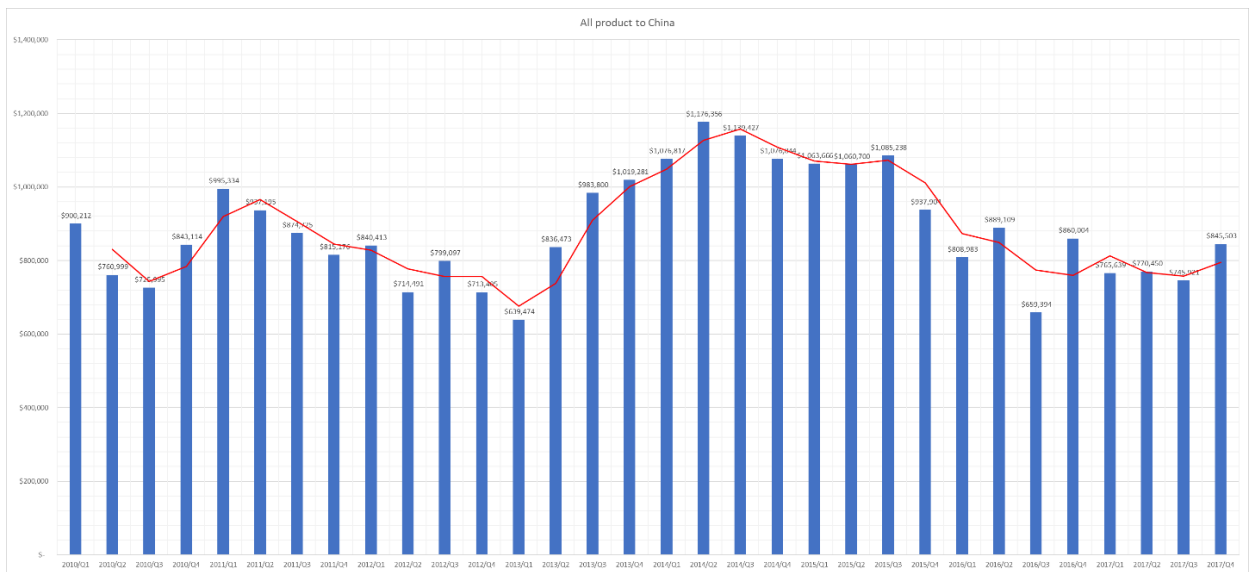


FIGURE 1.2 TOTAL EXPORT VALUES FROM NORWAY TO CHINA

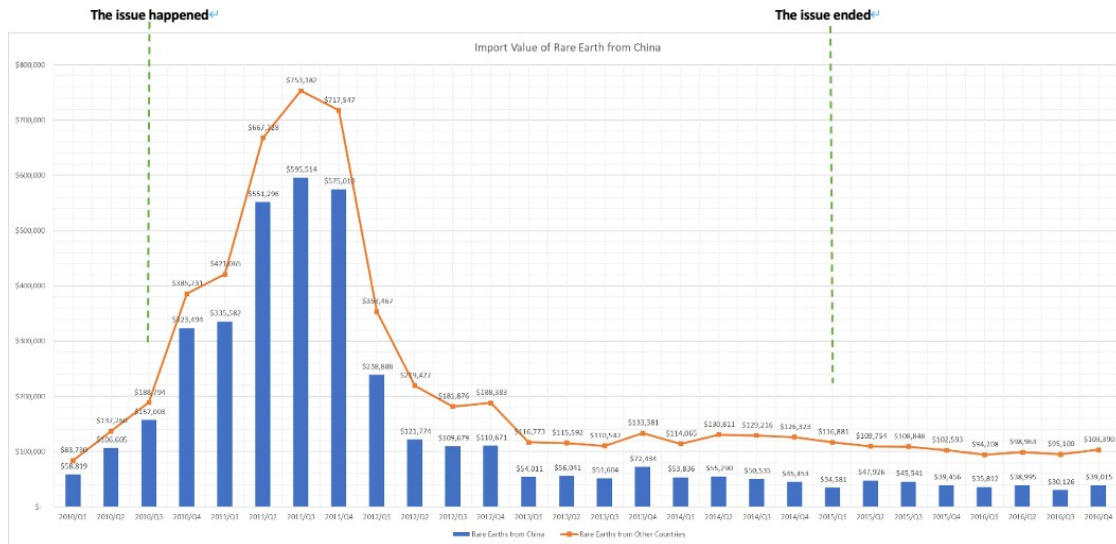


1.3.2 Economic Coercion against Japan (2010-2015)

Japan and China have a close but complicated relationship due to geographical, economic, historical and cultural factors. The territorial and maritime dispute arising from their competing sovereignty claims over the Senkaku/ Diaoyu islands is a fundamental source of tension. (Fravel, 2010, p. 144). In 2010, a Chinese fishing vessel collided with a Japanese coast guard patrol boat in the disputed sea area of the uninhabited islands. The Chinese trawler was seized by Japan for illegally entering Japanese controlled waters and unduly interfering with the Japanese coast guard (McCurry, 2010). The Chinese government strongly protested and took steps to halt the export of rare earths globally. While the export ban did not explicitly mention Japan, Tokyo was widely seen as the intended target and Japanese manufacturing suffered severe repercussions given China's control of 97% of global rare earths production. (Japantimes, 2010; Jha, 2010). Japan responded by uniting with some of its trade partners to challenge the legitimacy of the Chinese move at the WTO. The claimants won the case in 2014. The Dispute Settlement Body (DSB) of the WTO ruled that China should lift the export ban and export quotas that were hampering the export of rare earths.⁷

Figure 1.3 shows the import values of rare earths from China and other countries to Japan. While China had begun to cut overall export quotas of rare earths in 2006 because of its own national industry policy (Morrison & Tang, 2012, p. 12), it further restricted the volume of rare earths exports to Japan to retaliate over the territorial dispute. The export restrictions caused the value of rare earths to jump to a historical high in 2011. This phenomenon can be explained by shortages in supply chains that resulted in rocketing prices. Japanese industries managed to reduce their demand for rare earths and cut imports in response. Furthermore, after the WTO ruled that China's export ban was not in line with WTO rules, the import value of Chinese rare earths to Japan stabilized. Thus, Japan did not yield to China's demands, perhaps due to the highly sensitive nature of the territorial dispute. It had successfully collaborated with the US and other countries to challenge the legality of export bans and quotas.

FIGURE 1.3 THE IMPORT VALUES OF RARE EARTHS FROM CHINA AND OTHER COUNTRIES TO JAPAN



1.3.3 Economic Coercion against the Philippines (2012-2016)

The Philippines and China have long clashed over their overlapping territorial and maritime claims in the South China Sea (Storey, 1999). After 2012, tension escalated when both sides dispatched coast guard vessels to the waters surrounding the Scarborough Shoal, a chain of reefs off the west coast of the main Philippine island of Luzon, resulting in a prolonged standoff. The tension intensified when the Philippines initiated international arbitration against China’s territorial claims under the United Nations Convention on the Law of the Sea and challenged China over the historical rights it claimed in the area (Reed & Wong, 2017).⁸ Shortly after these events, China imposed strict phytosanitary controls on bananas imported from the Philippines. While neither the Chinese nor Philippine governments overtly connected the trade restrictions to the South China Sea dispute, the restrictions were imposed at about the same time as the territorial confrontation (Higgins, 2012). Bilateral relations improved in 2016 after the newly elected president of the Philippines, Rodrigo Duterte, sought to restore friendly relations. He agreed to set aside the 2016 arbitral award that had favored the Philippine position (Kreuzer, 2018, pp. 16-23).

The effect of the phytosanitary measures on Philippine bananas can be found in Figure 1.4, which shows that the export value of bananas from the Philippines to China decreased and remained low after 2012 Q1. Nevertheless, exports bounced back in 2014. While the value dropped again in 2015, this was attributed to a drought that significantly reduced the quality and volume of banana production (FAO, 2015-16). Interestingly, the export value

of bananas to other countries increased significantly during the period of China’s import restrictions (from 2012 Q1 to 2014 Q2), which indicates that the Philippines successfully diverted its banana exports to other markets. Moreover, after President Duterte was elected and decided to mitigate the tension between the Philippines and China, total export values to China significantly increased (Figure 1.5, 2016 Q2-Q4). Political considerations clearly played a critical role in affecting bilateral trade relations. In view of Duterte’s decision to set aside the South China Sea arbitration, China was successful in changing the targeted country’s behavior.

