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# The challenge to US hegemony and the “Gilpin Dilemma”

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## Abstract

This article makes a comparison between the challenges faced by the US to maintain its hegemonic position at the end of the 1970s and in the 2010s. To do so we review Robert Gilpin’s writing during the first period. He suggested the US had three options: 1) a defensive protectionist reaction 2) fragmentation of the international system 3) a new wave of innovation, (“rejuvenation”). It is argued that the Reagan administration was able to establish support for the third option. We argue the US is now faced with the same dilemma again, but with a different kind of challenger: China.

**Keywords:** China’s rise; Foreign Direct Investment; Robert Gilpin; US Hegemony.

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## Introduction

The US is going through its second crisis of world leadership. The first was at the end of the 1970s and was successfully overcome, giving rise to a new round of expansion that reached its limits during the 2008 financial crisis.

Although still the most powerful country in the world from an economic and military perspective, the US is facing difficulties in developing a *grand strategy* to maintain its leadership in the face of China’s economic rise. In the aftermath of the 2008 global financial crisis China began an expansion process to challenge US hegemony. China, more autonomous and assertive, started to compete for the control of technology, developing its own brands, conquering markets and organizing its own Global Value Chains.

The US-China dispute is focused on control of the digital revolution, which will restructure the organization of production, distribution and consumption through the large-scale introduction

of Artificial Intelligence, robotics and other technological disruptive innovations. The governments of highly developed countries and other nations on the rise are more and more aware that their position in the hierarchy of the interstate system depends on their industrial-technological base. This new reality contrasts with the neoliberal thesis of transnational capitalism, in which interdependence and integrated global chains controlled by stateless multinational mega-corporations would overcome the rivalry between national states. The dispute over leadership of the digital technology clusters involves competition between oligopolies and between more advanced countries. It became the most visible face of the competition between the US and China. The dynamics of this rivalry, combined with intensive oligopolistic competition, will characterize international political relations in the years to come.

The first section of this article will focus on challenges the US faced at the end of the 1970s and the beginning of the 1980s. To do so we will review Robert Gilpin's publications at the time. A comparison between the challenges faced then and now will highlight the emergence of a very different rival, China. Paradoxically, the rise of China was part of the solution used to consolidate US leadership from the end of the 1980s to the 2008 crises. The following section will focus on the main features of the second challenge to US hegemony and the third section on the policies implemented by the Trump administration to rebuild the US position of global leadership.

## The challenge to US hegemony – the 1970s experience

To understand the challenges faced by the US in the 2010s we reviewed Robert Gilpin's analyses of the previous experience. Gilpin was one of the principal authors who focused on the complicated relationship between the sphere of politics (interstate rivalry) and the sphere of the economy (capitalist competition). In the 1970s he was a pioneer, along with Susan Strange, in including political economy in the field of International Relations. This perspective will guide our analysis.

His research was focused on the dynamics of power, but he argued that power cannot be understood independently from its economic base. As Guzzini (1997; 2002) pointed out, for Gilpin technological and economic change affects the distribution of power in the system. At the same time, international competition between states provokes and accelerates technological and economic changes. Thus, "[...] for Gilpin, Realism needs to be broadened so as to become a form of neo-mercantilism" (Guzzini 1997, 131). However, there can be no doubt that Gilpin, like most of the IR mainstream theorists, had a US agenda. He wanted to understand the roots of the apparent decline of the US in the 1970s relative to Japan and Europe, warn of the long-term consequences this might have for US military power and hegemony, and point out possible scenarios for US reaction.

These analyses reveal a dilemma for the hegemon: to maintain its hegemony requires an expenditure of capital, internationalization of its currency and diffusion of its technology. Over time

this will have two unanticipated effects: one – the involuntary laying of the groundwork for rival states to emerge; and two – a domestic tendency to favor consumption over production and take advantage of existing financial privileges, at the expense of investing in a competitive production structure at home. Thus, what looks like an expression of power can result in the erosion of that same power in the long run. In this same vein Strange (1971) analyzed the changing role of the pound sterling for Great Britain, from a source of power to liability, whose defense could end up eroding its national production base. In the end, the loss of hegemony of the United Provinces and the United Kingdom can be explained in large part by the failure to maintain a strong and dynamic economic base in its own territory. Gilpin's work stressed the importance of the internal dynamics of US capitalism to understand its capacity to confront this dilemma.

Without overlooking the importance of national security issues, the author was one of the first to argue that the threat to US hegemony would no longer come from the Soviet Union, but from new dynamic economies: specifically the power of Japanese technology and, to a lesser extent, the German manufacturing. This was reflected in the debate in the literature over the next decade, which discussed the perceived Japanese challenge to US hegemony (Arrighi 1994). For Gilpin the dispute took place precisely in the field of economics, in particular the capacity for technological innovation, to increase productivity and control of global markets. There was still no mention of China in those days.

