

Evaluating Indonesia's Economic Adaptation to China's Growth and Tariff Policies through VECM Estimation

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ABSTRACT

This study analyses Indonesia's export vulnerability to China under global shocks and U.S.-China hegemonic rivalry by evaluating the long-and short-run effects of China's GDP, the Rupiah-Yuan exchange rate, import tariffs, and Chinese FDI from 1990 to 2023. Employing a Vector Error Correction Model (VECM), the results reveal a stable long-run cointegrating relationship in which China's GDP significantly increases Indonesia's exports, while Yuan appreciation, rising Chinese tariffs, and FDI inflows exert negative long-run effects due to Indonesia's high import-input dependence and limited export-oriented investment absorption. Short-run dynamics are weak, yet the system adjusts gradually toward equilibrium. These findings indicate persistent asymmetric interdependence and structural exposure to external shocks. The study contributes by integrating geopolitical rivalry and institutional perspectives into an econometric framework, highlighting the need for policies that deepen domestic value chains, strengthen export-oriented FDI, and reduce concentration risk toward China.

INTRODUCTION

Over the past three decades, the global economy has navigated a succession of external shocks that have tested the stability of international trade, investment, and exchange rates. From the 1998 Asian financial crisis and the 2008 global crisis to the COVID-19 pandemic and the 2018 U.S.-China trade war—each episode has left a distinct imprint on the world’s economic landscape. The trade war, in particular, marked one of the most defining turning points in modern economic history. When the Donald Trump administration imposed tariffs of up to USD 60 billion on 1,300 Chinese products—mainly in the technology, machinery, and electronics sectors (Badiri, 2020)—China swiftly retaliated by raising tariffs on 128 U.S. goods worth USD 3 billion, including those from agriculture, steel, and automotive industries. This confrontation reflected a structural shift away from the long-standing era of liberalization and market integration, disrupting global supply chains and contributing to a 1.9% decline in China’s manufacturing exports and a 2.9% contraction in global trade volume in 2019 (WTO, 2020; Sakinah et al., 2025).

A sequence of such global shocks has continuously reshaped the configuration of international economic relations. Their spillover effects have been particularly visible in countries with strong structural linkages to China—such as Indonesia, whose trade, investment, and industrial supply chains remain closely intertwined with the Chinese economy (Purwono et al., 2021; Reza Irdiansyah & Soelistyo, 2024). During 2018–2020, Indonesia’s exports to China declined from USD 27.1 billion to USD 25.8 billion, especially in manufacturing- and energy-based commodities (Alifath et al., 2025). Simultaneously, global financial volatility led to a 5.3% depreciation of the Rupiah against the Yuan, revealing how external transmission channels—through exchange rate movements and market expectations—directly influence domestic stability (Sinambela et al., 2022). Broadly speaking, these overlapping shocks illustrated not only the geopolitical tension between major powers but also the test of resilience faced by developing economies such as Indonesia in managing structural dependence on China while confronting new global economic risks (Bagaskoro, 2020; Kurniawan & Luthfi, 2023; T. Wijaya et al., 2025).

From the perspective of Mearsheimer’s (2001) Hegemonic Stability Theory, global economic dynamics are often driven by the rivalry of great powers seeking to sustain dominance through economic means. The U.S.-China trade war stands as a vivid manifestation of this logic, as it redefined global trade and investment flows. In response to such geopolitical pressures, China advanced the Peaceful Rise Strategy proposed by Zheng Bijian (2005), emphasizing long-term economic partnership and peaceful development without military expansion or economic coercion—particularly toward partners like Indonesia. This framework allowed China to maintain its position as the world’s growth engine and an essential development partner for Asian economies, while simultaneously enabling Indonesia to strengthen trade linkages and harness the spillover benefits of regional integration.

Yet, despite the opportunities that emerged, several studies show that Indonesia has not fully capitalized on industrial relocation and market

diversification following the trade war. Empirically, of the 33 multinational corporations that relocated production during the conflict, only seven chose Indonesia, while most shifted to Vietnam, Thailand, or Malaysia (Alifath et al., 2025; Karanasos et al., 2018; Sakinah et al., 2025). Indonesia's limited success was largely due to high logistics costs—around 23.5% of GDP, compared with the ASEAN average of 15%—and inefficiencies in port and transportation infrastructure (Hayakawa, 2022; Hendrati et al., 2024). Compounding this, inconsistent fiscal and investment policies, a shortage of industrial estates, and bureaucratic hurdles have led global investors to perceive Indonesia as a high-uncertainty-cost destination (Hasan, 2020; Kurniawan & Luthfi, 2023). Institutionally, these challenges signal the enduring non-inclusive character of Indonesia's economic and political institutions, where policy formulation often lacks effective cross-sectoral coordination (Pomfret, 2023). Consistent with Acemoglu and Robinson's (2012) institutional theory, the inability to translate external opportunities into sustainable growth reflects structural weaknesses rooted in extractive rather than inclusive institutions. Thus, Indonesia's underperformance in leveraging the trade war's positive spillovers is not simply an economic shortfall—it is a systemic issue that calls for deep institutional reform.