FIGURE 1.4 THE EXPORT VALUE OF PHILIPPINE BANANAS TO CHINA

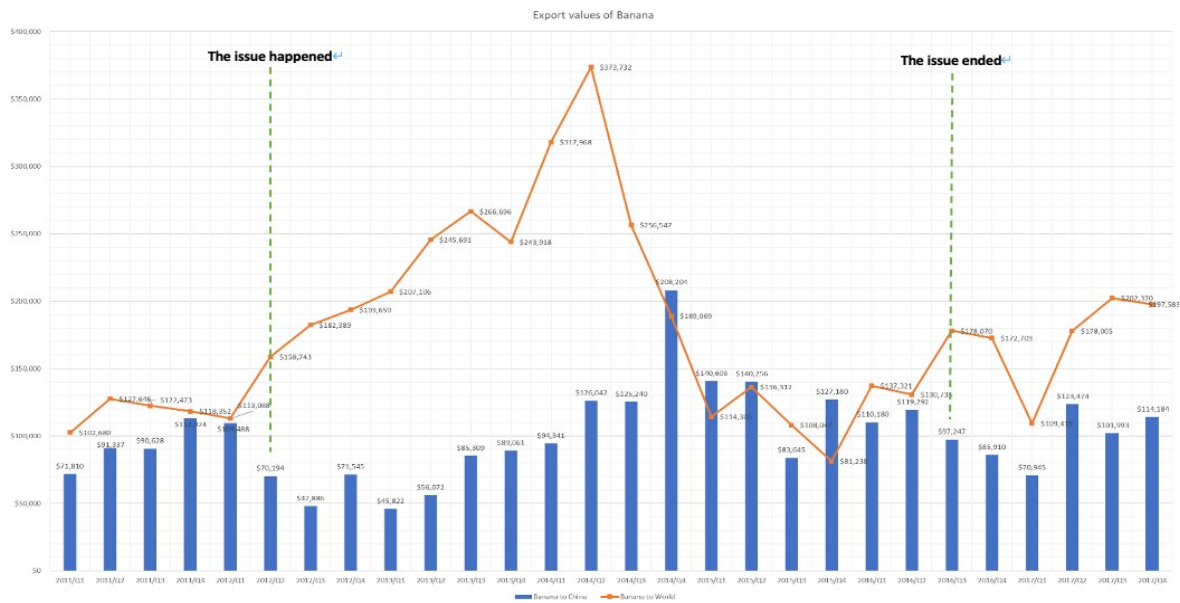
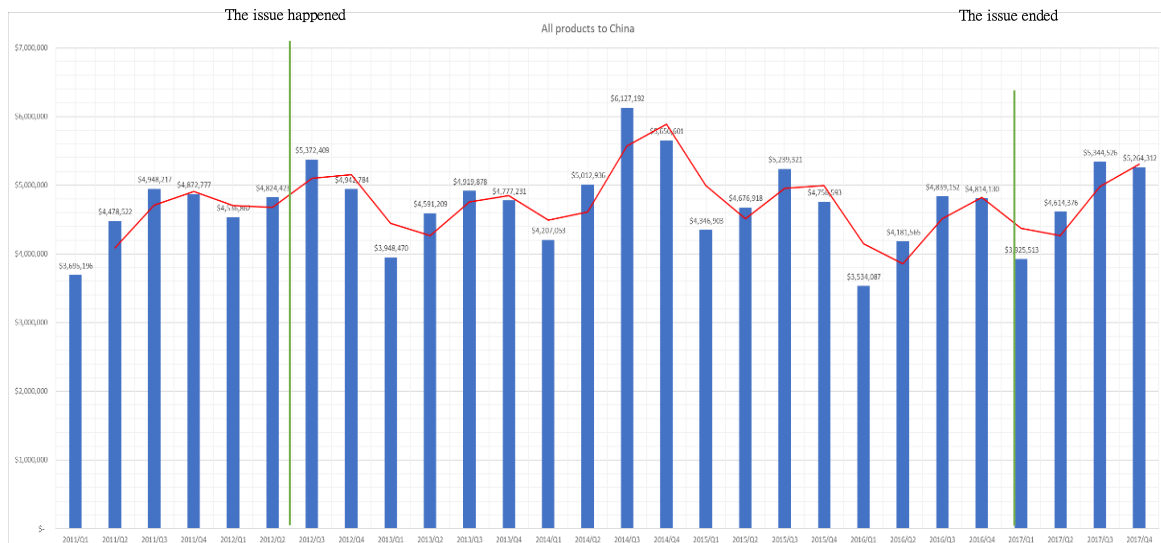


FIGURE 1.5 TOTAL EXPORT VALUES FROM THE PHILIPPINES TO CHINA



1.3.4 Economic Coercion against Mongolia (2016)

China is Mongolia's largest trading partner. Some 89% of Mongolian exports of goods are destined for China.⁹ Overall, the relationship between Mongolia and China is smooth and close. Nevertheless, when the Dalai Lama, whom China regards as a dangerous separatist, visited Mongolia in 2016, China asserted that hosting or meeting with the Dalai Lama was a major offense against China's sovereignty and the sentiment of the Chinese people. A week after the Dalai Lama's visit, China raised fees on mining product imports (mainly copper ore) from Mongolia and created delays at various border crossings. (AL JAZEERA, 2016). China also announced it would call off ongoing financial assistance negotiations with Mongolia (Aldrich, 2016). While China did not explicitly connect these measures with the visit by the Tibetan spiritual leader, it stated that the "Dalai Lama's furtive visit to Mongolia brought a negative impact to China-Mongolia relations (Reuters, 2017)."

The effect of China's trade disruptive measures is disclosed in Figure 1.6, which displays the export value of copper ore from Mongolia to China. The data show that it declined in December 2016 compared to October and November. Shortly afterwards, the Mongolian government expressed regret at the negative impact caused by its reception of the Dalai Lama and reassured China that it would not invite him back in the future (Caiyu & Tao, 2016). All the indicators in Figure 1.7 have bounced back since 2017. China's use of economic coercion against Mongolia was successful both in terms of curbing the country's exports to China and Mongolia's subsequent change of policy.

FIGURE 1.6 THE EXPORT VALUE OF MONGOLIAN COPPER TO CHINA AND OTHER COUNTRIES¹⁰

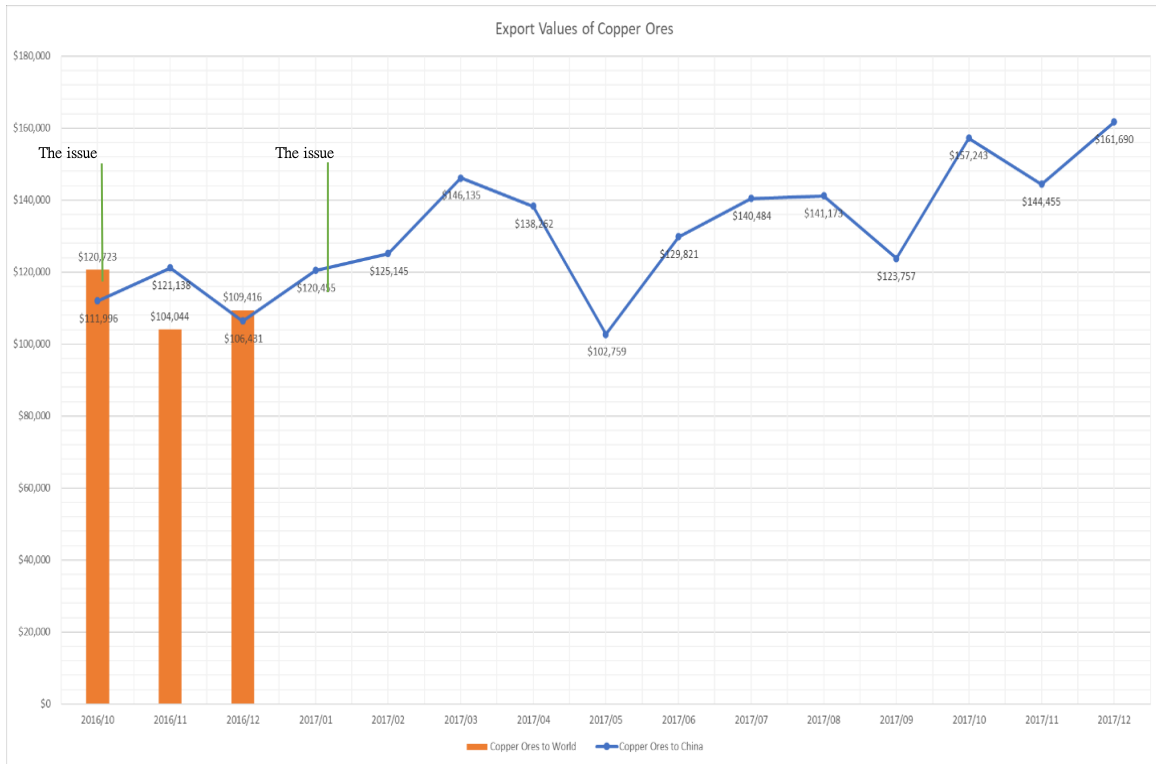
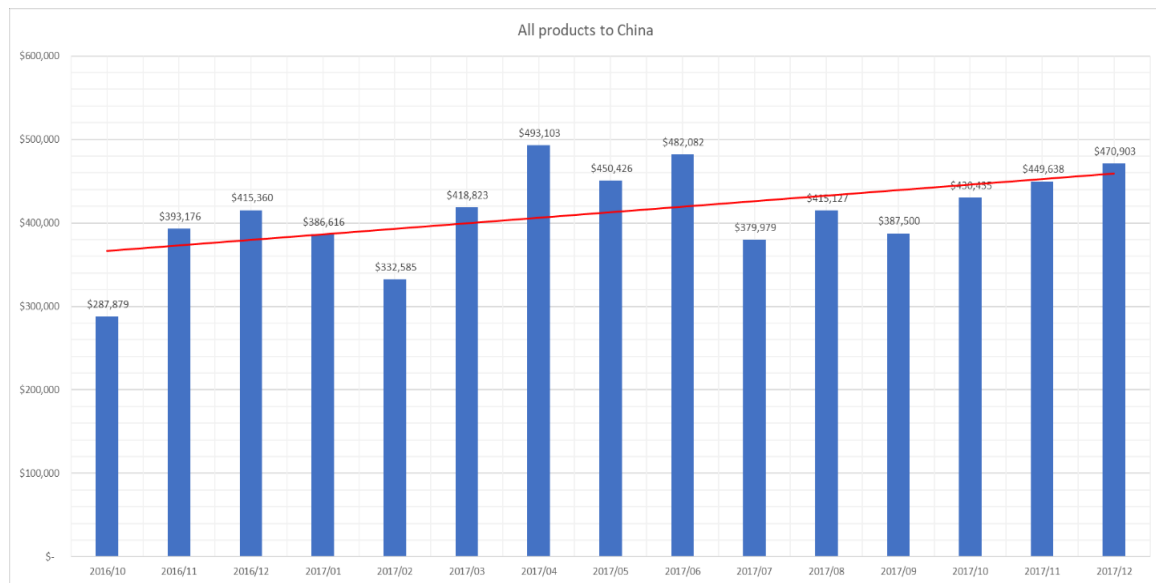