In the mid-1970s, Gilpin was rather pessimistic, suggesting that the relative decline in US economic leadership was a fact and that the US could be seen as a “declining core economy” (Gilpin 1976b, 70). This decline would not come all at once, but gradually, and would determine the dynamics of international relations extending into the first decades of the 21<sup>st</sup> century. The decline of US hegemony would imply the end of the liberal international order. For the author, this relationship was fundamental: capitalism was only able to expand around the world because there was an infrastructure created and defended by a hegemonic center. In his book *War and Change in World Politics* (1981), Gilpin, inspired by Charles Kindleberger, dealt specifically with hegemonic stability (or leadership). The main thesis defended is that instability arises when a rising state or group of states estimate that the cost of changing the international system to be less than the potential gains. In other words, the stability of the international system depends fundamentally on the existence of a hegemonic power, otherwise countries tend to close themselves off around economic nationalism. The process of uneven growth generates a tendency for conflicts between emerging and declining states to advance or maintain their position in the international division of labor.

There are two essential reflections in Gilpin's writings that can contribute to the development of analytical tools to understand the challenge faced by the US to maintain its hegemony after the 2008 crisis. First, the relationship between political power and economic power, or between strategic interests and the expansion of multinational companies. Gilpin predicted that this expansion, which was at first an integral part of the reaffirmation of US hegemony, would, in a second moment, contribute to the emergence of new centers that would compete with the US.

Second, his reflection on the US's response to the dynamism of West Germany and Japan in the late 1970s and 1980s.

The expansion of US multinationals met its first opposition in France with the policies of President Charles de Gaulle (1959-1969), supported intellectually by Jean-Jacques Servan-Schreiber's masterpiece "The American Challenge" (1968). The book's main argument was that American economic power, through its multinational companies, was putting Europe in a subordinate position. The answer lay in the organization of European political power, at a level that could not only serve as a counterweight to the power of American multinationals but sustain the formation and consolidation of European equivalents. De Gaulle's struggle failed for two reasons. The first is that Germany opted for the US security guarantee and did not accept De Gaulle's invitation to join him. The other was that the President of France lost his internal political strength in the face of the events of May 1968.<sup>1</sup> Gilpin concluded: "the first serious counteroffensive of the nation-state against the multinational corporation collapsed" (Gilpin 1971, 415).

However, while US multinationals contributed to the rise and consolidation of US hegemony, they also tended to contribute to its erosion and decline. Gilpin considered: "In contrast to the prevailing assumption that American corporate expansionism is in the greatest national interest of the United States, I believe the United States must address itself to the question of the costs and benefits of foreign direct investment" (Gilpin 1971, 7). This view was contrary to most of the literature at the time, not just in the liberal mainstream, but also in much of the critical thinking, which presumed that the age of unchallenged national sovereignty was ending. Inevitably, the economic expansion of capitalism would undermine national sovereignty. Liberals like Raymond Vernon (1971), saw the expansion of American capitalism as a natural process, and the multinationals would tend to detach themselves more and more from their original jurisdiction to become global actors, generating a world of economic and technological interdependence. In his view, nation states should step back and let this process take its course: sovereignty at bay.

But by the mid-1980s, Gilpin (1987, 91) observed that protectionism and economic nationalism were on the rise and threatening the liberal economic order, and warned that "Bilateralism, discriminatory policies, and economic nationalism would begin to supplant liberalism." This sentence could have been written in 2020. He also characterized the early 1980s as a period of transition and suggested that the US had lost its ability to sustain and coordinate the international order, while potential new rising centers did not have the capacity and/or willingness to assume that role. He came up with three scenarios: a purely protectionist defensive reaction, on the part of the US (a "retreat into protectionism"); the fragmentation of the international system into regional blocks, each with its dynamic center and periphery; or a new wave of innovation, which he called "rejuvenation<sup>2</sup> of the core economy" (Gilpin

<sup>1</sup> De Gaulle still won the parliamentary elections in the second half of 1968, but he was weakened to a point that he had to resign the following year.

<sup>2</sup> Note the coincidence: this word ended up being part of Xi Jinping's vocabulary to synthesize the Chinese ascension effort from the beginning of the 2010s.

1976a, 65). Rejuvenation was in fact viewed as the only real way out of the dilemma. Ronald Reagan translated the last option into his famous slogan, later copied by Donald Trump: *Make America Great Again*. This would require an effort to “redirect the flow of capital” to new leading sectors and modern infrastructure in the US itself.

In the mid-1970s, when Gilpin made this analysis, he himself was pessimistic about the possibility that this rejuvenation option would prevail, because it would require too much political will and strength. He even argued that the expansion of American multinationals had already reached the point of being an inhibiting factor in the process of rejuvenation of the US economy. In our opinion, however, the “rejuvenation” scenario prevailed at the time due to the strength and political will expressed in Reaganism, leading to the reorganization of US hegemony.

Part of this success was due to the “strategic trade policy,” which used protectionist measures selectively. The imposition of Voluntary Export Restraints (VERs), to slow the advance of the Japanese car industry, in combination with pressures for an appreciation of the Yen (the famous Plaza Agreement in 1985), were important milestones. Symbolically, one of the main players in the Reagan administration for the elaboration and implementation of this policy, Robert Lighthizer, became the US Trade Representative (USTR) in the Trump administration, contributing to the effort to stop the Chinese rise and accusing the country of engaging in unfair trade practices as they had in the past against Japan. Reagan’s narrative of “fair trade” and “reciprocity” was recycled by the Trump administration. Gilpin’s comment in the mid-1980s fits perfectly in the debate over the so-called “trade war” that the Trump administration started against China: “A major motive behind these policy changes is to prevent foreign economies from appropriating American technologies and the monopoly rents generated by innovation” (Gilpin 1987, 220).