Between 2018 and 2019, Indonesia adopted a pragmatic yet defensive stance in navigating the U.S.-China trade conflict, prioritizing external stability and regional engagement. The Ministry of Trade strengthened economic diplomacy through a hedging strategy—maintaining balanced relations with both powers—while advancing Indonesia's role in ASEAN Economic Community (AEC) and Regional Comprehensive Economic Partnership (RCEP) negotiations to secure regional market access (Bagaskoro, 2020; Rifawan et al., 2020; T. Wijaya et al., 2025). Concurrently, Indonesia expanded export market diversification toward non-traditional destinations such as India, the Middle East, and Africa, aiming to reduce dependence on both China and the United States (Reza Irdiansyah & Soelistyo, 2024). Bank Indonesia also intervened in the foreign-exchange market and coordinated macroprudential policies to stabilize the Rupiah amid global turbulence (Elahi et al., 2023; Sinambela et al., 2022; L. I. Wijaya et al., 2022). Additional measures—including relaxed export-import licensing, fiscal incentives for export-oriented industries, and the establishment of the National Logistic Ecosystem (NLE)—were introduced to lower logistics costs and boost competitiveness (Anas et al., 2022; Sakinah et al., 2025). In line with long-term objectives, Indonesia also promoted industrial down streaming, particularly in mining and manufacturing, to enhance export value-added and attract foreign direct investment (FDI) that could strengthen domestic production and resilience against external shocks (Alifath et al., 2025; Elahi et al., 2023; Juwita et al., 2020; Rosadi et al., 2025). While initially cautious and reactive, Indonesia's policy trajectory gradually evolved toward a more adaptive and strategic framework in managing the spillover effects of the China centered global trade war.

Consistent with Bhagwati's (1988) Trade Protectionism Theory, the escalation of U.S. tariffs on Chinese imports represents a contemporary form of

protectionism, where trade policy functions not solely as an economic instrument but also as a political mechanism to maintain global hegemony (Arlingga et al., 2023; Badiri, 2020; Purwono et al., 2022). Following tariff increases of up to 25% on over USD 250 billion worth of Chinese goods, global supply chains—particularly in electronics, textiles, and basic metals tied to Southeast Asian industries—experienced severe disruptions (Sakinah et al., 2025). In response, China implemented selective retaliatory tariffs to prevent a domino effect that could destabilize trade with strategic partners such as Indonesia (Bagaskoro, 2020; Farnillah & Paksi, 2023; Yasyifa et al., 2025). This measured response reflects Zheng Bijian's (2005) Peaceful Rise principle, in which China prioritized regional stability over escalating trade confrontations.

For Indonesia, this situation presented both opportunities and vulnerabilities. On the one hand, it allowed Indonesian products to serve as substitutes for Chinese goods facing U.S. tariffs; on the other, it deepened Indonesia's dependence on the Chinese market, heightening external risks to macroeconomic stability (Alifath et al., 2025; Anas et al., 2022; Napang & Rohman, 2022). Data show that Indonesia-China trade value rose from USD 52.4 billion in 2014 to USD 110.1 billion in 2022, with Indonesia's exports to China accounting for over 20% of total national exports in 2023 (Y. Chen et al., 2024a; Li et al., 2023). Despite global turbulence, this trend underscores the resilience of Indonesia-China trade relations, sustained by China's selective protectionism and Indonesia's adaptive policy responses.

From an open-economy perspective, the Mundell-Fleming Model (1960) posits that the interplay between monetary, fiscal, and exchange-rate policies determines output stability in an open system. In Indonesia's case, fluctuations in the Yuan-Rupiah exchange rate—driven by the trade war and shifting global interest rates—have shaped export competitiveness and capital movements (Candra et al., 2021; Elahi et al., 2023; Sinambela et al., 2022; L. I. Wijaya et al., 2022). As China's economy slowed under higher U.S. tariffs, demand for Indonesian exports fell; yet, the accompanying Rupiah depreciation improved performance in some export-oriented sectors sensitive to global prices (Cali et al., 2026; Elahi et al., 2023). This pattern aligns with the J-Curve effect (Lestari et al., 2022), wherein initial depreciation worsens the trade balance before strengthening exports in the long run. However, Indonesia's dependence on imported intermediate goods limited these positive effects (Mayesti et al., 2021; Siringoringo et al., 2013). Moreover, heightened exchange-rate volatility during global uncertainty periods placed pressure on foreign reserves and inflation, demanding close coordination between Bank Indonesia's monetary stance and the government's fiscal measures (Gourdel et al., 2025; Iqbal et al., 2022; Yasyifa et al., 2025). Consequently, the effectiveness of Indonesia's macroeconomic policy transmission hinges on its ability to respond swiftly to global developments through timely fiscal adjustments, exchange-rate stabilization, and export support—an increasingly complex challenge amid intensifying geopolitical tensions and trade fragmentation (Airlangga, 2024; Alifath et al., 2025; Dwinata et al., 2025; Purwono et al., 2021).

Furthermore, Foreign Direct Investment (FDI) continues to serve as a critical driver of long-term growth under the Endogenous Growth Theory (Romer, 1990), which emphasizes capital accumulation, technology transfer, and productivity gains. Chinese FDI inflows into Indonesia have surged since 2010, reaching USD 8.2 billion in 2022 and positioning China as Indonesia's second-largest investor after Singapore (Candra et al., 2021; F. Chen et al., 2025; Guo et al., 2024). Y. Chen et al. (2024) estimate that a 1% increase in Chinese FDI can raise Indonesia's GDP by 0.71%, underscoring its substantial contribution to long-term economic expansion. However, the effectiveness of this investment remains constrained, as much of it flows into non-tradable sectors such as infrastructure and real estate rather than export-oriented manufacturing (Anas et al., 2022; Hasan, 2020; Herdian et al., 2025). Consequently, the expected technology transfer and productivity spillovers have not materialized fully. Purwono et al. (2022) further note that many FDI projects in Indonesia exhibit enclave-type characteristics, with limited connections to local industries. Bureaucratic rigidities, regulatory uncertainty, and uneven infrastructure further inhibit FDI's transformative potential (Alifath et al., 2025; Sakinah et al., 2025; Wulandari & Inayah, 2021). Hence, despite the steady rise in FDI inflows, their impact on Indonesia's structural transformation remains modest—suggesting that institutional quality and the direction of investment policy are the true determinants of productivity and sustainable growth, consistent with Acemoglu and Robinson's (2012) framework.