FIGURE 1.7 TOTAL EXPORT VALUES FROM MONGOLIA TO CHINA



1.3.5 Economic Coercion against Canada (2018-)

In late 2015, when Justin Trudeau became prime minister, the China-Canada relationship became more cooperative, and trade and investment grew (Blanchfield, 2015). However, Ottawa's relations with Beijing deteriorated shortly after 2018. The turning point was the arrest of Meng Wanzhou, the chief financial officer and deputy chair of Huawei (Wakabayashi & Rappeport, 2018). A few days after her arrest, unilateral economic measures were adopted by the Chinese government to increase pressure on the Canadian government. The targeted product in this case was canola seeds. China accounted for 40% of Canada's exports of the product. (Johnson, 2019). It imposed trade restrictions alleging that the seeds carried diseases and were contaminated with insects and weeds that threatened human, animal, and plant health.¹¹ In response, Canada took its case against China to the WTO and initiated a consultation procedure.

The value of canola exports from Canada to China steadily decreased after January 2019 (Figure 1.8). According to the Canola Council of Canada, canola seed exports to China "were down approximately 70 per cent in 2019 due to trade disruptions, resulting in an estimated \$1 billion in lost revenue from canola (Lester, 2021)." However, the value of canola exports to other countries increased after the import ban thanks to Ottawa's drive for new markets to mitigate the impact. (Patey, 2021). Nevertheless, as the Meng case dragged on, Canada's canola exports to China steadily rebounded, and in June 2021 they reached \$220,637,000, 95.6 percent of the level before Meng was arrested. Also, whereas it is undeniable that overall diplomatic relations between Canada and China have been undermined, Canada's total exports to China first decreased but have grown again since February 2020. They had reached the same level as before the dispute by July 2021 (Figure 1.9). The Meng dispute finally came to an end on 24 September 2021 when Meng and the US Department of Justice reached a settlement and the Canadian court concluded that there was no need for an extradition ruling.

The effectiveness of China's attempt at economic coercion against Canada cut both ways because of the complexity of the case. Meng was arrested because of an extradition request by the US. The move was seen by China as part of Washington's attempt to constrain Huawei's expansion into global 5G networks, a key element in the US-China trade war and technological competition. On the face of it, China succeeded in its aim to get Canada to release Meng. However, her release was in effect the result of a settlement between Meng and the US Department of Justice. Canada's actions came against the backdrop of China's resort to hostage diplomacy. Two Canadian citizens were detained in China on national security charges (BBC, 2019b) and two were executed after convictions on criminal charges (BBC, 2019a). Therefore, the effectiveness of China's economic sanctions must be seen in the light of the broader diplomatic context. Canada's exports of canola continued to increase despite the measures, while China was forced to import canola

oil from third countries, much of which derived from Canadian canola seeds, because of its huge demand for the product. China's goal of hitting Canadian exporters had backfired, and Chinese consumers paid the price. Total exports from Canada to China, meanwhile, continued to increase regardless of the dispute. The case provided further evidence that China's high demand for raw materials can stymie its attempts at economic coercion.

FIGURE 1.8 THE EXPORT VALUE OF CANADIAN PRODUCTS TARGETED BY CHINA

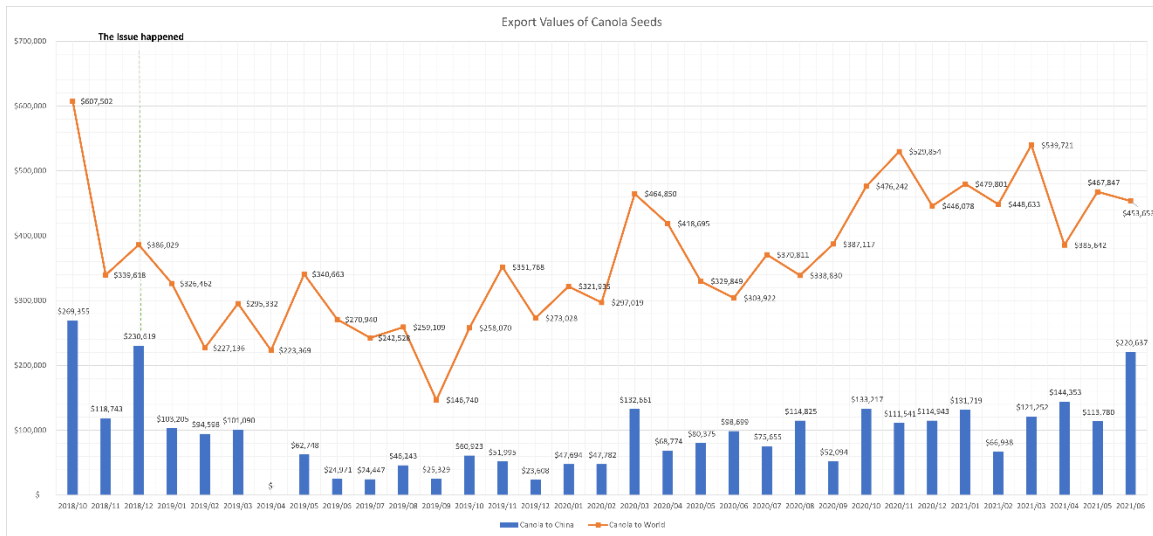
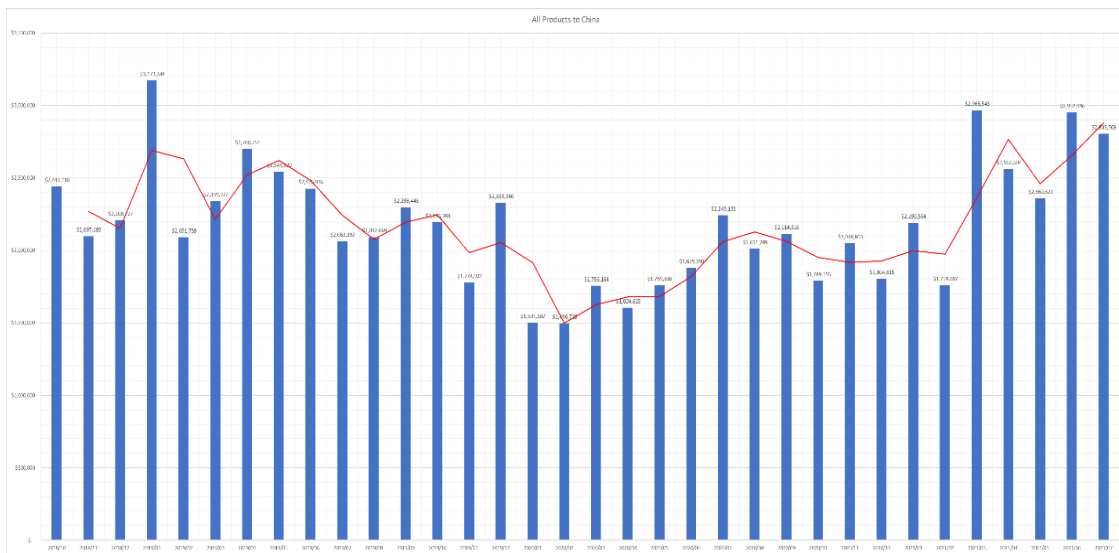