Part of the strategic trade policy was the defense of industries classified as sensitive and of national security interest. These were used to defend domestic employment in sectors such as car or steel, but also linked to the race for technological leadership, very similar to what happened under the Trump administration.

Another fundamental element in understanding the capacity to reorganize US hegemony from the early 1980s on was the dollar offensive, due to an extraordinary increase in interest rates by the FED under Paul Volcker’s Chairmanship, which even caused a recession in the country in the short-term. The FED policy was successful in returning financial flows to the USA, thereby guaranteeing the financing of the double deficit (trade and fiscal). The resumption of hegemony was based on a massive transfer of income and capital from the rest of the world. This also involved the return of part of the capital generated in the branches of American multinationals (Tavares 1997).

Altogether, Gilpin and others underestimated at the time the US’s capacity to deliver on technological innovation as a key element to reinvigorate its hegemony. The US did not only use defense and restrictive policies. More important was in fact the drive to innovation focused on microelectronics, biotechnology and new materials, sectors dominated by American companies,



symbolized by the Silicon Valley and supported by state investments in the military-industrial technological complex.

By mobilizing this comprehensive set of policies under strong political leadership, the US was able to restore global leadership: a grand strategy approach.

## China's role

In the literature on the supposed decline of the American empire in the late 1970s China was hardly ever mentioned. But in the process of reorganizing American hegemony, China's return to the global capitalist system played a very important role. Or, put in other terms: the reorganization of US hegemony opened huge opportunities for China.

The China-US rapprochement in the early 1970s with Nixon and Kissinger had on the part of the USA a much more strategic objective, in the sense of creating a new policy for continental Asia in order to overcome the trauma of Vietnam on the one hand, and balancing the Soviet Union on the other. But the consolidation of this policy under the Carter administration in 1979, with the agreement to normalize relations, coincided with the opening by Deng Xiaoping (Arrighi 2007). From the perspective of Zhu Enlai, the rapprochement with the US can be seen as the beginning of his *Four Modernizations* program for China.

Thus China gradually became a new frontier for the expansion of American capitalism. The interests of the multinationals again coincided with the strategic and economic interests of the US. The growth of Chinese participation in the world economy since the 1980s, but above all since 2001, after it joined the World Trade Organization (WTO), occurred as a complementary relationship to the US economy. The access by multinationals that were able to take advantage of cheap labor for export (*the China factory*) also had a deflationary effect on manufactured products. This increased the purchasing power of American workers, even if they lost their relative share of national income (*the Walmart-effect*). At the same time, Chinese dollar reserves generated by the huge trade surpluses and the inflow of FDI financed the hegemon's indebtedness at low interest rates (Panitch and Gindin 2013a). This can all be characterized as a complementary and interdependent relationship.

But interdependence tends to be asymmetrical. This was certainly the case in the US-China relationship at the time. This hierarchical control determined the appropriation of profits generated by the Global Value Chains (GVCs). The classic example is the global production of an iPhone, which, when it cost US\$ 300 for the consumer in the US, left only 1.8% of that amount to compensate the final production in China (Panitch and Gindin 2013b, 288).

In this perspective, the recent US debate on its China policy in that period sounds strange when it focuses on 'failures' and 'policy errors' (Harding 2015). From a political economy perspective these policies were quite successful. However, it is also essential to emphasize that for China, this smaller part of the added value enabled the country to achieve significant growth and a rapid

transformation of the society from underdeveloped agrarian to predominantly industrial. Therefore, although unequal, there was a clear gain for China, and the attraction of FDI was considered a central factor in modernizing the Chinese economy (Naughton 2007). Also crucial were China's economic policies that enabled Chinese companies to take advantage of FDI to enter a growth path of technology learning and increasing productivity (Schutte and Reis 2020).

## US hegemony challenged again

Changes in the location of economic activities do not necessarily change the distribution of wealth and power among the states in the system. For example, the decision by US multinationals to move low-end manufacturing to the *maquiladoras* in northern Mexico did not empower Mexico, neither did it upgrade its industrial base, let alone its technological capacity. In other words, there is no natural, inevitable tendency that leads multinationals to gradually work in the interest of the receiving countries at the expense of the country of origin. Gilpin understood that there is a fundamental variable needed to put FDI at the service of industrial-technological up-scaling of the receiving country to a point that it could challenge the capital-exporting countries: political moves by the host government to force foreign capital to serve its interests. So, this process is far from automatic or homogenous. The author identified as a precondition for this occurrence: "The existence of some centralized political power which can counteract the economic power of existing centers and the centralizing tendency of market forces" (Gilpin 1976a, 52). He certainly did not have the Chinese Communist Party (CCP) in mind at the time, but the Chinese experience would fit perfectly with this conclusion.

