The Challenge:
The Domestic Determinants of International Rivalry between the U.S. and China

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Economic and political power within the international system is becoming more diffuse. Nonetheless, China is today the principal challenger to the United States (Mansfield this issue). The European Union remains an economic powerhouse, but is currently plagued by economic problems centering on the euro and the austerity Germany and the fixed exchange rate regime have imposed on the continent. Europe has also shown little interest in challenging the United States in past decades and, in fact, has been a stalwart supporter of American hegemony for nearly 70 years. Japan remains the world's third largest economy and fourth largest trader, and after decades of stagnation may finally be on the road to economic recovery. Yet, it too remains a supporter of continued American leadership. Brazil, Russia, and India have garnered much attention recently but still rank low on the scale of economic power, whether measured by GDP or trade (Mukherhi this issue). China is the world's second largest economy and largest trader. By any measure, it is the only state likely to overtake the United States in international power in the near future, although its ability to do so is not a foregone conclusion. The diffusion of international power may look a lot like a return to bipolarity.

The challenge posed by China to the United States, however, arises not just from its emergence as a 21st century superpower. In the past, other hegemons have managed transitions to challengers without significant conflict, as when Britain ceded leadership over first the Western hemisphere and then all of the world economy to the United States (Lake 1988). Rather, the challenge—if it occurs—will emerge from fundamental differences in the domestic political economies of the United States and China. The United States is a liberal market economy in which prices are the primary determinant of the allocation of resources. China is a state market economy, increasingly controlled by narrow party elites and their families, in which politics determine resource allocation. The U.S. has successfully generalized its liberal market system to the international economy through seven decades of hegemony. The question for the future is whether integration into the American-led international economy will transform China's domestic political economy from statism to liberalism. If integration strengthens market forces within China, cooperation between the two superpowers will likely be expanded as common interests prevail. If political forces remain dominant in China, greater conflict may emerge.

The American System

The United States is a fundamentally liberal state in which political authority is highly decentralized in both government and society. With a limited and tightly constrained state, it relies primarily on market-based mechanisms to guide its economy. Public policy matters for the allocation of resources, of course, but principally through tax and fiscal incentives that, in turn, condition the structure of relative prices. With many competing centers of economic power, reinforced by rules limiting monopolistic and anti-competitive practices, society responds relatively efficiently to price signals.

This liberal domestic political economy is constantly changing as technology and comparative advantage evolve, but it has retained its basic structure over time. That institutions are "sticky" is a commonplace observation, but not one that actually explains why structure endures. In my view, domestic structures are stable because social forces that benefit from the policies they produce develop interests in preserving those institutions and their privileged position within them. In turn, it is the domestic social interests vested in particular institutions that set states along a particular developmental path (Hall and Soskice 2001; Gourevitch and Shinn 2005). Liberal market economies, like the United States, have large spheres of private authority, rely more on market-based allocation systems, and offer fewer social protections. In turn, both firms and workers develop flexible economic strategies that discourage investments in specific processes or skills, creating a large pool of "generic" capital and labor that flows (relatively) easily across sectors. Having invested in flexible production and skills, however, society has little motivation to press government for policies that encourage long term holding of assets, apprenticeship programs tailored to long term employment contracts, and other features common in "organized market economies" found in continental European states. Adapted for flexibility, changing policies are of less import in liberal market economies and the political arena is characterized by institutions that if they do not amplify at least do not dampen political swings, such as single-member electoral districts and majority party rule. The economy and its political actors are, thus, vested in a particular, self-reinforcing mode of production. The bottom line is that liberal market economies beget more liberal markets not because they are "institutionalized" but because social actors become vested into particular domestic structures.

The great innovation of American hegemony has been to externalize the liberal domestic economy of the United States onto the international economy, which has in turn gradually reshaped the domestic political economies of its smaller constituent members

(Ikenberry 2001). Although vested interests make domestic structures hard to change, as in the United States, they are not immune to disruption. The "liberal project" of the United States after 1945 was greatly facilitated by the destruction of World War II and, especially, its postwar occupation of West Germany and Japan, its two previous antagonists but also two of the largest economic powers of their age. As defeated countries, West Germany and Japan were highly plastic after 1945. The war itself destroyed enormous economic assets, "divesting" domestic interests of much of their prior wealth and political interests. The old regimes were also strongly delegitimated. The United States, in turn, dangled significant rewards before them if they would join the American-led international economy. This favored the rise of politically moderate, capitalist, and Western-oriented elites surrounding Konrad Adenauer in Germany and Shigeru Yoshida in Japan. Spreading the rewards of the American system broadly across the populations of these countries also brought the masses onboard and facilitated the consolidation of liberalism and democracy.[1] In the end, it was an American empire, but it was an "empire by invitation" (Lundestad 1990).