FIGURE 1.9 TOTAL EXPORT VALUES FROM CANADA TO CHINA

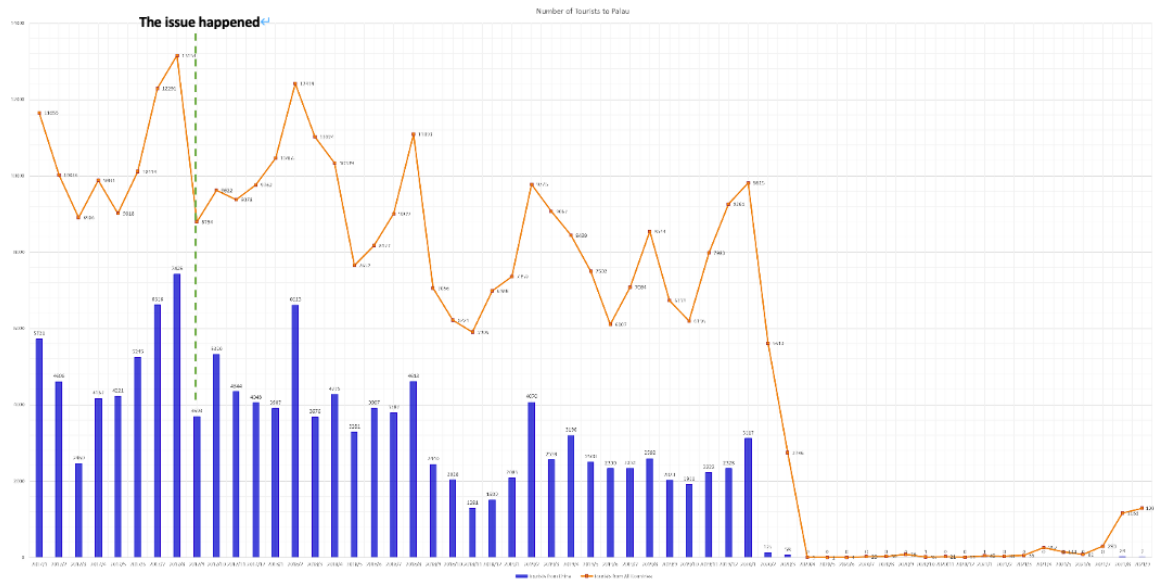


1.3.6 Economic Coercion against Palau (2017-)

Palau is a Pacific nation and one of Taiwan's 14 remaining diplomatic partners. The two countries established diplomatic relations after Palau achieved independence in 1994. Tourism is Palau's main industry, accounting for over 50% of its GDP before the pandemic. Some 50% of the tourists come from China, especially on package tours which constitute a major part of China's tourism market (Beldi, 2018). Hence, China has a strong hand in the economy of Palau and Chinese tourists have been weaponized by China to serve its foreign policy – namely to lure and to threaten Palau to try to shift its diplomatic recognition from Taipei to Beijing. The carrot and the stick have both been used. China's attempt at coercion focused on the use of its Approved Destination Status (ADS) system, which permits state-run tour agents to operate package tours only to listed countries (Arita et al., 2012). In other words, China can punish any country that challenges its national interests simply by removing it from its ADS list and prohibiting operators from sending tourists to that country. This was applied to Palau at the end of 2017 when the Chinese government designated Palau an illegal destination, and banned tourist groups from visiting, because it refused to sever diplomatic relations with Taiwan (Master, 2018).

Figure 1.10 shows the fluctuations of tourist arrivals from China and from the rest of the world. The data¹² suggests that the travel ban imposed by China caused a sharp decline in the number of Chinese tourists, which dropped 22.7% between the third and fourth quarters of 2017. Simultaneously, the total number of tourists declined by 16% over the same period. The statistics correspond with reports and interviews which indicated that the Chinese travel ban had inflicted serious damage (Lyons, 2020). Palau's hotels experienced a substantial drop in bookings after the ban and Palau Pacific Airways announced the termination of flights to China (Master, 2018). However, this attempt at economic coercion was ineffective in its attempt to force Palau to adjust its foreign policy. Palau still maintains diplomatic relations with Taiwan and both sides built closer ties after the outbreak of the pandemic (Agence France-Presse, 2021). Overall, the effectiveness of China's economic coercion against Palau was not decisive even though it did inflict harm. Palau did not yield to China's demands and did not change its diplomatic orientation. Such an outcome highlights how bilateral trade relations are only one part of the picture when geopolitics and strategic interests are in play. Strong support from the US, including security assurances and financial support, are the primary buttresses that enable Palau to resist pressure from China (Seidel, 2018). The fact that the US ambassador to Palau accompanied the Palauan president on an official visit to Taiwan demonstrates the US's strong influence over the Pacific island and its intention to counter China's growing presence in the Pacific.

FIGURE 1.10 NUMBERS OF TOURISTS FROM CHINA AND OTHER COUNTRIES TO PALAU¹³



1.3.7 Economic Coercion against Australia (2020-)

China is Australia’s largest trading partner and the relationship between Canberra and Beijing reached new heights in 2015 when the Australia-China free trade agreement was signed.¹⁴ However, in 2020, bilateral relations sharply deteriorated due to Canberra’s support for an independent investigation into the origins of COVID-19 and China’s handling of the initial outbreak (Wong, 2021). In addition, Canberra expressed concern over China’s implementation of the National Security Law in Hong Kong and its suspected use of forced labor in Xinjiang (Reuters, 2021). These steps antagonized the Chinese government, and it has since imposed a series of restrictions on the import of Australian goods, including barley, wine, beef, lobster, and coal. The measures have ranged from levying extra tariffs to imposing import bans and restrictions. Like Canada, Australia also brought Beijing’s attempt at economic coercion to the WTO. China responded that its trade measures were applied in line with its obligations.¹⁵

The impact on the export of the targeted Australian products is illustrated in Figures 1.11 to 1.13. The data suggests that China’s trade restrictions resulted in significant decreases in export values. We can even observe that the export of Australian wine, barley and coal were banned outright after December. However, the deterrent effect might not have been as pronounced as expected because the Australian government successfully diverted most of the targeted products to other countries. For example, overall exports of barley and wine increased in the aftermath of China’s moves. Coal exports also thrived in 2021 despite China’s ban. Commentators noted that “Australian coal exporters seem to have been quite

successful in diverting to other markets (Tan, 2021),” and “exports to other markets initially rose as China first reduced its coal imports starting around mid-year. The trend then accelerated as China targeted Australian coal specifically starting in October 2020 (Tan, 2021).” Moreover, Figure 1.14 shows a positive trend in the total value of exports from Australia to China despite the economic measures. The data shows that while Beijing resorted to trade disruption to try to influence Canberra, it remained highly dependent on exports from Australia in other sectors.

China’s attempt at economic coercion against Australia was also highly complex and touched on many sensitivities. Australia and China had originally had a close economic relationship, with Australia one of the first countries to sign a free trade agreement with China. China also accounts for a large proportion of foreign investment in Australia and many Chinese students go to Australia for higher education. Beijing’s initial move was likely fueled by anger, but the measures should also be seen in the broad context of Australia’s close alliance with the US, including its role in the Indo-Pacific Strategy and subsequently the AUKUS (Australia, UK and US security pact). Trade data demonstrates that China effectively prevented the targeted products from entering the Chinese market, but that Australia overcame any losses by diverting to other markets. Moreover, Australia’s total export volume to China increased despite the sanctions, due largely to China’s demand for Australian iron ore. Australia did not yield to China’s demands for changed policies and challenged the legality of the measures at the WTO. China’s attempt at economic coercion cannot be said to have been effective or successful.

