

Driving Decline?

Economic Crisis and the Rise of China

Dr Nicholas Kitchen is a Fellow of the Transatlantic Programme at LSE IDEAS and Editor of IDEAS Reports. **Michael Cox** is Professor of International Relations at the London School of Economics and Political Science and co-Director of LSE IDEAS.

Decline, Charles Krauthammer tells his disciples on the American right, is a choice. If only that were so, might be the reaction of a President who has spent his first year in office attempting to make progress on an ambitious foreign policy agenda against the backdrop of diminished American capability, authority and prestige. The United States' ability to influence international politics has been conspicuously limited by two interrelated and reinforcing factors: the fallout, both in terms of the health of America's domestic economy and its neoliberal ideology, of the 2008 financial crisis, and the economic rise and increasing political assertiveness of China. Rebuilding the health of the American economy – and with it, the American system of open-door global capitalism – has of necessity been Obama's top priority, dominating lesser concerns and overriding nobler ambitions.

AMERICA'S 'BOUNCEBACKABILITY'

Whether the twin harbingers of decline – recession and rising powers – can be defeated remains to be seen, but the United States has been here before. The American decline debate is as old as the rise of American power, the zenith of which was reached not in 2001 but in 1945, when the United States accounted for half of the world's economic product and held over two-thirds of the world's gold reserves, a predominance from which decline was inevitable. Real pessimism concerning American vitality surfaced amidst the cultural and economic upheavals of the 1960s, was highlighted by talk of the 'missile gap', confirmed by the twin political shocks-to-the-system of Vietnam and Watergate and laid bare in Carter's now-ridiculed 'malaise speech'. Despite the astonishing demonstration of American technological prowess represented by the moon landings; despite Reagan's 'morning in America' rhetoric, the success in the late 1980s of Paul Kennedy's *Rise and Fall of the Great Powers* reflected America's perpetual obsession with its own decline. Indeed, candidate Obama successfully exploited that obsession to base his own election campaign around the attainability of national regeneration.

That Kennedy's book so animated American strategy debates in the early 1990s owed much to a combination of circumstances similar to that which exists today. In this case the rising Asian power was Japan, which had emerged as the world's most competitive economic power and biggest creditor in the 1980s, having exploited the 'new industrial revolution' in manufacturing and invested heavily in research and development. Japan's economy had grown rapidly and consistently as a de facto American protectorate during the Cold War, and by 1991 it was the second-largest economy in the world with growth rates over the previous three years above 5%, whilst in the same year America slipped into recession.

Yet between 1990 and 1998, the US economy grew by twenty-six percent, compared with Europe's seventeen percent and Japan's seven percent. The United States accounted for around one quarter of world GDP throughout the 1990s and remained the most technologically advanced major economy with expenditures on research and development nearly equalling the rest of the G-7 combined. The long boom that came after 1992 even allowed the United States to eradicate its near three-decades-old budget deficit, an achievement that saw Clinton ranked as the most successful President in economic terms since Lyndon Johnson. The United States had managed to extend its lead in every aspect of power capabilities whilst avoiding significant balancing behaviour as other powerful states chose to bandwagon on the back of the renewed American system.

That the United States was able to rise again into a position of unparalleled imperial dominance by the dawn of the twenty-first century should not assuage American policymakers' concerns about the challenges the United States faces in the coming years. Yet it does show that the force and inevitability of decline can be overstated, and that the United States has historically been able to bounce back and prove the prophets of doom wrong. At the same time, the situation Barack Obama has faced since taking office certainly appears more serious – and less easily reversed – than any of the setbacks the United States has encountered since 1945.

RECESSION OR CRISIS?

When the collapse of Lehmann brothers precipitated a massive financial crisis, and, on one reading of the opinion polls, the election of Barack Obama, comparisons abounded with the Great Depression of the 1930s. In order to avoid a prolonged and globalised depression, Western economies, and in particular the United States, were forced to undertake coordinated central banking interventions, directly capitalise and in some cases nationalize financial institutions, and inject massive fiscal stimulus into their broader economies. Despite the stimulus, US unemployment rose to its highest levels since the early 1980s, and the cost of preventing a more serious economic meltdown left the United States facing a budget deficit in 2009 equivalent to 13.5% of GDP.