Over time, states and more important societies within what Peter Katzenstein (2005) has called the "American imperium" have become vested in that unique international system. Groups develop interests in sustaining the international political order to which they have adapted and prospered. In this way, the international order becomes self-enforcing. Imagine the political outcry from industries around the world that have adapted their production and sales to a global market if the WTO were, say, to come under threat from more protectionist forces. Previous collapses notwithstanding, globalization appears to have created interests sufficiently vested in economic openness

[1] This contrasts with earlier cases in Central America (Lake 2011).

that it is now a one-way bet – an observation supported by the near absence of protectionism in the Great Recession that began in 2008 (Kahler 2013). Free trade does not require homogenization of economies and polities, but does reward winners and punish losers, tilting the political playing field increasingly in favor of the former and against the latter (Rogowski 1989). Export interests and others that benefit from an open world economy gain, prosper, and expand their political influence. Import-competing sectors and others that lose steadily shrink in size and influence. Exporters become ever more dependent on world markets and the national economy becomes increasingly specialized. These "internationalist" interests, in turn, develop stronger interests in maintaining market openness, both at home and abroad. International liberalism becomes self-sustaining and perhaps even expands. Thus, the American imperium has—slowly but inexorably—reshaped the domestic political economies of its members, an effect that is deeper and more dramatic the higher the level of integration. This has created, over time, a highly robust and even "institutionalized" international system.

The Rise of China

As China becomes more powerful in the decades ahead, it is widely expected to challenge the United States either because it can, the traditional realist view (Mearsheimer 2001), or because it favors a different package of policies and international economic rules, although the content of this package is typically left unspecified. That China will overtake the United States is often taken as given, with analysts only differing on the timing. But China's rise is by no means a certainty. One need only remember the fear of "Japan, Inc." in the 1980s – an overhyped trend that was followed by an American technological resurgence and two decades of stagnation in Japan -- to know that long term predictions of national growth can often be wrong. Much could change in China and elsewhere that would alter its current trajectory. Equally important, however, even pessimists do not have a good theory or empirical foundation for predicting what a stronger China will want in international politics. Examining China's domestic structure can give us some broad hints about its likely policy preferences and, thus, the potential for conflict with the United States.

China is a highly centralized state dominated by a single political party that fuses state and society. Local governors may appear to have substantial authority, but it is clearly delegated and controlled from the center (Landry 2008). In turn, with its special position guaranteed by the constitution, the party retains a parallel structure to the state and, through its cadre system, permeates all levels of society both channeling issues upwards to the center for resolution and ensuring that directives from the center are appropriately implemented at the local level. Factions within the party compete, though programmatic differences appear limited and personal relationships among party elites are more important.[2] Importantly, the party and state stand above the law, not subject to it, and personal connections and influence apparently figure large in political decisions. In an oft-repeated phrase, China is characterized by rule by law but not the rule of law. Finally, after decades of near-totalitarian rule and single party dominance, private authorities able to restrain the state have either been fractured, coopted, or purged from the political system (Yu and Guo 2012). Although new social forces are arising in China and penetrating politics (Mertha 2009; Saich 2000), they remain highly fragmented

[2] The factions are sometimes described as the elitist faction of officials rising through the party from the more prosperous provinces, and the populist faction of officials from the rural interior (Li 2009). For an alternative ordering of the factions, see Zhiyue (2007).

(Yang 2006). This highly decentralized society leaves a relatively open playing field for the state and its new private-sector allies.

Though significantly liberalized relative to the past, the state and party retain control over the economy through continued government planning and price setting, state-owned enterprises in key sectors, and control over access to scarce finance, access to factors of production, industry siting and the development of new enterprises, and a variety of other economic levers.[3] The fusion of public and private authority in China ensures reciprocal influence between business and the state and relatively harmonious interests between government and private elites (Chen and Dickson 2010; Li et al. 2008). Promoting export-led growth since the economic reforms of 1978, China's economy has grown rapidly. Business has profited handsomely, and the state has enjoyed increased legitimacy by its ability to deliver higher standards of living to the average citizen (Guo 2010; Laliberte and Lanteigne 2008). More directly, and reflecting the importance of personal ties in a state-dominated economy, family members of high ranking party officials have amassed large fortunes either as favored entrepreneurs or as intermediaries between business and the state.