In fact, the periphery needs to be "willing [in terms of political will] and able [market strength] to change the terms on which foreign investment takes place." De Gaulle, in the 1960s had the political will, but France did not have the market strength. Japan and Germany might have had the market strength but not the political will. China seems to combine both.

The 2008/2009 global financial crisis can be seen as a game-changer in this process. It revealed China's economic and political strength especially in regard to the situation in the US and Europe. In the aftermath of the crisis China's expansion became more robust and the country became a net exporter of capital between 2014 and 2015. The state-led export of capital did not only focus on the guarantee of energy and raw materials supplies, but also on the control of technological assets and exploration of market opportunities (Baiyi 2017, 13-14).

China had become the factory of the world, surpassing the US in participation in global manufacturing value added in 2008, and responsible for more than 25% by 2015, leaving the US in second with 18% (United Nations 2020). There was no doubt that China was moving at impressive speed, leaving behind the initial stages of industrialisation. However, for China to make the crucial step to move towards being a developed country it would need to develop widespread endogenous technological capacity. That is the key to preventing the country getting mired in the



middle-income trap (Huang 2015). In the end it is technological innovation that leads to growth in total factor productivity, leading the way to further rising income. China became the country with the sharpest increase in R&D spending in relation to GDP: from 0,89% in 2000 to 2,15% in 2018. But it still lagged behind the US, which in the same period showed an increase from 2,6% to 2,8% (OECD 2020).

In the discussion of the meaning of China's rise as a challenge to US hegemony, Panitch and Gindin emphasized what they characterize as "centrality of the American empire to capitalist globalization" (Panitch and Gindin 2013a, 147). Transnational production networks and global finance would still rely on US political-military power. So for China the option left would be at best "[...] duplicating Japan's supplemental role in terms of providing the steady inflow of funds needed to sustain the US's primary place in global capitalism" (Panitch and Gindin 2013a, 146). Starrs (2019, 186) argued in the same way by pointing out that China is "not only dependent on integrating into global capitalism, but is actually driven by foreign capital in key respects."

However, this argument might become more and more difficult to defend, given the continuation of China's rise, not only economically but also as a technological powerhouse, climbing the ladder and further closing the gap every time. One should focus on the film and not on the photo.

Especially after the 2008 global financial crisis, one can see a quite different attitude on the part of the Chinese leadership, in particular Xi Jinping (Jiechi 2017). While the collapse of Lehman Brothers revealed the weakness of US hegemony, it also showed the relative strength that the Chinese economy had acquired. Overcoming the global crisis depended to a large extent on the ability of the Chinese economy to maintain its momentum. The transformation of the G-7 into the G-20 meant recognition of the country's role in ensuring the governance of the international economic system.

New thinking emerged in the Chinese leadership. A more autonomous and assertive China would need, and was now able, to compete for control of technology, to develop its own brands and control markets. In the middle of the 2010s the PRC became extremely assertive and transparent in its intentions. The launch, in 2015, of the *Made in China 2025* plan, through which the country intends to lead in ten cutting-edge technological innovations, is a clear case (Wübbeke et al. 2016). The attempt to be at the forefront of key technologies that will shape the digital revolution has a direct impact on China's relations with the rest of the world.

In the Xi Jinping era, Chinese FDI flows linked to international financing – as in the case of the Belt and Road Initiative (BRI) – gained strategic importance in the context of a new geo-economic and geopolitical vision.

In other words, it is not just the relative or absolute strength in relation to the US. A key variable is also what Weber (1968) called the "will to power." Starrs (2019, 193) himself admits that "The Chinese state has greater autonomy than most states to try to carve out its own protected niche within global capitalism and develop indigenous technology."

## In search of a new American grand strategy?

Although the problems that the US faced in the first decade of this century, in particular the disastrous wars in the Middle East, the financial crisis, stagnation in productivity and low investment rates, are not directly related to China, it is China that is seen as the threat to US hegemony and therefore considered an obstacle in the effort to “Make America Great Again.” This is not only a bipartisan consensus at the top, but also among a majority of public opinion, notwithstanding the huge ongoing economic and financial engagement of interests with China. So, the question for the US was: how to react? Or to use Chang’s concept: how to kick away the ladder (Chang 2002)?

The Obama administration (2009-2017) had already tried to stop the rise of China, in particular with the Transpacific Partnership (TPP) and the intensification of the diplomatic and military presence in East Asia. In fact, it was Obama who in 2011 called for a “Sputnik moment” (Obama 2011). However, there was not yet the same sense of urgency and political determination.

In the 2016 election, Trump’s proposal was clearly different from that of Hilary Clinton, who had argued the US cannot solve the most pressing problems on its own, which is in line with Nye (2011). Nye had argued that the US problem was not the decline of power, but not understanding that even the most powerful country in the world would not be able to achieve its goals without cooperation.

Trump, on the other hand, considered this approach defeatist and insisted on military, economic and political strength capable of unilaterally disciplining allies and opponents, through tough negotiations or economic sanctions if needed.