FIGURE 1.11 THE EXPORT VALUE OF AUSTRALIAN BARLEY TO CHINA

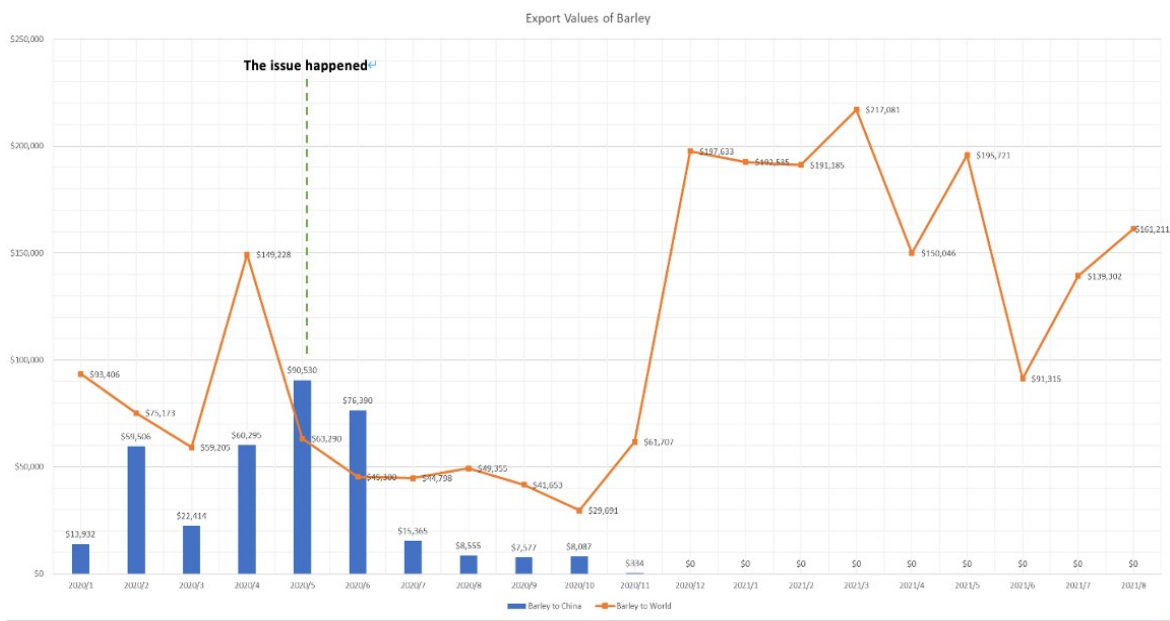


FIGURE 1.12 THE EXPORT VALUE OF AUSTRALIAN WINE TO CHINA

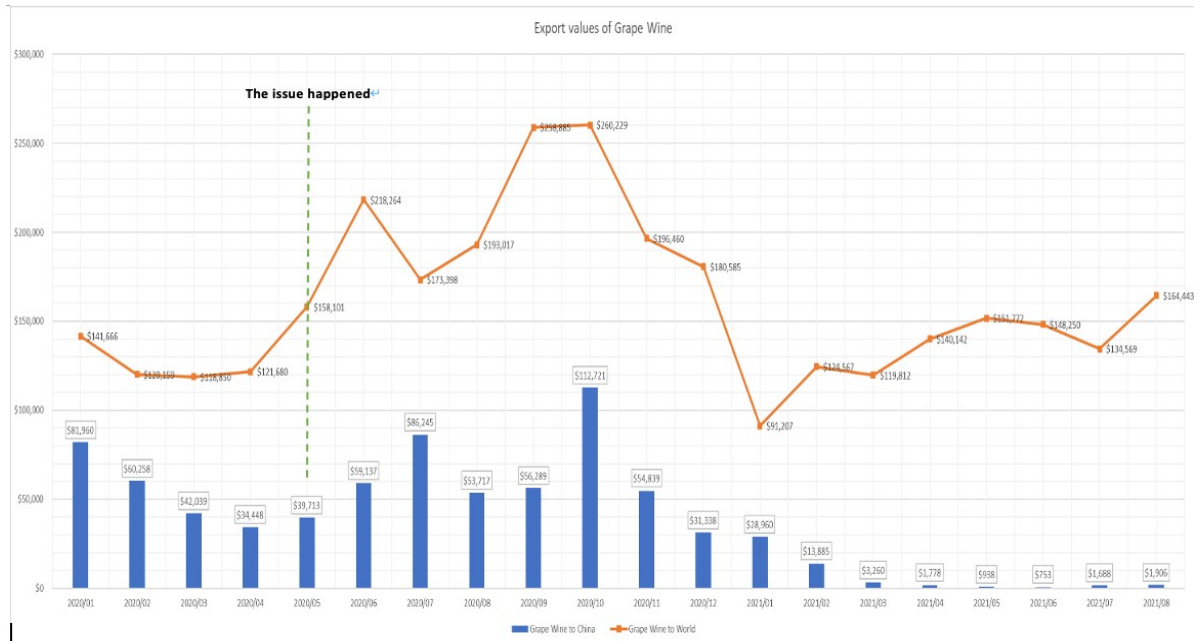


FIGURE 1.13 THE EXPORT VALUE OF AUSTRALIAN COAL TO CHINA

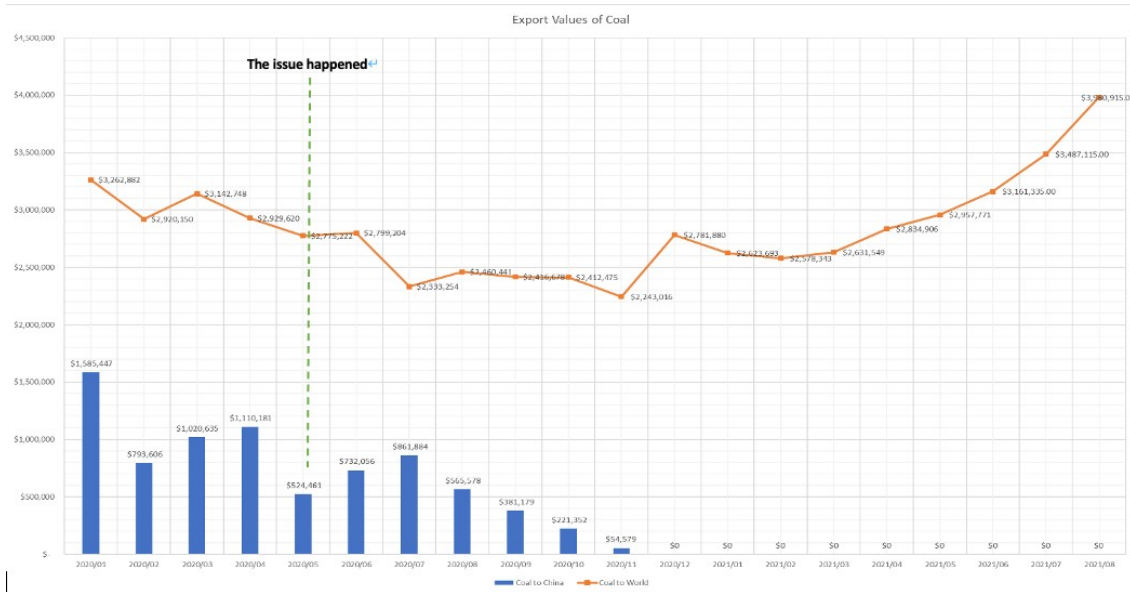
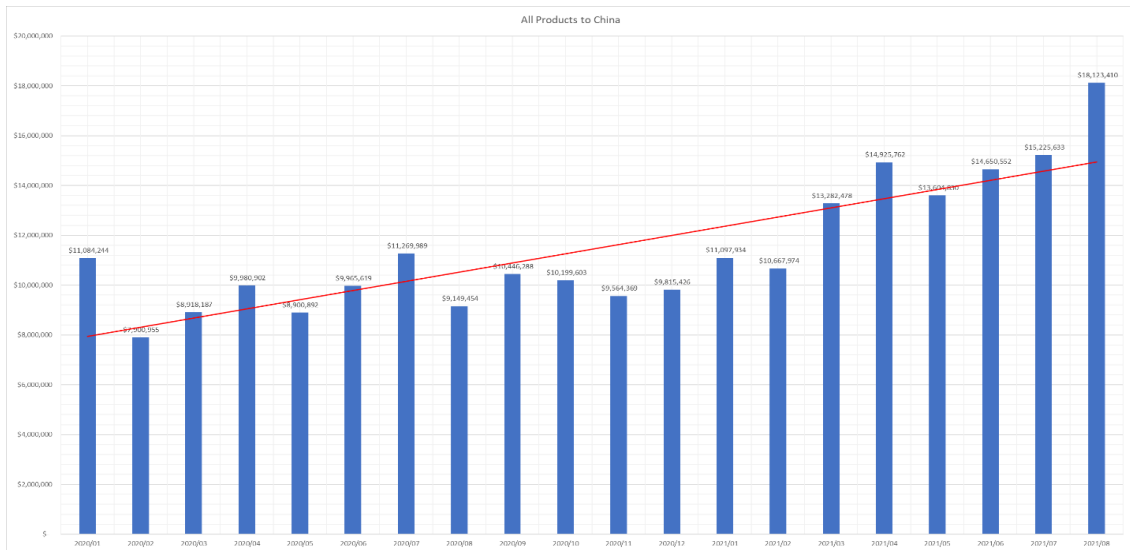