Yet underlying the talk of credit default swaps, mortgage backed securities and collateralized debt obligations is something far more fundamental than a banking-crisis precipitated recession, even one as globalised and deep as this one. It is the loss of confidence in the very system of neoliberal international capitalism that was so lauded at the end of the Cold War and which sustained the long boom of the 1990s. That the future of global capitalism in its current form has been put up for reconsideration strikes at the heart of American structural power, from the role of the dollar as the reserve currency to the international institutions and policies of the 'Washington Consensus'. Even the previous strength of the American economy itself began to look illusory, having been underpinned by unsustainable rises in house prices and debt-based consumer spending.

The economic challenge that Obama faced was therefore twofold: first, to return the US economy to sustainable growth, and second, to rebuild confidence in the structures of the international financial system, the central element of America's uniquely advantageous structural power in the international system. At the same time, the United States' position as the guarantor of international economic and political order is being challenged by the most populous nation on the planet.

THE CHINESE ALTERNATIVE

Chinese foreign policy has grown increasingly assertive since its accession to the WTO in 2001 gave it greater access to export markets and fuelled average growth rates of ten percent as exports to the United States alone rose more than threefold. By the end of 2009 China looked to have overtaken Germany to become the world's biggest exporter and is expected to leapfrog Japan to become the world's second-largest economy in 2010. This growth, fuelled by China's huge stocks of cheap labour and aggressive currency controls to keep the value of the yuan low, created both massive cash surpluses and a hugely increased demand for raw materials, a combination that has allowed and mandated a more expansionary foreign policy on the part of the Chinese government.

On the one hand China has used its export earnings to invest heavily in its military capabilities. Confident in its land security where once it worried about the Soviet Union's Red Army, China has embarked on a shipbuilding policy that some estimates suggest will result in it having more ships than the US Navy in the next decade. Already China's naval reach has been felt in the Gulf of Aden, where it has undertaken anti-piracy patrols and proposed the construction of a permanent naval base. China's increasing military assertiveness – and its sense of regional influence – was hinted at by the CCP's criticism of the US's decision to sell almost \$1 billion in anti-missile batteries and missiles to Taiwan, and graphically illustrated by China's test of its own missile-intercept systems, which unusually was publicly reported – apparently as an explicit response to the Taiwanese sales. With the United States legally bound to provide for Taiwan's defense under the 1979 Taiwan Relations Act and with considerable pressure from hawkish Republicans in Congress to that end, the Obama administration will continue to walk a tightrope to manage tensions with a Chinese government increasingly forceful on the issue of Taipei's independence.

On the other hand China's resource requirements have extended its interests in other regions of the world from which it imports its raw materials. Domestic energy requirements have seen the Middle East become an increasingly important region for China, from where it imports 60% of its oil, in particular Saudi Arabia and Iran, which constitute the bulk of those imports, and to a lesser extent Oman and Yemen. Competition for resources in this vital region sees Chinese interests come into direct conflict with those of the United States, in particular over the possibility of imposing sanctions on Iran over its nuclear programme. Further afield China has invested heavily in African development in return for rights to natural resources including oil in Angola, Ethiopia, Nigeria and Sudan, copper in Zambia and the DRC, iron ore in Gabon, and minerals and precious metals in South Africa. Crucially, unlike the United States or the European Union, China's policy does not link trade and investment to political reform or human rights issues, creating a genuine and attractive alternative to Western development norms – a "Beijing Consensus" for resource-rich developing nations. This guarantee of non-interference gives China an advantage with less legitimate regimes in the region, as evidenced by China's staunch support of President Mugabe in Zimbabwe, as well as access to export markets for Chinese goods, in particular textiles. In Latin America China has stepped into the United States' back-yard with cheque-book diplomacy in Venezuela, Ecuador, Argentina and Brazil.