Gilpin’s message began to prevail in Washington: the transnationalization of productive capital and finance does not guarantee the reproduction of American hegemony, and international oligopolies per se do not necessarily defend the strategic interests of the US. It was urgent to redirect capital in the same way as it would become necessary to rediscipline allies.

The Trump administration’s most visible and controversial answer was to launch, at the end of 2018, a so-called trade war, to try to rein in not only China, but also the European Union. But the problem is not so much related to the trade balance as it is to a geo-economic and geopolitical one. As Lin noted: “One of the United States’ key objectives in its rivalry with China was to maintain U.S. technological superiority” (Lin 2020, 137). Targeted protectionism was once again seen as a useful tool.

The annual average of protectionist measures adopted by the various administrations since mid-1970, clearly shows the higher-than-average use by the Reagan and Trump governments, using mainly countervailing duties (CVD) and the constant reliance on references to national security (Congressional Research Service 2020). In the case of the Reagan administration, this trade policy was useful for the reestablishment of US leadership. In the case of the Trump administration, it was also about making America great again, but as part of a less comprehensive strategy; above all, against a much more powerful challenger.

During the Trump administration, tariffs on China's imports were increased in almost all major product categories, ranging from 10%-15% on monitors and televisions to 25%-30% on motor vehicle parts (Congressional Research Service 2019). This strong and unprecedented offensive should have resulted in a substantial drop in the US trade deficit. However, the results are quite different. Monthly US trade deficit in overall trade in goods increased from US\$ 65.50 billion in January 2017 (when Donald Trump came into office) to US\$ 85.50 billion in November 2020. In the same period the trade deficit with China fell from US\$ 31.40 billion to US\$ 30.70 billion (US Census Bureau 2020). This confirms that the measures did have some impact on trade flows, not in the sense of reducing the total deficit, but of reducing the flow of direct trade with China, which was offset by an increase in imports from neighboring Asian countries (Vietnam, Taiwan, and South Korea). Trade diversion is highly likely to be carried out or coordinated by the same multinational companies. In any case total manufacturing trade deficit in the first 9 months of 2020 stood at US\$ 649.36 billion, of which US\$ 222.8 billion was with China, and thus still a significant problem. The sharp drop in trade surplus in services with China is also remarkable. After a marginal decrease in 2019 compared with 2018, the surplus dropped sharply in the first nine months of 2020, from US\$ 27 billion in the previous year to US\$ 16,9 billion.

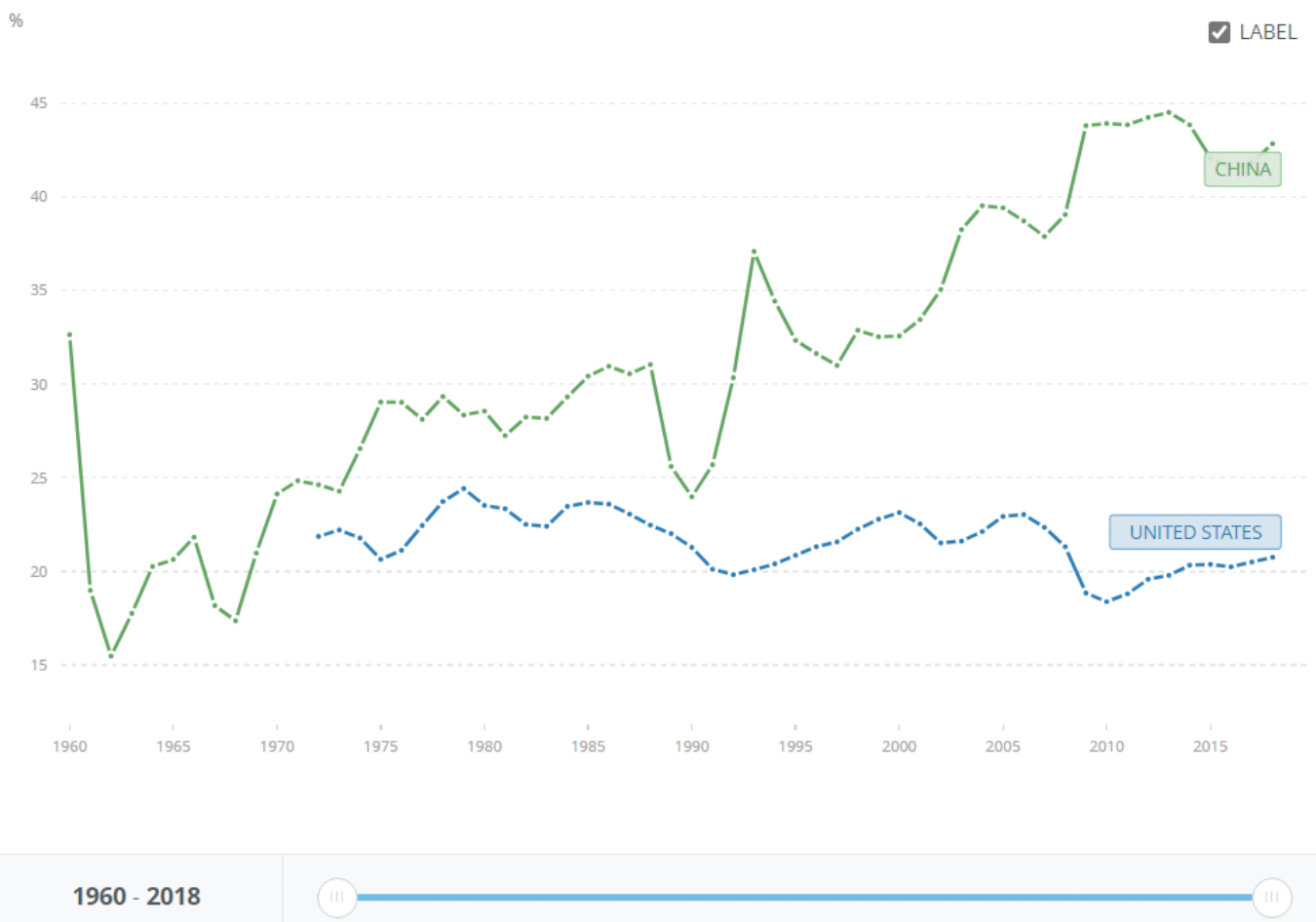
One could ask the question: Why did the trade deficit suddenly become the big issue? Trade had been a major issue in the mid 1980s. Under the Reagan administration there was a sharp reduction in the deficit between 1985 and 1990. However, paradoxically, in the following decades, the trade deficit increased and became a pillar of US hegemony. In fact, what ultimately matters is the maintenance of control over the value chain, meaning technology, finance, and the organization of international trade. Or, in other words, to have the capacity to appropriate the value generated throughout the chain. In 2018, for example, about two-thirds of Chinese exports to the US were organized by foreign companies, mostly either from the country itself or subordinated to value chains controlled by American companies.