FIGURE 1.14 TOTAL EXPORT VALUES FROM AUSTRALIA TO CHINA



1.3.8 Economic Coercion against Lithuania (2021-)

China and Lithuania established diplomatic relations when Lithuania achieved its independence from the Soviet Union in 1991. However, the relationship has not been easy. In 2021, Vilnius withdrew from the China-CEEC (Central and East European Countries)

framework, known as the 16+1 format, because the mechanism was failing to deliver sufficient benefits. Lithuania's foreign minister further appealed to other EU countries to form a unified policy to counter threats from China (Lau, 2021).¹⁶ The latest factor in an escalating confrontation was Lithuania's decision to allow Taiwan to open a *de facto* embassy in Vilnius under the name of the "Taiwanese Representative Office," in November 2021 (Huang, 2021). China accused Lithuania of undermining its sovereignty (FMPRC.GOV, 2021)¹⁷ and downgraded diplomatic ties from ambassadorial level to that of *chargé d'affaires* (Lau & Momtaz, 2021). Additionally, an attempt at economic coercion was launched. Some Lithuanian enterprises reported that China appeared to be hindering economic transactions. (Davidson, 2021). Lithuanian enterprises further reported that Chinese customs authorities were blocking their exports by removing Lithuania from the Chinese customs registry system (Sytas, 2021).

Among exports from Lithuania to China, dairy products, beef and timber were reported to have faced disruption. Hence, we investigate the trade flow of these three products to explore the effects of China's measures. Figure 1.15 displays the values of Lithuanian beef, dairy products and timber exports to China from January 2021 to October 2021. We can observe that the export values of the products declined significantly after the confrontation began. There were further falls after December following Beijing's decision to remove Lithuania from its customs registry system (Figure 1.16). The Lithuanian government showed no sign of backing down and appeared robust enough to withstand the pressures from China. It further appealed to the European Commission, which raised concerns over China's unannounced sanctions at the WTO (Nardelli & Baschuk, 2021). Unlike other EU members which have significant interests in maintaining close relations with China, Lithuania's relatively few economic ties have been a shield against attempts at coercion. Given that Lithuania has little to lose from the dispute, it can stand firmly against the pressure. (Lau, 2021).

China's coercive and retaliatory measures against Lithuania for allowing Taiwan to establish a representative office under its own name went beyond the expectations of the EU. The deletion of Lithuania from China's customs registry system in effect means a complete ban on Lithuanian exports to China, a blatant violation of WTO laws. In addition, China imposed secondary sanctions by pressuring European enterprises to reject intermediate goods from Lithuania (BBC, 2022), a move that undermines the fundamental principle of the EU internal market: the free circulation of goods. For these reasons, the European Commission felt obliged to challenge the compatibility of China's restrictive measures at the WTO. China's economic sanctions on Lithuania also had repercussions in the US. The EU's Vice President/High Representative, Josep Borrell Fontelles, and the US Secretary of State, Antony Blinken, "highlighted their shared concerns about escalating political pressure and economic coercion by the People's Republic of China against Lithuania, which are impacting both U.S. and European companies." (US State of Department 2021)

China's attempt to intimidate Lithuania over its outreach to Taiwan has so far failed to effect any change in policy or behavior. In doing so, it also sought to undermine the fundamental principles of EU integration and violated the spirit of the WTO. China's sanctions cannot be said to have been effective, notwithstanding their scale and intensity.

FIGURE 1.15 THE EXPORT VALUE OF LITHUANIAN TARGETED PRODUCTS TO CHINA

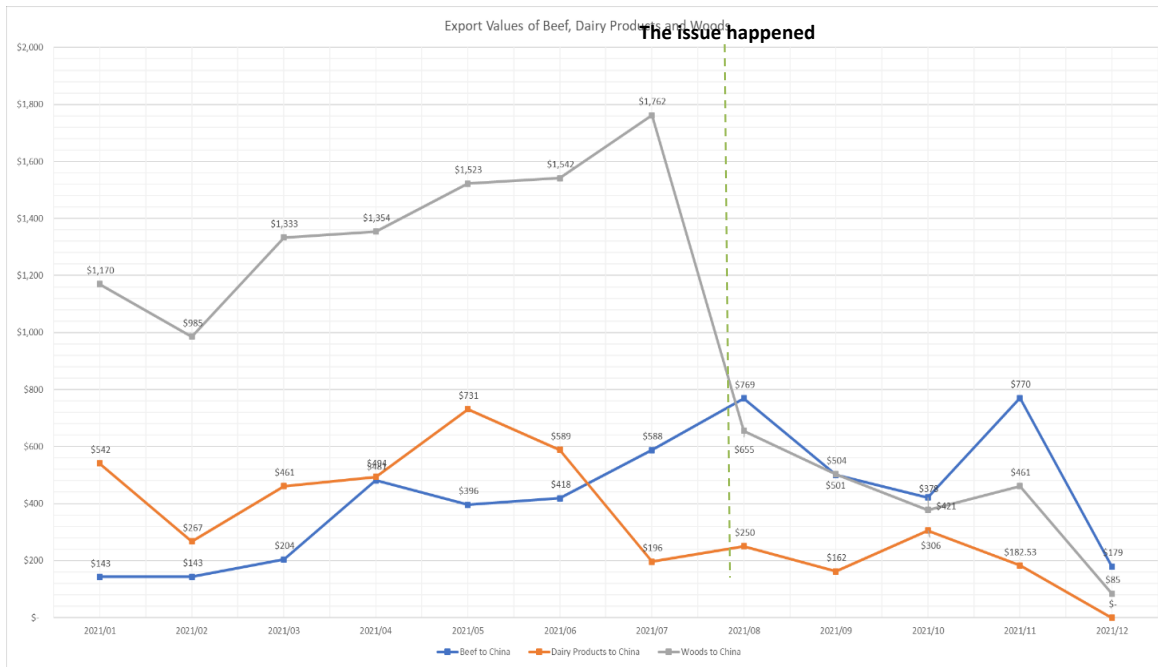
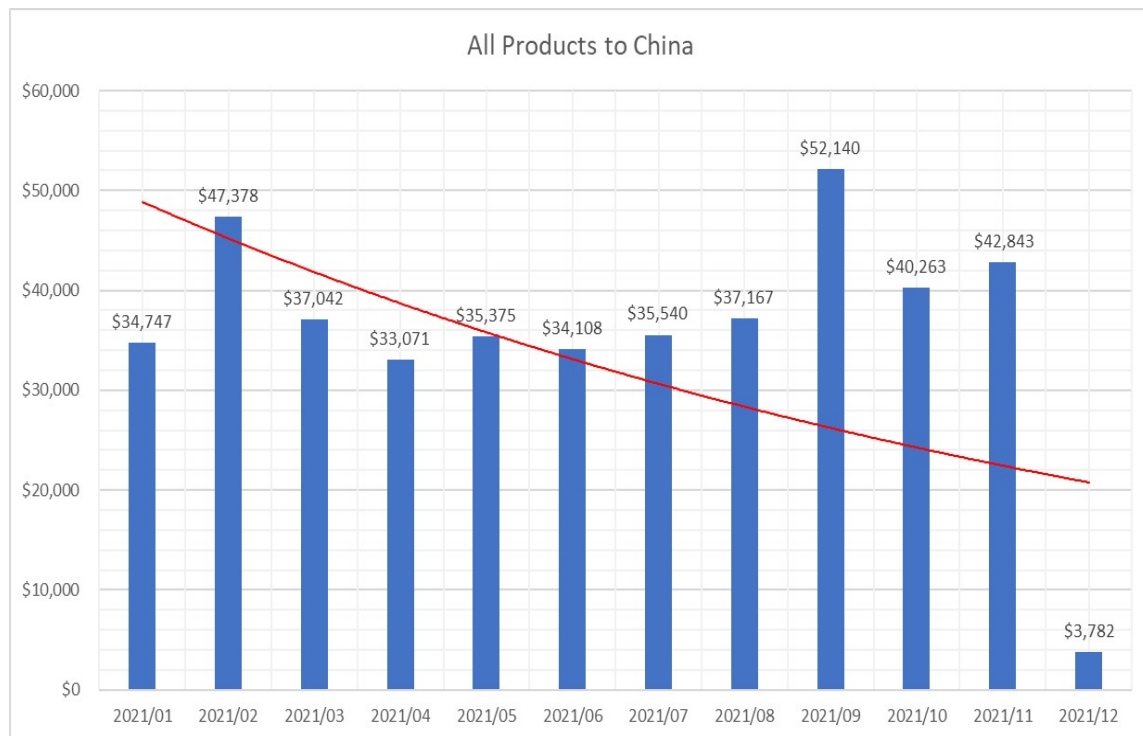