The mutual dependence of public and private elites on export-led growth suggests, at one level, that China will continue to support international economic liberalism. Like Europe and the rest of Northeast Asia, China has been integrated into and shaped—to a degree—by the American imperium. For those in the West who see China as more a partner than a competitor in world politics, the expectation is that the vesting of its export industries in the state, and vice versa, will lock China into the present American

[3] On China's "bamboo economy," see *The Economist*, "Entrepreneurship in China: Let a Million Flowers Bloom," March 10, 2011. Available at: http://www.economist.com/node/18330120 (accessed Jan. 18, 2013).

imperium and liberal international economy. Evidence of this can be found in the tendency of the United States and China to date to bargain hard but ultimately settle their differences and, more deeply, the possible emergence of interconnected, transnational global capitalist class of U.S., European, and Chinese business leaders.

At another level, however, China's statist economy fits poorly with the free and open competition and the rules embedded in the institutions of the American imperium. China's ideal international economy might look a lot like its domestic economy with markets functioning widely but with the permission and in the interests of its political leaders. A Chinese-led international regime would likely not operate under the impersonal rules of the American imperium but under personal ties and to the advantage of China's individual political leaders. In this view, the United States and China might not clash over whether the international economy should be market-based, but would differ significantly on whether markets would be governed by prices or politics. This is less of an ideological distance, perhaps, than that which separated the market-oriented United States and command-oriented Soviet Union at the height of the Cold War, but it is still a substantial distance in preferred rules for the international economy.

Whether or not China chooses to accommodate or challenge the American imperium will depend in large measure on the gains for its leaders as individuals and a group from a liberal market-based international economy v. a state market-based international economy. The challenge, if it occurs, will be rooted in the differing domestic structures of the two 21st century superpowers. Integration into the American imperium is not likely to disrupt China's domestic structure as deeply as World War II and the American occupation did to its postwar allies. China is less likely to change its fundamental institutions than either Germany or Japan. Given the vesting of business in the state, and vice versa, the most likely prospect is for at least a degree of international challenge in the future. Personalist rule conflicts with an international rule of law, and like the United States before it China will seek to promote its domestic system abroad.

Scholars interested in the future of U.S.-China relations should pay particular attention to the composition of the "winning coalition" in China. Is the party elite composed of those with bases of political support in the most competitive sectors of the economy, or those who rely on the backing of the least competitive sectors? Is the political opposition drawn from the "netizens" in China who favor political and economic transparency or nationalists who regularly engage in anti-foreign protests? To the extent that the winners from globalization win politically, the tensions between the United States and China will be less intense, and to the extent that the losers from globalization triumph politically, these tensions will be greater.

Conclusion

The brightest future for the American imperium is for China's growing middle class to demand a rule of law within China.[4] This is, in part, what the United States and the West more generally hope to achieve in pressing China on human rights and other "internal" political practices. Since such reforms would restrain the state and its high-ranking officials, and reduce their rent-seeking abilities, they are resisted. The United States and others, in turn, are limited in the pressure they can bring to bear on the regime for fear that it will provoke a backlash and the very challenge to the American imperium

[4] Shirk (2007) argues that China's domestic regime is actually quite fragile, given threats from below from those both empowered by economic prosperity and shut out of the political system.

that they hope to avoid. The international balance hangs on the domestic balance between the forces of resistance in China currently vested in the state and popular forces of reform calling for greater rule of law. Without significant private authorities able to help the masses overcome their collective action problems, the vested interests are likely to prevail and the challenge to the American imperium is likely to be a serious one.

What is to be done? Increased trade and investment by the West with China is incentive compatible, and may eventually "tip" the political balance in China in a more liberal direction or at least mitigate the interests now vested in a more politically-based system. Confrontation now with China will only reinforce those who would seek a Chinese Asian Co-prosperity Sphere. The United States and others should do everything possible to encourage the rule of law and price-led market incentives in China. At the same time, the optimal strategy towards China – no matter its internal fissures – is to maintain the power and resilience of the American imperium, including strengthening relations with other members. Maintaining a strong and open international economy that China wants to be part of—and maintaining a unified front in enforcing the rules of that economy—will maximize leverage for all over China's future and the fate of its possible challenge.

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