Another aspect of the Trump's strategy in his 2016 election promise was to rebuild production capacity in the US and bring investment back home. This intention would be in line with Gilpin's rejuvenation scenario mentioned earlier, which would need "redirection of the flow of capital" to new leading sectors and modern infrastructure in the US.

In 2018, for the first time, there was even a negative net outflow of US FDI, followed by a modest recovery in 2019. According to the data of the World Bank, there was a drop in outflows from US\$ 380 billion in 2017 to US\$ -50.6 billion in 2018. FDI flows are highly sensitive to tax measures. During many years, the US tax system had been very favorable for the international expansion of capital. However, during the Trump administration, there was an important change in legislation in December 2017, considered the most significant amendment of the US corporate tax code since 1986 (Reagan administration). In addition to a reduction of the corporate income tax rate from 35% to 21%, and a switch from worldwide income taxation to territorial taxation, there was also an immediate deduction for certain assets. The goal was to improve the attractiveness of the US in the global tax competition, clearly aiming to influence international investment

decisions. Because of the short-term deduction opportunities, there was a massive repatriation of financial gains accumulated by branches abroad. The immediate effect was exaggerated in 2018. It is difficult to conclude how far and to what extent this would in fact lead in any way to a kind of reallocation of productive capital to the US in specific sectors and whether this will contribute to the strengthening of its industrial-technological base. For 2019, the figures indicate lower levels of outflows compared to inflows; however, Covid-19 makes it very difficult to analyze 2020. In any case, Gross Fixed Capital Formation (GFCF) as percentage of GDP in the US continues to be much lower than in China, as shown in Figure 1. The US was not even able to regain the levels achieved before the 2008 crash.

**Figure 1. Gross Fixed Capital Formation in the US and in China as % of GDP 1960-2018**



Source: World Bank 2020.

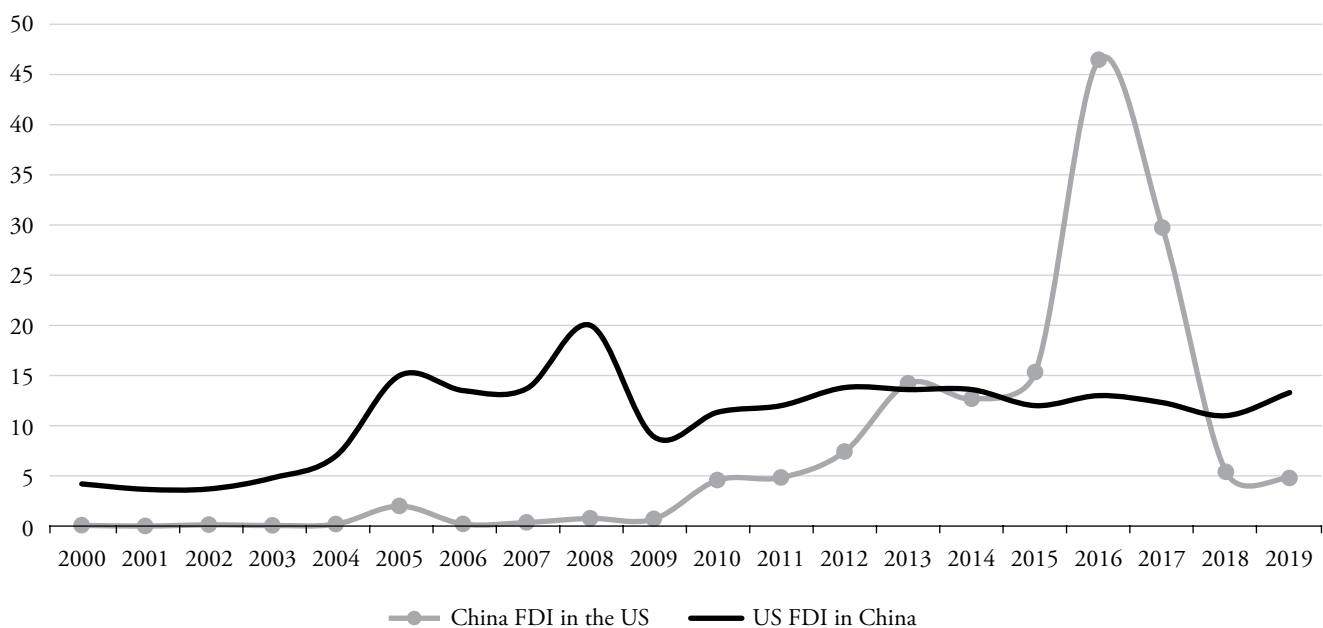
This huge difference in capital formation in relation to GDP between the US and China indicates flows and not stocks and does not reveal the quality of the investments. However, they explain the rise of up-to-date infrastructure at all levels in China and a growing awareness of the risk of falling behind in the longer term in the US. The same accounts for R&D spending where the US is still in front, but research on this concluded: “data measuring R&D relative to