Despite extensive research on the macroeconomic implications of the U.S.-China trade war, existing studies have largely examined Indonesia's exposure through isolated channels—such as trade diversion, exchange rate volatility, or sectoral shocks—without integrating these mechanisms into a unified empirical framework. Moreover, prior analyses seldom account for the interaction between hegemonic rivalry and domestic institutional constraints, even though Indonesia's structural dependence on China—reflected in high import-content production, concentrated FDI inflows, and limited export diversification—suggests that vulnerability is shaped not only by external shocks but also by internal absorptive capacity. Current literature also overlooks how these dynamics evolve over long historical horizons that include multiple crises (AFC 1997/98, GFC 2008, commodity cycle shocks, and the 2018 trade war). This study fills these gaps by combining geopolitical theory (Offensive Realism), China's Peaceful Development perspective, and Institutional Theory within a VECM framework to empirically model both long-run equilibrium and short-run adjustments between China's GDP, exchange rate, tariffs, FDI, and Indonesia's exports over 1990–2023. This interdisciplinary integration constitutes the novelty of the paper, offering a comprehensive explanation of Indonesia's asymmetric dependence that previous studies have not captured.

In light of the U.S.-China trade war and its global reverberations, it becomes essential to examine how economic variables—such as China's GDP, Indonesia's exports to China, the Rupiah-Yuan exchange rate, import tariffs, and Indonesia's total FDI—interact to influence Indonesia's GDP. Employing the VECM is therefore crucial to identify both short- and long-run dynamics,

quantify the spillover effects of China's economic performance on Indonesia, and evaluate how Indonesia's policy responses mitigate the adverse impacts of global shocks.

Existing empirical studies on the Indonesia–China economic relationship remain largely fragmented and sector-specific, offering limited insight into the broader structural interconnections among key macroeconomic variables. For instance, Guo et al. (2024) and Li (2023) confirmed the positive influence of China's economic growth on Indonesia's exports, yet their analyses overlooked how this linkage operates through channels such as exchange rate dynamics, FDI inflows, and bilateral trade policies. Similarly, Sinambela et al. (2022) and Lestari et al. (2022) examined exchange rate volatility and its implications for export performance but did not consider the role of major global shocks – such as trade wars or the COVID-19 pandemic – that have reshaped trade behavior in recent years. Meanwhile, Juwita et al. (2020) and Sakinah et al. (2025) discussed FDI's contribution to national productivity but failed to connect investment performance with export activity and GDP growth under a framework of external interdependence. Consequently, the current understanding of the Indonesia–China economic nexus remains constrained to partial findings that do not fully capture the long-term dynamics among GDP, exports, exchange rate, import tariffs, and FDI.

Beyond thematic gaps, previous studies have also tended to exclude geopolitical and institutional perspectives in explaining the evolution of bilateral economic relations. As Mearsheimer (2001) and Zheng Bijian (2005) emphasized, global hegemonic competition and China's "peaceful development" strategy form an essential foundation for understanding how international trade policies evolve. Although Purwono et al. (2021) and T. Wijaya et al. (2025) identified shifting trade patterns driven by global power realignment, they did not integrate Indonesia's domestic institutional capacity – an aspect underscored by Acemoglu and Robinson (2012) – into their analyses. The same limitation appears in more policy-oriented studies, such as Bagaskoro (2020) and Anas et al. (2022), which examined structural reform and industrial downstreaming but did not relate these transformations to external forces shaping Indonesia's economic direction. Hence, a key research gap persists in explaining how geopolitical strategies and institutional quality jointly influence Indonesia's economic resilience amid global pressures.

From a methodological standpoint, most existing works rely on relatively short observation periods – typically post-2000 – and employ simple econometric approaches such as linear regression or ARDL, which are insufficient for capturing long-term equilibrium relationships among macroeconomic variables. Alifath et al. (2025) stressed the importance of dynamic modeling to better trace spillover effects from major economies like China to developing partners. Building on that, the present study employs a VECM using annual data from 1990 to 2023 to investigate the long-run interlinkages among Indonesia's GDP, China's GDP, Indonesia's exports to China, the Rupiah–Yuan exchange rate, import tariffs, and Indonesia's FDI – while accounting for the influence of global shocks over the past three decades.

By integrating empirical analysis with a cross-disciplinary theoretical foundation—drawing from Global Hegemony Theory (Mearsheimer), Trade Protectionism Theory (Bhagwati), China's Peaceful Rise Strategy (Zheng Bijian), Open-Economy Macroeconomic Models (Mundell-Fleming), Endogenous Growth Theory (Romer), and Economic Institutions Theory (Acemoglu & Robinson)—this study aims to provide a more comprehensive, contextually grounded, and policy-relevant understanding of Indonesia's evolving economic landscape.