This extension of Chinese interests and its willingness to play more of a traditional great power role reflects the shifting balance in the international system away from American dominance. In this sense the flipside of China's rise is American decline. For the United States, the days of being the world's biggest creditor are long gone – it is now the world's biggest debtor, and China is the largest overseas holder of U.S. debt instruments: \$2.27 trillion in foreign exchange reserves, the world's largest cache, most of which is in dollar-denominated bonds. Yet, as was the case with the alarmism surrounding the rise of the Japanese economy in the late 1980s, the implications of China's dollar holdings can be overstated. America's indebtedness does not place China in a position of dominance over the United States, far from it - American consumers remain the guarantors of Chinese growth, and by extension, the domestic legitimacy of the Chinese Communist Party. What it does mean is that the United States and China are locked together in a symbiotic relationship that seems destined to define international relations over the coming years, and Obama has been quick to understand that and to treat China as the United States' 'most-favoured nation' in diplomatic as well as economic terms: dropping references to Chinese human rights abuses and seeking out President Hu Jintao first at every major international summit.

SOFTLY DOES IT

In the 1990s the Clinton administration was able to play hardball with Japan – effectively a US protectorate since 1945 – in order to force favourable trade agreements and enhance American economic interests. China, however is different, and the US doesn't hold the position of strength that it did vis-à-vis Japan then. The Obama administration has wisely sought to reach out to China rather than treat it as a rival to avoid creating any insecurities within the Chinese government that might lead it to increase the pace of its military buildups or seek to present itself as an explicit alternative to American power in international relations more generally. In this sense mollifying China buys time for the United States to rebuild its economic fundamentals.

At the same time the United States retains a number of significant – and arguably fundamental – advantages over China that inspire confidence over the long term and which should assuage calls for short-termist and potentially destabilising policies to contain Chinese ambitions. Internally, the tensions between an open economy and a closed politics will only increase as China continues to grow, until either productivity or social stability are sacrificed at the altar of the other. Indeed, the liberal ideals often associated with American foreign policy and which neoconservative critics have accused Obama of abandoning in his foreign policy continue to operate without the explicit backing of American public diplomacy,

as Google's apparent willingness to take on the CCP over internet censorship demonstrates. Moreover, China still has a very long way to go before it has satisfied the demands of its own citizens sufficiently that it can turn to focus its attention on international leadership: Chinese per capita income remains less than one-eighth of America's. As James Fallows recently pointed out in *The Atlantic*, American 'decline' is from a level that most of the world still envies.

Internationally, America's political leadership endures. Whilst the misadventure in Iraq may have dealt a blow to America's ability to mount unilateral interventions, the fact remains that where such interventions may be required the world must apply to American power in pursuit of American principles. Obama's reversion to the type of multilateralism that characterized the earlier parts of Clinton's administration is therefore less a sign of American decline than it is an indication that this administration recognizes the value of America's soft and structural power in a way that its predecessor did not, and is seeking to protect and consolidate those assets.

Critics such as Robert Kagan argue that this move is accommodationist and that the Obama administration has rejected an enduring tradition in American foreign policy of perpetuating American primacy in favour of seeking to manage what it regards as America's unavoidable decline. Yet Obama's engagement of China as a strategic partner, far from breaking with established norms of American diplomacy, stands in line with forty years of Sino-American cooperation going back to Nixon. Rather than being the architect of a post-American world, the President's strategy is based around the need to restore the legitimacy of American leadership, and in doing so to prevent other powers from seeking or offering an alternative. Gaining Chinese assent for renewed American leadership is the first and most fundamental step in that strategy, which, far from being declinist, seeks to revive American power and standing from its nadir in Iraq.

That the United States will be able to recover the kind of multi-faceted dominance it held at the dawn of this century is profoundly unlikely, the dangers of such unipolarity having been exposed to the world by the policies of the Bush administration. Yet to view this as confirmation of American decline is as misguided as it would be to claim that European recovery after the Second World War undermined the power of the United States. International power, influence and leadership is not a zero-sum game, and on the evidence of the first cautious year of foreign policy under Obama, the United States has a President who recognizes that. ■