FIGURE 1.16 TOTAL EXPORT VALUES FROM LITHUANIA TO CHINA



1.4 The Effectiveness of China’s Attempts at Economic Coercion and Legal and Policy Redress

1.4.1 New Trends and the Effectiveness of Chinese Economic Coercion

After examining China’s recent use of coercive economic measures, we demonstrate that China has expanded its use of economic coercion as an important component of its foreign policy. The punitive measures have primarily been triggered when China considers foreign countries are challenging its core interests, such as meetings with the Dalai Lama, territorial/maritime disputes, or any official engagement with Taiwan. Moreover, a recent trend seems to indicate that even relatively minor offenses against China, such as Meng Wanzhou’s detention, or the appeal to China to be transparent over the COVID-19 outbreak, may also result in an economic backlash. Moreover, it seems that China no longer seeks to keep its economic counter-measures free from challenges at the WTO. This development can be understood as an example of China’s growing skills at using legal weapons, and its greater confidence in standing up to Western countries in international judicial forums. (Yang, 2015).

In terms of its success rate in inflicting damages and forcing policy changes, the descriptive statistics results reveal that China succeeded in some circumstances but not in others (Harrell et al., 2020, pp. 29-30).¹⁸ Any success is at best termed as limited or qualified. Specifically, economic coercion is much more effective against those countries with the following characteristics: First, economic dependence on the Chinese market results in greater harm (Ravindran, 2012, p. 116; Reilly, 2013, p. 9; Macikenaite, 2020, pp. 110-112). For instance, for Mongolia, the Philippines, and Norway, China is an important export market. Hence, punitive action resulted in a significant decrease in exports to China, and subsequently these three countries decided to restore the relationship either by offering a public apology or accepting the Chinese government's demands. Second, power asymmetry between China and targeted countries is a critical factor. (Reilly, 2013). Coercive measures are more influential against China's smaller neighbors; in contrast, larger countries have stronger leverage to withstand pressure. As has been shown, while the trade restrictive measures did result in visible decreases in the export or import of targeted products from Canada, Australia and Japan, these countries employed more policy measures to mitigate the effects, enabling them to resist compromise. Moreover, while China is an important market for these countries, conversely, these developed economies also control critical supply chains of high-tech products or fundamental raw materials that are indispensable for China's economic development. Escalating confrontations with such countries might also further damage the confidence of foreign enterprises in the Chinese business environment (Harrell et al., 2018, p. 15; Patey, 2021).¹⁹

In brief, we can conclude that China's use of economic coercion is less effective when China and the targeted countries maintain a highly interdependent economic relationship; in contrast, if the targeted country one-sidedly depends on China for exports, China's economic coercion is more likely to succeed. However, it must be recognized that measuring "success" or "failure" merely by examining the impact on trade may be incomplete because other political or diplomatic factors can also help nudge countries towards compliance or resistance (Harrell et al., 2018, p. 30). China's economic coercion against Lithuania best illustrates this. Whereas Lithuania's exports to China significantly decreased and European or foreign enterprises investing in Lithuania were also affected, the economic costs did not automatically produce policy changes from Lithuania. Any retreat by Lithuania would have had geopolitical implications, signaling an erosion both in European solidarity and in transatlantic partnerships.

1.4.2 Legal and Policy Redress against China's Use of Economic Coercion

1.4.2.1 Diversifying economic partnerships to reduce dependence on the Chinese market

As shown by the descriptive statistics results in the previous section, an excessive economic reliance on China renders countries deeply vulnerable to economic coercion (Mazarr & Wyne, 2020). Hence, with a view to mitigating the negative impacts arising from China's economic statecraft, diversification of economic partners is the most effective means to retain independent action and stave off China's fast-growing influence. For instance, in response to China's export ban on rare earths, the Japanese government reacted by supporting its domestic enterprises in their efforts to develop new technologies to reduce dependence on the minerals (Hui, 2021). Alternatively, strengthening a country's role in the supply chain of critical goods for China's domestic production is an effective way to deter sanctions. While China has one of the largest consumer markets in the world, it is still highly dependent on market access, investment flows and advanced technology transfers from Western countries and their allies. Hence, if targeted countries control critical items that are necessary for China's national development blueprint, such as semiconductor chips, coal, and other sources of energy, they can exert this economic leverage to pressurize China to refrain from implementing coercive measures. China's aggressive economic statecraft cannot last long if its coercive measures harm domestic industries.

1.4.2.2 Legal redress and collective responses against China's economic coercion

China's economic statecraft is aimed at challenging the international order founded by the US, in an attempt to forge a direction better suiting China's national interests (Williams, 2020). The competition between China and the US-led camp contains an increasingly important ideological component (Mazarr & Wyne, 2020). Therefore, economic coercion employed by China should not be considered as merely an example of bilateral discord between China and the targeted country. Instead, these coercive measures should be understood in the context of China's ambition to use its economic power to reshape the current rules-based international order (Ginsburg, 2020).

In response to Beijing's ever more aggressive foreign policy, we argue that the immediate priority for democratic countries is to work together and undertake joint action to confront Chinese attempts at economic coercion. To start with, an information-sharing and coordination mechanism should be established. Even though there is no doubt that China is increasingly adopting coercive measures, there has been no attempt at a systematic examination of the patterns, the triggers and the implications of Chinese actions. The primary role of any coordinating mechanism should be cooperation between democratic partners to better understand China's methods and predatory activities (Harrell et al., 2020,

p. 36). Annual ministerial level meetings between like-minded countries could be held to serve as a platform for cooperation and to incorporate all possible legal and diplomatic means to build resilience against economic coercion. Ideally, democratic countries could consider the feasibility of launching an international code of conduct in response to China's growing assertiveness, with the aim of regulating the use of economic coercion as a policy tool in international relations. Recently, the EU initiated a proposal for an anti-coercion instrument (ACI), a positive step towards cooperative action (European Commission, 2021).²⁰

In addition to any preventive mechanism, we propose that legal remedies under international law should also be in the toolbox available to targeted countries. (Glaser, 2021). The available international forums include the WTO and the UN system such as the International Court of Justice (ICJ). Each could be employed depending on the nature of the Chinese action. Some cases could be challenged for violating the principles of non-interference and the prohibition on intervention under Article 2(4) of the UN Charter (Helal, 2019-2020, pp. 98-108). China could also be challenged when it deviates from its legal commitments under WTO agreements. Some might contend that resorting to the international legal system is unlikely to provide meaningful relief for targeted countries because China tends to tailor its measures with such potential challenges in mind (Harrell et al., p. 23; Kreuzer, 2018, pp. 7-14); nor has China consented to the compulsory jurisdiction of the ICJ.²¹ Beijing can also utilize its influence as a permanent member of the UN Security Council to counter criticism of its actions. However, we believe that recourse to legal remedies through the WTO or other international judicial forums should still be seriously considered. China now presents itself as a "responsible great power" within the international system and as a faithful supporter of UN-centered multilateralism. It could pay a significant reputational cost if it declined to resolve disputes through a rule-based international judicial forum, or respond to concerns about its aggressive economic statecraft from the international community (Guzman, 2002).²²

The strategies that Japan, the US and the EU collaboratively adopted, namely, to seek legal recourse against China through the WTO dispute settlement mechanism, could be seen as a successful model (Glaser, 2021). Trade data confirms that after the WTO Appellate Body published its report, China lifted relevant trade restrictions on rare earth exports and notified its implementation to the WTO Dispute Settlement Body.²³ Currently, Canada, Australia, Lithuania and Taiwan are seeking to, or have launched, consultation requests under WTO platforms to express their concerns over China's use of unilateral economic sanctions (Glaser, 2021; Nardelli & Baschuk, 2021).²⁴ If these countries can adopt a coherent position and produce legal remedies in international forums to challenge China, it would constitute a significant blow against China's ever more assertive economic statecraft.