THEORETICAL REVIEW

The evolution of global economic relations over the past three decades has been inseparable from shifts in the international power structure and competition among major nations. Mearsheimer (2001) emphasized that global economic stability ultimately rests on the balance of power among hegemonies, where the rivalry between the United States and China has become the central force shaping global dynamics. While the established hegemon seeks to sustain its dominance through economic and trade mechanisms, emerging powers such as China pursue a more peaceful path of development to broaden their influence in the international economy (Bijian, 2005). This interplay between competing powers has repeatedly triggered global shocks—from the 1998 Asian Financial Crisis and the 2008 Global Crisis to the 2018 Trade War and the COVID-19 pandemic—demonstrating how great-power competition continuously reverberates through developing economies (Alifath et al., 2025; Hayakawa, 2022; Purwono et al., 2021).

In the sphere of international trade, Bhagwati's (1988) notion of New Trade Protectionism provides a relevant lens to understand how modern protectionist practices have evolved. Instead of outright prohibitions, states now rely on subtler instruments such as tariffs, export subsidies, and non-tariff barriers to defend national interests. Yasyifa et al. (2025) noted that this evolving protectionism induces volatility in global trade flows, compelling developing countries to constantly adjust to the policy shifts of major economies. Similarly, Sakinah et al. (2025) found that Indonesia's policy response to external shocks tends to be reactive and fragmented, lacking cross-sectoral coordination. These findings reaffirm that structural dependence on large economies—particularly China—exposes developing nations to uncontrollable risks of global shock transmission (Y. Chen et al., 2024a; Reza Irdiansyah & Soelistyo, 2024).

Zheng Bijian's (2005) concept of China's Peaceful Development Strategy offers further insight into how this dynamic reshapes East Asia's economic architecture. By rejecting military expansion and prioritizing economic diplomacy, China has expanded trade networks across developing regions, including Indonesia (T. Wijaya et al., 2025). Empirical evidence suggests that China's rapid growth produces substantial spillover effects within ASEAN. For instance, Chen et al. (2025) found that a 1% rise in China's GDP increases its partner economies' output by approximately 0.4–0.7%. Reza Irdiansyah and Soelistyo (2024) also observed that Indonesia's exports to China exceeded USD 110 billion in 2022 during China's high-growth period. These findings

underscore that the deepening Indonesia–China trade link serves as a vital channel for value creation and capacity building within Indonesia’s domestic economy.

The theoretical foundation of this interaction can also be traced to the Mundell–Fleming model (1960), which illustrates how monetary, fiscal, and exchange rate policies interact in an open economy. The Yuan–Rupiah exchange rate functions as a key transmission channel through which external policy shocks influence domestic output (Sinambela et al., 2022; L. I. Wijaya et al., 2022). Rupiah depreciation against the Yuan may improve Indonesia’s trade balance in the long run through the J-Curve effect (Lestari et al., 2022). However, in the short term, it often raises the cost of imported inputs, thereby constraining domestic production. This demonstrates that exchange rate stability remains an essential instrument for maintaining external balance amid global turbulence. Bhagwati (1988) also emphasized that protectionist measures—such as import tariffs—shape bilateral trade flows, where higher tariffs in one economy can redirect trade to alternative markets, potentially opening new opportunities for Indonesia (Yasyifa et al., 2025).

FDI constitutes another critical variable driving economic growth. Within Romer’s (1990) Endogenous Growth Theory, FDI facilitates productivity gains through technology diffusion and knowledge transfer. Nonetheless, Juwita et al. (2020) and Sakinah et al. (2025) revealed that FDI’s effect on Indonesia’s growth remains limited, as most investments are concentrated in resource-based or domestically oriented sectors rather than export-driven industries. Consequently, FDI’s contribution to Indonesia’s export performance—particularly to China—has yet to reach its full potential, despite rising investment inflows. Alifath et al. (2025) further highlighted that the growth-enhancing impact of FDI largely depends on the strength of public policy and institutional adaptability in responding to global change.

Institutional quality, as conceptualized by Acemoglu and Robinson (2012), determines whether nations can effectively transform global integration into sustainable growth. Economies governed by inclusive institutions are more capable of adapting to external disruptions and converting them into developmental opportunities. In Indonesia’s case, Bagaskoro (2020) and Anas et al. (2022) emphasized that institutional reforms—ranging from investment deregulation and industrial downstreaming to fiscal reinforcement—have been pivotal in sustaining macroeconomic stability amid uncertainty. Since 2015, structural reforms in business licensing simplification and fiscal–monetary coordination have reflected the practical embodiment of institutional theory in navigating global volatility (T. Wijaya et al., 2025).

Overall, the reviewed literature consistently demonstrates that China’s GDP, Indonesia’s exports to China, the Rupiah–Yuan exchange rate, import tariffs, and FDI are structurally significant determinants of Indonesia’s economic growth. Yet, the direction and magnitude of these linkages vary across studies, depending on the period and methodological design. Accordingly, this study employs a VECM using annual data from 1990–2023 to capture both short-run dynamics and long-run equilibria among these variables. By adopting this

framework, the research aims to deepen the empirical understanding of how China’s economic spillovers transmit to Indonesia amid global shocks and evolving domestic policy responses—situated within hegemonic stability, protectionist, endogenous growth, and institutional theoretical perspectives.