manufacturing value added indicate that the intensity of U.S. manufacturers' research spending has not increased since 2008," while Chinese spending is increasing rapidly (Levinson 2018, 14/15). There can be no doubt that the US is still a powerful economy, but the gap is closing consistently and a major psychological blow can be expected as Chinese surpasses the US's GDP, a perspective that has become more real as a result of the economic impact of the Covid-19 pandemic.

The preliminary conclusions of these data are that the measures taken by the Trump administration had so far only small impact on the origin of imports (to the detriment of China), but not on the trade deficit. At the same time tax measures had a significant impact on FDI flows in absolute amounts in 2019, but do not necessarily indicate a long-lasting change in US multinational investment strategies.

Figure 2 allows a closer look at the US FDI flows from and to China. For the time being, US capital has not been moved by anti-China rhetoric and is apparently not reluctant at all to continue to invest in what is considered in Washington to be the US's main rival. On the other hand, there was a strong reaction from the Chinese side with significant reduction of FDI flows to the US.

**Figure 2. US FDI in China x China FDI in the US. Annual flows in USD, 2000-2019.**



Source: The US-China Investment Hub ([us-china-investment.org](http://us-china-investment.org))

While much has been said about the trade balance, few realize that by now total revenues of US subsidiaries operating in China selling to the Chinese markets is greater than the US trade exports to China. In 2015, the last year for which official US statistics are available, US multinational subsidiaries based in China earned a total of US\$221.9 billion in sales to the domestic market. Under these conditions, it is no wonder that China remains a top priority for

most U.S. companies (Kynge 2018). The June 2019 survey of the member companies released by the US-China Business Council showed that 87% responded that they had no intention to move out of China, notwithstanding the US administration's rhetoric. 97% responded positively to the question on whether their China operations were profitable. Therefore, it seems we can identify the Gilpin-dilemma: first, from 1990 to the end of the 2000s, the expansion of US capital towards China worked for US leadership in the world, but then its operations in China helped to undermine this leadership.

At the same time, the aggressive policies to kick away the ladder by denying China access to the technology necessary for its advanced sectors, like Huawei, might work out very badly for US competitiveness. First, US companies risk losing a significant part of their market. Second, they encouraged China to mobilize huge resources to overcome its technology dependency, and this could end up helping China climb faster. Although damaging for the Chinese economy at the short term, it might help to diminish the gap in the medium term. Apart from the economic features of this process, there are also political ones: there are no gains for the US public, either in the short, or in the medium term. On the Chinese side, however, it will reinforce the nationalist narrative and social cohesion around its leadership, determined not to be pushed back into a century of humiliation.

## Post-Covid-19 US rejuvenation?

One of China's advantages in the global tech race has been its state planning capacity, by which long-term technological growth paths can be pursued, so far with great success. The experience of the pandemic has given new input to consider industrial-technological policies in combination with public investments in the Western countries as well. Some even suggest a kind of '*Chinanization*' of some aspects of the economic policy of Western countries (McNally 2020). The pandemic also provoked a widespread discussion on the organization and control of GVCs, more specifically the dependence of US and EU economies on China's production capacity. This could reinforce a broader awareness that a country's position in the hierarchy of the interstate system ultimately depends on its industrial-technological base.

Looking at the situation at the end of 2020 objectively, the US didn't seem to be well prepared for this challenge, but one should never underestimate the resilience and the strength of its basic assets: the US dollar, its technological and military capacity. On the other hand, the PRC is showing its power as the only major economy to deliver economic growth figures in 2020 and 2021. This performance is related to its capacity to control the pandemic in a much more effective way than the Western countries.