1.5 Conclusion

After reviewing a series of cases of China's use of economic coercion, we found that while China is a trade giant its use of economic pressure is not always effective. Its impact is limited or qualified by a number of factors. In some cases, exports from the targeted sector to China do shrink while total global exports increase, as shown in the case of Canadian canola and Australian barley. Moreover, whereas in some cases, such as Australia, the export volume of a given targeted sector to China decreases, the country's total exports to China increase. In some cases, such as over Canadian canola seeds, China eventually implicitly abandoned its import ban because of large domestic demand for the product. Therefore, if a country or a given sector is less dependent on China, it is less likely that China's attempt at economic coercion will be effective. Also, the effectiveness of China's economic coercion also depends on the elasticity of China's demand. If China is highly dependent on the targeted sector and has no access from other sources it's unlikely to be able to sustain the pressure. Above all, collective action by like-minded countries can help deter China, whether by providing relief for the targeted sector, lending support to the targeted country, or challenging the measures in question in international forums.

Some policy implications can be drawn. Countries should be warned of the danger of being economically overdependent on China, and thus vulnerable to China's economic pressure with a consequent loss of policy autonomy. The diversification of markets is one of the highest priorities for countries aiming to shield themselves against China's economic coercion. Whilst such diversification takes time, once a country is targeted by China like-minded countries should demonstrate their solidarity and safeguard fundamental values and principles underpinning the international order. Despite its limitations, action at the WTO can have a deterrent effect through the naming and shaming of China's activities. The WTO's inability to adopt disciplinary measures against violations, however, is a significant shortcoming.

Finally, it is worth noting that when a third country switches diplomatic relations from Taiwan to China, Taiwan reacts by revoking or cancelling scholarships given to nationals of the country, as will be illustrated in the Africa chapter. Such action does not amount to economic coercion on the Chinese scale given the obvious difference in size and power between Taiwan and China. Nonetheless, the policy undermines goodwill and social contacts at a time when formal ties are no longer possible. Therefore, we propose an end to such punitive action.

NOTES

¹ See *The Five Principles of Peaceful Coexistence*, Ministry of Foreign Affairs, https://www.fmprc.gov.cn/web/ziliao_674904/wjs_674919/2159_674923/t8987.shtml (last visited Dec. 19, 2021). The five principles are: “(1) mutual respect for each other’s territorial integrity and sovereignty, (2) mutual non-aggression, (3) mutual non-interference in each other’s internal affairs, (4) equality and mutual benefit, and (5) peaceful co-existing”.)

² The BRI is a “development strategy that aims to build connectivity and cooperation across six main economic corridors encompassing China and: Mongolia and Russia; other Eurasian countries; Central and West Asia; Pakistan; other countries of the Indian sub-continent; and Indochina.” See OECD, *China’s Belt and Road Initiative in the Global Trade, Investment and Finance Landscape*, at 3, <https://www.oecd.org/finance/Chinas-Belt-and-Road-Initiative-in-the-global-trade-investment-and-finance-landscape.pdf>

³ “Chinese President Xi Jinping has a stated and demonstrated desire to shape the international system, to use China’s power to influence others, and to establish the global rules of the game.”

⁴ We collected the data from the International Trade Centre, which is the joint agency of the World Trade Organization and the United Nations. See International Trade Centre, <https://www.intracen.org/itc/about/> (last visited Dec. 21, 2021). All the values used in the figures are in thousand US dollars.

⁵ Zhonghua Renmin Gongheguo Guojia Zhiliang Jiandu Jianyan Jianyi Zongju (Central office of quality supervision, inspection and quarantine of the People’s Republic of China), Guanyu jiaqiang jinkou sanwenyu jianyan jianyi de gonggao (General notice on strengthening inspection and quarantine of imported salmon), January 28, 2011, https://m.cqn.com.cn/zj/content/2011-02/10/content_1155486.htm

⁶ Statement of the Government of the People’s Republic of China and the Government of the Kingdom of Norway on Normalization of Bilateral Relations, https://www.regjeringen.no/globalassets/departementene/ud/vedlegg/statement_kina.pdf

⁷ Appellate Body Report, *China — Measures Related to the Exportation of Rare Earths, Tungsten and Molybdenum*, WT/DS433/AB/R (Aug. 7, 2014).

⁸ *South China Sea Arbitration (Phil. v. China)*, PCA Case No. 2013-19, Award (UNCLOS ANNEX VII Arb. Trib. July 12, 2016).

⁹ Mongolia Balance of Trade, Trading Economics, <https://tradingeconomics.com/mongolia/balance-of-trade> (Last visited Dec. 15, 2021).

¹⁰ The export values of Mongolian Copper Ores to other countries are missing from the database.

¹¹ Panel established to review Chinese measures on imports of Canadian canola seeds, WTO, https://www.wto.org/english/news_e/news21_e/dsb_26jul21_e.htm (last visited Dec. 20, 2021).

¹² The data is collected from the official statistics database maintained by the Palauan government: <https://www.palaugov.pw/executive-branch/ministries/finance/budgetandplanning/immigration-tourism-statistics/>

¹³ The number of tourists sharply decreased since February 2020 because of the outbreak of COVID-19.

¹⁴ China-Australia Free Trade Agreement (ChAFTA), Asialink Business, <https://asialinkbusiness.com.au/china/getting-started-in-china/china-australia-free-trade-agreement-chafta?doNothing=1> (last visited Dec. 20, 2021).

¹⁵ Panel established to examine Chinese duties on imported Australian wine, WTO, https://www.wto.org/english/news_e/news21_e/dsb_26oct21_e.htm (Last visited Dec. 13, 2020). Australia initiates WTO dispute complaint against Chinese barley duties, WTO, https://www.wto.org/english/news_e/news20_e/ds598rfc_21dec20_e.htm (Last visited Dec. 13, 2020).

¹⁶ Lithuania stressed that “it is high time for the EU to move from a dividing 16+1 format to a more uniting and therefore much more efficient 27+1.”

¹⁷ The spokesman of China’s Ministry of Foreign Affairs blamed Lithuania for “brazenly violat[ing] the spirit of the communiqué on the establishment of diplomatic relations between China and Lithuania and severely undermin[ing] China’s sovereignty and territorial integrity.”

¹⁸ The success or failure of coercive measures are be evaluated by several factors, including any change in behavior by third countries or any expression of formal apology or regrets, any substantial concessions or commitments, and the amount of harm inflicted on targeted countries.

¹⁹ For instance, even after imposing export restrictions on rare earths, China refrained from escalating the confrontation with Japan for fear of jeopardizing high-tech Japanese investment. Tougher measures would have further undermined the confidence of Japanese companies in the Chinese investment environment. Similarly, hefty anti-dumping tariffs and other trade restrictive measures on Australian barley, wine, lobster and coal exports, were balanced by an increase in other Australian exports to China. These included mineral resources (i.e., iron ore) where China faces difficulties in finding replacements. The same happened in the case of Canada, where Canada, the world’s largest canola exporter constrained China’s ability to uphold a widespread, long-term ban. Without giving explicit notice, China resumed the procurement of Canadian canola seeds because of food insecurity caused by the pandemic. Additionally, as we have already demonstrated, total export values from Australia and Canada to China during the year when the measures were imposed were only slightly lower than the year before, which indicate that overall economic relations remained robust regardless of the attempt at economic coercion.

²⁰ Lithuania and other EU member states have expressed concern about the use of economic coercion and appealed to the EU Commission to establish a mechanism to deter such tactics. This led to the proposal for an EU level legislative instrument to deal with such disruption

through a structured and uniform approach. According to the proposal, the concept of economic coercion is defined as “a situation where a third country is seeking to pressure the Union or a member state into making a particular choice by applying or threatening to apply measures affecting trade or investment.” If one member state is targeted, the EU is empowered to respond through counter measures, including restrictions on access to the EU market. The EU stated that possible countermeasures under the ACI will be exercised only when necessary and will be consistent with international law. Most importantly, the EU’s ACI proposal also emphasized the importance of creating a platform to promote international collaboration with other non-EU member states on the issue of tackling economic coercion. Such a cooperative mechanism corresponds to our policy recommendations in terms of employing a multilateral approach to deter China from using economic coercive measures as part of its economic statecraft.

²¹ The Statutes of International Court of Justice, Art. 36.2.

²² Regarding the concept of reputational costs and its relationship with international law compliance.

²³ Understanding between China and Japan regarding procedures under articles 21 and 22 of the DSU, *China - Measures Related to the Exportation of Rare Earths, Tungsten, and Molybdenum*, WT/DS433/15 (May 26, 2015).

²⁴ Note by the Secretariat, *Committee on Sanitary and Phytosanitary Measures - Summary of the meeting*, G/SPS/R/104 (Dec. 17, 2021). *The Taiwan Mission raised specific trade concerns against China at WTO SPS Committee*, Permanent Mission of the Separate Customs Territory of Taiwan, Penghu, Kinmen and Matsu to the World Trade Organization (Nov. 9, 2021), https://www.roc-taiwan.org/wto_en/post/1600.html

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