METHODOLOGY

This study employed a quantitative approach using time series econometric methods to analyze the dynamic interactions between Indonesia’s macroeconomic indicators and its trade relations with China. The research focuses on the spillover effects of global shocks—particularly the U.S.–China trade war and other external instabilities—on Indonesia’s economic growth. The analysis covers the period 1990–2023, providing a long-term perspective on how external shocks transmit through trade, exchange rate, tariff policy, and investment channels.

The dataset was obtained from several international and national sources, including the World Bank, UN Comtrade, and the World Integrated Trade Solution (WITS), ensuring consistency and comparability across years. Six key macroeconomic variables were utilized: Indonesia’s GDP (GDPI) as the dependent variable, and China’s GDP (GDPC), Indonesia’s exports to China (EXP), Rupiah–Yuan exchange rate (ER), China’s import tariffs on Indonesia (TIMPC), and Indonesia’s total FDI inflows (FDI) as the independent variables. The variables were chosen to capture both external and domestic dimensions of economic interaction, particularly within the context of regional interdependence between Indonesia and China.

Table 1. Description of Variables

Variable	Indicator	Source
GDP of Indonesia (GDPI)	Annual GDP growth rate in percentage	World Bank
GDP of China (GDPC)	Annual GDP growth rate in percentage	World Bank
Export to China (EXP)	Export values in USD (net)	UN Comtrade
Exchange Rate (ER)	Annual nominal exchange rate Rupiah/Yuan	IMF
Import Tariff (TIMPC)	Average tariff rate imposed by China on Indonesia	WITS
Total FDI of Indonesia (FDI)	Net FDI inflows in USD	World Bank

The analytical method employed in this study was the VECM selected for its ability to identify both short-run and long-run relationships among variables while simultaneously capturing the adjustment mechanisms of shocks toward long-run equilibrium. VECM was considered appropriate because the research

data are non-stationary at level but cointegrated, making the use of a Vector Autoregressive (VAR) model insufficient without incorporating cointegration correction. Compared to conventional regression, VECM provided a more accurate framework in the presence of cointegration, as it incorporated an error correction mechanism to explain long-run equilibrium dynamics (Gujarati & Porter, 2015; Juanda & Junaidi, 2012). In this context, VECM is a derivation of VAR that emphasizes the dynamic interactions among variables rather than relying solely on a static model of causality. The following was the VAR equation derived into VECM:

VAR Equation:

$$Y_t = A_0 + A_1Y_{t-1} + A_2Y_{t-2} + \dots + A_pY_{t-p} \quad (1)$$

Description:

- α_i : Equation constant i
- β_{ij} : The coefficient of influence of the first lag j on the i equation
- ε_{it} : Error term for equation of i on t period

VECM Equation:

$$\Delta y_t = \alpha + \sum_{i=1}^{p-1} \beta_1 \Delta Y_{t-1} + \sum_{i=1}^{p-1} y_i \Delta X_{t-1} + \lambda EC_{t-1} + \varepsilon_t \quad (2)$$

Description:

- Δ : First Difference's Variable
- y_t : Dependent Variable (Indonesia's Exports to China)
- X_t : Independent Variable (GDP of China, Exchange Rate, Import Tariffs, FDI)
- EC_{t-1} : Error Correction term from long run
- λ : Adjustment Coefficient
- ε_t : Error term

After specifying the VECM equation, the next step is to estimate the model using annual time series data for the period 1990–2023. Through this estimation, the VECM framework enabled the identification of short-run dynamics, such as shocks triggered by external events like the 2018 U.S.–China trade war, while also capturing the long-run equilibrium relationships among variables, including GDP China, the Rupiah–Yuan exchange rate, import tariffs, and Indonesia's FDI. This dual capability is particularly relevant, as it provides a comprehensive understanding of how short-term volatility is absorbed and adjusted toward a long-term balance, reflecting the structural linkages in Indonesia–China trade. Hence, the VECM served not only as a statistical tool but also as an analytical framework to evaluate the persistence of external shocks and the resilience of Indonesia's trade performance within the global economic system.

RESULTS

Descriptive Statistic

Table 2. Descriptive Statistic

Variables	Obs	Mean	Std. Dev.	Min	Max	Skew.	Kurt.	Jarque-Bera
GDPI	34	4.71	3.66	-13.12	8.22	-3.85	17.66	395.87
GDPC	34	8.83	2.90	2.34	14.29	-0.07	0.11	0.03
EXP	34	14.89	17.49	0.38	65.92	1.77	2.87	23.72
ER	34	1017.28	572.04	250.70	2138.41	0.40	-0.72	1.75
TIMPC	34	9.42	8.23	2.00	32.17	1.48	1.56	13.34
FDI	34	1.29	1.31	-2.75	2.91	-1.49	2.18	15.71

Source: Author's calculation using Microsoft Excel and Stata.

Reflects Indonesia's economic sensitivity to external changes, particularly those arising from trade relations with major partners such as China. Conversely, China's GDP recorded a higher average of 8.83 with a relatively small deviation, illustrating the consistency of its economic growth as an emerging economic powerhouse in East Asia. The EXP variable showed an average of 14.89 with a high standard deviation of 17.49, indicating significant volatility in Indonesia's export activities. This volatility may be attributed to external dynamics such as global demand fluctuations, tariff policy changes, and the U.S.-China trade war, which represented one of the most substantial global shocks during the study period.