Paradoxically, the pandemic created an opportunity for the Biden administration. A consensus in developed countries has been generated among important sectors of the ruling classes that it will not only be impossible, but also undesirable, after having controlled Covid-19, to return



to normal by immediately reducing the public deficit with adjustment policies and letting the market restore the equilibrium level of employment and investment. What is being discussed in the major countries are massive investment programs maintaining high levels of public spending (IMF 2020).

This unprecedented public spending might be used to do more and different than just rebuild and restore, by focusing on the country's competitiveness in the digital revolution (*the Screen Deal*) in combination with developing technologies to respond to Climate Change (*the Green Deal*). In this sense, the economic impact of the pandemic could turn out to be a Schumpeterian creative destruction process.

In March 2020, there was a pre-announcement of a US\$ 2 trillion plan for the post-pandemic "rebuilding" of the economy. President Trump said at the time it would target "infrastructure", and tweeted: "it must be VERY BIG & BOLD" (Stein and Kim 2020). Ten months later, the newly elected president, Joe Biden, did launch a US\$ 1.9 trillion "American Rescue Plan" followed by the announcement of an even bigger infrastructure plan. This is about much more than restoring the economic damage of the pandemic. Janet Yellen, on her nomination as Treasury Secretary, tweeted about "restoring and rebuilding the American Dream."

The question is whether it will allow the US to achieve Gilpin's rejuvenation as necessary to regain its global leadership. But it gave the US an opportunity to come out of the defensive line and, instead of just trying to block China from continuing to climb the ladder, it might develop a modernization strategy to widen the gap by moving upward in the technology race. This of course demands strategic vision and forward-looking leadership. It will be Biden's litmus test.

## Conclusion

For the second time since World War II, US hegemony is being confronted in the economic arena. To analyze the challenge in the 1970s and beginning of the 1980s, we reviewed Robert Gilpin's analyses, which identified a clear case of a declining hegemon whose expansion of capital and finance had given rise to rivals and neglected its own industrial base at home. As the privileged position of the US did not generate the necessary sense of urgency, he was skeptical of the possibility the US would be able to meet this dilemma successfully. He pointed out at the time that this could only be done by a rejuvenation of its economy with emphasis on technological innovation to maintain productivity growth and a strong industrial base at home. In case of failure he foresaw two other scenarios: a defensive protectionist reaction or the fragmentation of the international system into regional blocks.

It seems, therefore, useful for the understanding of the present situation to compare these two moments and the way in which the Reagan administration successfully managed to reorganize US leadership which, Gilpin's pessimism notwithstanding, gave rise to a renewed US hegemony.

China's integration into the global capitalist system was an important element in the consolidation of this process. This gradually changed, especially after the 2008 global financial crisis, which showed the limits of neoliberalism, and the force of sino-capitalism. China was not only the 'factory of the world' anymore, but it had also accumulated the strength and willingness to compete for technological leadership and control over international production and supply chains. This is being broadly considered in the US debate as an obstacle to the challenge to "Make America Great Again" (Trump administration) or to "Reclaim the American Dream" (Biden administration).

Contrary to the situation faced by the Reagan administration, when there was no country with a political will to challenge its leadership, this now seems to have changed. There is a clear feeling in the U.S. that the Chinese rise must be stopped. The rivalry with China focuses on the field of technology and involves the international corporations on both sides that control it. Therefore, the dispute is not about trade itself and can be analyzed as a "policy of competitiveness" between national states to guarantee the development of advanced technologies in their territory. What used to be called a "trade war" seems to be a war for the ownership and control of the technologies of the fourth industrial revolution. Without this, the central position of its currency and the predominance of its military capabilities would begin to erode.

An analysis has been made of Trump's restrictive trade policies and attempts to shift global productive investments back to the US. The preliminary conclusions of these figures are that the measures taken by the Trump administration have had a limited impact on the origin of imports (to the detriment of China) so far, and a larger but still undetermined impact on overall FDI flows, but nothing that seems to be able to slow the relatively fast diminishing gap between the US and China or increase US investments rates. A closer look at US FDI flows to China shows that for the time being US capital has not been moved by anti-China rhetoric and is apparently not reluctant at all to continue to invest in what is considered in Washington to be the US's main rival.

At the same time, the aggressive policies to kick away the ladder from its rival by denying China access to technology necessary for its advanced sectors, like Huawei, might work out very badly for US competitiveness. First because, in the short term, it damages US companies, who will lose a significant part of their market. Second because it encourages China to mobilize huge resources to overcome its technology dependency, which might make it climb the ladder even faster.

The COVID-19 pandemic is not by itself a game-changer, but it will tend to have a significant impact on ongoing processes, accelerating and expanding some, decreasing and decelerating others. The pandemic is an important factor in explaining Trump's defeat and has, in short-term, deepened the crisis and geopolitical conflicts. However, it is argued that the post-pandemic political constellation might paradoxically create opportunities for the Biden administration to confront the Gilpin dilemma by using the massive recovery funds to generate new dynamics in the economy and at the same time recreate a basic social cohesion necessary to strengthen international leadership and finance US rejuvenation.

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