Augmented Dickey-Fuller (ADF) Stationary Test

Table 3. ADF Stationary Test Results at Level and First Difference

Variable	ADF Level	Prob	Description	ADF Difference	First Prob	Description
GDPI	-4.226	0.0006	Stationary	—	—	—
GDPC	-2.758	0.0645	Non-Stationary	-7.311	0.0000	Stationary
EXP	2.160	0.9988	Non-Stationary	-3.513	0.0077	Stationary
ER	-2.739	0.0675	Non-Stationary	-5.729	0.0000	Stationary
TIMPC	-1.490	0.5383	Non-Stationary	-6.405	0.0000	Stationary
FDI	-2.257	0.1863	Non-Stationary	-5.448	0.0000	Stationary

Source: Author's calculating using Stata.

The results of the stationarity test using the Augmented Dickey-Fuller (ADF) method indicated that most of the research variables—namely GDPC, EXP, ER, TIMPC, and FDI—were not stationary at the level form, as their probability values were greater than 0.05, implying the presence of a unit root. Meanwhile, GDPI was already stationary at level, with an ADF value of -4.226 and a probability of 0.0006, which is below the 5% significance level. After applying the first differencing, all variables became stationary, with probability

values below 0.05. Specifically, the ADF values for EXP (-3.513; $p = 0.0077$), GDPC (-7.311; $p = 0.0000$), ER (-5.729; $p = 0.0000$), TIMPC (-6.405; $p = 0.0000$), and FDI (-5.448; $p = 0.0000$) indicated that all five variables achieved stationarity. Hence, it can be concluded that all variables in this study possess an integration order of $I(1)$ – meaning they were non-stationary at level but became stationary after first differencing. This condition fulfilled the prerequisite for conducting cointegration testing and long-term relationship analysis using the VECM.

Optimal Lag Test.

Table 4. Optimal Lag Length Selection Criteria

Lag	LL	LR	df	P	FPE	AIC	HQIC	SBIC
0	-	.	.	.	1.3e+11	42.6174	42.7071	42.8977
1	633.261	183.82	36	0.000	3.3e+09	38.89	39.5176	40.8517*
2	-	68.375	36	0.001	5.1e+09	39.0109	40.1763	42.654
3	507.163	121.31*	36	0.000	2.7e+09*	37.3672*	39.0706*	42.6918*
4	446.509	36	.	-2.9e-07*

Source: Author’s calculating using Stata.

The determination of the optimal lag length was conducted using several information criteria, namely the Akaike Information Criterion (AIC), the Hannan–Quinn Information Criterion (HQIC), and the Schwarz Bayesian Information Criterion (SBIC). Based on the estimation results, the most appropriate model was identified at lag 3, where all three information criteria (AIC = 37.3672; HQIC = 39.0706; SBIC = 42.6918) recorded the lowest values compared to other lag specifications. This finding indicates that employing a three-period lag captures the dynamic relationships among variables most efficiently without losing essential information from the model.

Empirically, these results suggest that the interactions among GDPI, GDPC, EXP, ER, TIMPC, and FDI are influenced not only by the current-year macroeconomic conditions but also by the cumulative effects of policies and external shocks from up to three previous years. The selection of lag 3 is further supported by a statistically significant Likelihood Ratio (LR) value of 121.31 ($p = 0.000$) and the smallest Final Prediction Error (FPE) value of 2.7e+09. Therefore, lag 3 is considered the optimal lag length for accurately capturing both short-run and long-run relationships among the variables within the VECM analytical framework.

Cointegration Test.

Table 5. Johansen Cointegration Test Results

Rank	Eigenvalue	Trace Statistic	5% Value	Critical Value	Description
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0	-	106.2557	94.15	Cointegrated
1	0.76118	60.4306*	68.52	No Cointegration (at 5%)
2	0.52288	36.7509	47.21	No Cointegration
3	0.47009	16.4295	29.68	No Cointegration
4	0.25578	9.6762	15.41	No Cointegration
5	0.12053	2.8662	3.76	No Cointegration

Source: Author's calculation using Stata.

The results of the Johansen cointegration test indicated the presence of a long-term equilibrium relationship at rank 0, where the trace statistic value (106.2557) exceeded the 5% critical value (94.15), suggesting the existence of at least one cointegrating vector among the variables in the model. However, at ranks 1 to 5, the trace statistics were lower than their respective critical values, implying that no additional long-run relationships were identified. This finding demonstrates that the combination of Indonesia's GDP, China's GDP, Indonesia's exports to China, the Rupiah-Yuan exchange rate, China's import tariffs, and Indonesia's FDI forms a single stable cointegrating vector over the long term.

This condition reflects that the Indonesia-China economic system maintains a unique structural equilibrium, where external shocks – such as trade wars, exchange rate fluctuations, or tariff adjustments – are temporary in nature, as the variables eventually return to their long-run equilibrium path. Econometrically, the identification of a single cointegrating vector supports the appropriateness of employing the VECM framework, which captures short-run adjustments toward long-run equilibrium through a single Error Correction Term (ECT). Therefore, these results confirm that the bilateral economic relationship between Indonesia and China is structurally interdependent and stable, whereby changes in China's GDP, the Yuan-Rupiah exchange rate, import tariffs, or Indonesia's FDI a persistent influence on Indonesia's exports in the long run, indicating the presence of a natural adjustment mechanism within both economies.

VECM.

Table 6. VECM Estimation Results

Variable	Coefficient	T-Statistics
Long Term		
GDP	-0.8437	-7.4900*
EXP	-0.2727	-6.1200*
ER	0.0017	3.0200*
TIMPC	-0.0357	-1.3600
FDI	0.3431	1.5300
C	3.5143	-
Short Term		

Δ GDPC	-0.0016	-
Δ EXP	-0.0824	[-0.83]
Δ ER	0.0020	[-0.95]
Δ TIMPC	0.3482	[1.02]
Δ FDI	1.5074	[1.24]
ECT	-0.6198	-2.77*

Source: Author's calculation using Stata

The VECM estimation results indicated that, in the long run, GDPC had a negative and statistically significant effect on GDPI (coefficient = -0.8437), suggesting a competitive relationship within the economic growth structures of both countries. This finding implies that China's accelerated growth was not necessarily followed by an increase in Indonesia's output, possibly because Indonesia still functions primarily as a raw material supplier within China-dominated production networks. In addition, EXP also exerted a negative and significant influence (coefficient = -0.2727), reinforcing the notion that Indonesia's export structure has yet to optimally stimulate domestic growth. Conversely, the ER exhibited a positive and significant effect on GDPI (coefficient = 0.0017), indicating that exchange rate stability contributed to enhancing economic activity through improved price competitiveness and stable trade flows. Both TIMPC and FDI were found to be statistically insignificant in the long term, although FDI showed a positive direction (coefficient = 0.3431), implying that the contribution of investment to GDP remains uneven across sectors.

DISCUSSION

The findings of this study reveal that the dynamics of the Indonesia-China economic relationship capture a complex interplay between global geopolitical rivalry, structural trade linkages, and Indonesia's internal ability to absorb external spillovers. Within the lens of Hegemonic Stability Theory (Mearsheimer, 2001), the shifting landscape of global trade and investment—especially following the U.S.-China trade war—reaffirms that global economic stability remains deeply shaped by the competition among major powers. As a rising power, China has responded to such external pressures through its Peaceful Rise Strategy (Zheng Bijian, 2005), emphasizing cooperation and economic partnership rather than confrontation. This strategic stance has gradually positioned China not only as the epicenter of global manufacturing but also as one of Indonesia's most important partners in trade, investment, and regional value-chain integration. These findings are consistent with Muslim & Lubis (2024), Purwono et al. (2021), and Reza Irdiansyah & Soelistyo (2024), who affirm that China acts as a catalyst for Indonesia's growth through export demand spillovers and FDI inflows.

China's FDI, however, displays a negative long-term relationship with Indonesia's GDP, implying that foreign investment has not yet translated into substantial economic expansion. This can be traced to the dominance of non-tradable sector investments—such as infrastructure, real estate, and long-term construction projects—which offer limited multiplier effects on exports and productivity (Anas et al., 2022; Hasan, 2020). While these investments stimulate

short-term growth, they fail to create sustainable value due to limited technology transfer, weak supply-chain integration, and minimal backward-forward linkages with local industries. From an Institutional Theory perspective (Acemoglu & Robinson, 2012), this reflects Indonesia's still-extractive institutional character, in which investment policies focus heavily on physical infrastructure rather than export-oriented industrial development. To address this, the government has introduced several initiatives—such as the Omnibus Law on Job Creation, the establishment of the Indonesia Investment Authority (INA), and the development of integrated downstream industrial zones. Yet, these efforts remain centered on licensing and infrastructure facilitation rather than advancing technological innovation and export-oriented manufacturing capacity. Thus, Indonesia's investment strategy should move beyond merely increasing FDI volume and instead prioritize the quality, direction, and value of capital inflows to reinforce the domestic industrial base in the long run (Hasan, 2020; Thia & Hu, 2025).

In the short run, the VECM results reveal no statistically significant relationships among variables, indicating that external changes—such as exchange rate movements, trade policy shifts, and investment flows—did not immediately affect Indonesia's GDP. This highlights the existence of a transmission time lag in cross-border economic linkages, particularly those originating from China. Such a pattern is consistent with the Mundell-Fleming model (1960), which posits that in open economies, monetary and fiscal policies exert delayed effects when exchange rates and capital flows are exposed to global uncertainty. Moreover, Indonesia's reliance on imported raw materials and capital goods tends to slow the transmission of export gains from China, as currency depreciation often increases production costs (Elahi et al., 2023; Ratten et al., 2022; Sinambela et al., 2022). Hence, while long-run relationships are statistically significant, the short-run effects remain limited due to structural rigidities and slow domestic adjustment to external shocks.

Nonetheless, the negative and significant coefficient of the ECT confirms the presence of an automatic adjustment mechanism toward long-run equilibrium. This implies that although Indonesia's economy does not react instantly to external disturbances, it gradually returns to equilibrium, reflecting the long-term stability of its trade relations with China. This process demonstrates Indonesia's adaptive resilience—its ability to absorb external shocks and realign through exports and FDI channels, even if the convergence is relatively slow (Sinambela et al., 2022). Essentially, short-term fluctuations such as exchange rate volatility or tariff shifts tend to be temporary and fade as equilibrium is restored. The effectiveness of this adjustment, however, depends on the strength of macroeconomic management and fiscal-monetary coordination to sustain exchange rate stability and enhance domestic production responsiveness to external conditions.

From a policy perspective, Indonesia's responses during 2018–2023 reflected an adaptive-defensive stance toward global shifts, particularly the U.S.–China trade war and its spillover effects. The government pursued a hedging strategy—avoiding explicit alignment with either power—while reinforcing its regional position through ASEAN and RCEP economic diplomacy (Bagaskoro, 2020; Hayakawa, 2022; Hendrati et al., 2024; T. Wijaya et al., 2025). In trade, the

Ministry of Trade launched the Market Diversification Policy to expand exports to India, the Middle East, and Africa, alongside Local Content Requirements to strengthen industrial competitiveness. On the fiscal side, super tax deductions of up to 300% were introduced for R&D and labor-intensive export industries (Anas et al., 2022). Bank Indonesia complemented these efforts with exchange rate stabilization through dual interventions and macroprudential coordination (Sinambela et al., 2022). The government also advanced the National Logistics Ecosystem (NLE) initiative to cut logistics costs from 23.5% to the ASEAN average of 15% of GDP (Rifawan et al., 2020; T. Wijaya et al., 2025), and pursued mineral and manufacturing downstreaming to reduce raw-material dependency and boost value-added exports (Rifawan et al., 2020; Sakinah et al., 2025). Nevertheless, various studies highlight persistent challenges – weak cross-sector coordination, regulatory uncertainty, and uneven infrastructure – that continue to constrain these policies' full impact (Napang & Rohman, 2022; Sakinah et al., 2025).

Looking ahead, Indonesia's structural transformation agenda must rest on three strategic pillars. First, broadening the export base by deepening industrial down streaming and diversifying toward non-traditional markets to reduce dependence on China and the U.S. Second, improving logistics and port efficiency to bring trade costs closer to ASEAN benchmarks. Third, strengthening fiscal-monetary synergy through exchange rate stabilization and targeted investment promotion in tradable, export-oriented sectors. This approach aligns with the Mundell-Fleming model's (1960) principle of coordinated policy in open-economy stability and with Acemoglu & Robinson's (2012) framework of inclusive institutional development – emphasizing that sustainable growth depends not only on capital inflows, but on strong, transparent, and productive institutions that convert those inflows into real economic capacity.

CONCLUSIONS AND RECOMMENDATIONS

This study concludes that the dynamics of Indonesia-China economic relations are shaped by the intricate interplay between global hegemonic rivalry, trade interdependence, and Indonesia's domestic institutional ability to absorb and respond to external shocks. The VECM findings confirm the presence of a long-run cointegrated relationship among China's GDP, Indonesia's exports to China, the Rupiah-Yuan exchange rate, import tariffs, and FDI toward Indonesia's GDP. This implies that Indonesia's economic trajectory is structurally bound to China's economic performance. Such evidence reinforces Mearsheimer's (2001) Hegemonic Stability Theory, which argues that global economic order and regional stability are sustained by the balance of power among dominant states, as well as Zheng Bijian's (2005) Peaceful Rise Strategy, which underscores that China's expansion is driven by economic interdependence rather than conflict escalation.

In the long term, China's sustained growth exerts a significant and persistent spillover effect on Indonesia's output, validating Romer's (1990) Endogenous Growth Theory, which emphasizes trade and investment integration as key drivers of productivity and technological diffusion. However, the negative coefficients of exports and exchange rate variables suggest that Indonesia's export

structure remains primarily commodity-based and heavily reliant on imports—conditions that limit its ability to translate external demand into stable, long-term growth. This pattern reflects the structural vulnerability highlighted by Purwono et al. (2022) and Sakinah et al. (2025), where Indonesia's trade engagement with China generates asymmetric benefits due to weak industrial linkages and limited domestic value-added capacity. Likewise, the statistically insignificant role of FDI suggests that foreign investment inflows have yet to create meaningful technology transfers or productivity spillovers. This finding aligns with Acemoglu and Robinson's (2012) Institutional Theory, which posits that extractive institutional arrangements constrain nations from transforming external opportunities into inclusive and sustainable development.

In the short run, the absence of significant effects from major variables implies that Indonesia's macroeconomic transmission mechanism operates with a noticeable lag—consistent with the Mundell–Fleming (1960) open-economy framework, where fiscal and monetary adjustments require time to influence domestic output amid exchange rate fluctuations and global capital mobility. Nonetheless, the negative and statistically significant Error Correction Term (-0.6198) indicates that Indonesia's economy possesses a built-in capacity for adjustment, gradually restoring equilibrium after short-term disturbances. This supports the observations of Sinambela et al. (2022) and Elahi et al. (2023), who emphasize that Indonesia's exchange rate stabilization and macroprudential coordination have been instrumental in cushioning the economy against global turbulence.

From a policy standpoint, the results highlight three key priorities for Indonesia's economic strategy. First, to accelerate export diversification and industrial down streaming in order to reduce overdependence on China while enhancing domestic value-added production. Second, to improve logistics efficiency and infrastructure connectivity, aligning trade costs with ASEAN benchmarks (Hendrati et al., 2024; Rifawan et al., 2020). Third, to strengthen fiscal-monetary synergy, stabilizing exchange rates and enhancing the responsiveness of domestic sectors to global fluctuations. In the long term, Indonesia must shift from reactive stabilization to proactive structural transformation—fostering innovation-driven industries and reinforcing institutional inclusiveness, as emphasized by Acemoglu and Robinson (2012). By aligning macroeconomic management with institutional reform, Indonesia can sustain growth, deepen regional resilience, and transform external dependence into a strategic advantage within an evolving global economic order.

FURTHER STUDY

This study is limited by its linear VECM approach, omission of major shock variables and key external indicators, and potential data inaccuracies, suggesting that future research should use non-linear or structural models, include shock controls, and expand variables to better capture Indonesia's geopolitical-macroeconomic dynamics.

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