Texas National Security Review: Volume 6, Issue 2 (Spring 2023)
Print: ISSN 2576-1021 Online: ISSN 2576-1153

PAYING THE DEFENSE BILL: FINANCING AMERICAN AND CHINESE GEOSTRATEGIC COMPETITION

Rosella Cappella Zielinski
Samuel Gerstle

In the face of what could be a decades-long competition, the United States and China must consider how they will finance defense spending. Leaders in both states are constrained by an intertemporal dilemma: pay the high political cost of raising taxes today, thereby establishing a sustainable revenue source, or avoid political costs and borrow, risking the economic vitality of the state. A state's status in the international system shapes its ability to navigate this dilemma. Rising challengers can frame fiscal sacrifice today via taxes as an investment in a bright future, while dominant powers face a public that is skeptical that the future will be better than the present, causing leaders to resort to taking on debt. Early evidence suggests that the Biden administration's framing of a return to a great-power status quo will not result in increased taxes. For China, the narrative of "national rejuvenation" has supported the country's rise and fiscal strength and may allow for increased taxation despite slowing growth, positioning Beijing to sustain military spending over the long term.

Geopolitical competition tends to last for decades, if not longer. Success in great-power competition therefore requires defense budgeting that not only delivers the necessary military power but can also be sustained — politically, economically, and fiscally — over the long term. As the United States and China set out on a potentially decades-long competition, sustainable defense spending is of critical importance to both countries.

The United States is faced with a daunting defense bill after decades of war associated with the Global War on Terror. Shifting focus to great-power competition — which will require modernizing conventional and nuclear forces, adjusting regional military postures, integrating next-generation warfighting technologies, and supporting key allies and partners — will be incredibly costly.[1] Competition with China is just one part of America's global foreign policy, which includes deterring aggression across Europe, commitments in the Middle East, and worldwide counterterrorism operations. Although the 2021 withdrawal from Afghanistan was intended, in part, to align U.S. commitments with stated priorities, without additional major alterations to America's overseas commitments, current funding is expected to fall short. A 2021 comprehensive study of modernization requirements found that the Department of Defense's baseline budget will need to "increase by 11 percent in real terms by 2033" to simply sustain current plans.[2] And an external review of the 2018 *National Defense Strategy* by a committee of prominent former policymakers warned that without 3 to 5 percent annual real budget growth, the United States faces "strategic insolvency."[3]

China is also spending heavily on its military. As a state with great-power ambitions, it aims to achieve a "world-class" military by 2049, a goal essential to the "great rejuvenation of the Chinese nation." The Chinese Communist Party has accordingly poured resources into defense. Since 2012, China has increased its annual defense budget by an annual average of seven percent. In 2023, Beijing announced a defense budget of $230 billion, a 7.2 percent jump over the previous

1 Mackenzie Eaglen, *The 2020s Tri-Service Modernization Crunch*, American Enterprise Institute, March 2021, 10, https://www.aei.org/wp-content/uploads/2021/03/The-2020s-Tri-Service-Modernization-Crunch-1.pdf?x91208.

2 Mark F. Cancian, *U.S. Military Forces in FY 2021*, Center for Strategic and International Studies, March 2021, 9–10, https://csis-website-prod.s3.amazonaws.com/s3fs-public/publication/210318_Cancian_Military_Forces.pdf?6iYr0beO.Ps9rQJQCQjTPPPKndGuLGxg.

3 Eric Edelman, et al., *Providing for the Common Defense: The Assessment and Recommendations of the National Defense Strategy Commission*, United States Institute of Peace, November 2018, xii, https://www.usip.org/sites/default/files/2018-11/providing-for-the-common-defense.pdf.

year.[4] Yet, People's Liberation Army officers and Chinese defense analysts complain that funding remains too low to meet the Chinese Communist Party's grand ambitions.[5] And, as China turns to more technology-intensive capabilities, the cost of future military modernization is likely to rise.[6] Finally, our own analysis of China's fiscal system suggests that current military and domestic spending is outpacing central government revenue as economic growth slows.

How will the United States and China sustain the large defense budgets required for long-term competition? Both countries' abilities to sustain high military expenditures is complicated by competing budgetary needs, notably public welfare spending. For the United States, shifting greater resources to defense, either through cutting non-defense spending or moving funds around within the defense budget, is not a realistic solution to rising defense budgets. Reining in popular social programs, which are mandated by law, is institutionally difficult and would require a large number of politicians to take major political risks. Paying interest on the national debt increasingly dominates the U.S. federal budget: Interest payments alone will be the single largest line item in the budget by 2033.[7] Complicating matters further is the limited ability to shift funds within the military budget to create newfound efficiencies or quickly realign the budget with strategy. The antiquated Planning, Programming, Budgeting, and Execution system, combined with Congress's institutional control over funding, has created a rigid defense budget. This system privileges parochial interests within both the services and Congress, and limits the ability to shift funds within the defense budget.[8] Thus, barring major changes to the budgetary process, congressional authority, or U.S. foreign policy priorities, rebalancing funds across the federal budget or within the military budget to meet the needs of U.S.-Chinese competition is largely moot.[9]

While China's closed political institutions provide a great degree of insulation from the public, Chinese leadership is constrained by an implicit social contract to deliver rising standards of living and social stability in addition to external security and national prestige.[10] Due to its close observation of the fall of the Soviet Union, the Chinese Communist Party leadership is well aware of the tradeoffs between defense spending, social welfare, and economic growth and knows that failure to deliver on the latter two could destabilize the party's rule.[11] The Chinese government provides its people with high levels of public goods and is wary of overspending on defense. Even considering high-end estimates of People's Liberation Army budgets, China has spent a relatively small percentage of national wealth on defense since the early 1990s. Thus, like the United States, China is budgetarily constrained by its commitment to social spending and economic growth.

Without making significant changes to foreign policy or budgetary priorities, the competition between the United States and China will require both states to continue to spend enormous sums on defense. Although there are many options and financial mechanisms for garnering additional revenue to pay the defense bill, most options can be broadly separated into the tax versus debt dichotomy.[12] Borrowing, the "go to" means of financing such high levels of the military spending, is often (and rightly so) met with fears of strategic "overstretch." That is when great

4 Matthew P. Funaiole and Brian Hart, "Understanding China's 2021 Defense Budget," Center for Strategic and International Studies, March 5, 2021, https://www.csis.org/analysis/understanding-chinas-2021-defense-budget.

5 Brian Lafferty, "Civil-Military Integration and PLA Reforms," in *Chairman Xi Remakes the PLA: Assessing Chinese Military Reforms*, ed. Phillip C. Saunders et al. (Washington, DC: National Defense University Press, 2019), 631.

6 Andrea Gilli and Mauro Gilli, "Why China Has Not Caught Up Yet: Military-Technological Superiority and the Limits of Imitation, Reverse Engineering, and Cyber Espionage," *International Security* 43, no. 3 (February 2019): 141–89, https://doi.org/10.1162/isec_a_00337; and Stephen G. Brooks and William C. Wohlforth, "The Rise and Fall of the Great Powers in the Twenty-First Century: China's Rise and the Fate of America's Global Position," *International Security* 40, no. 3 (January 2016): 7–53, https://doi.org/10.1162/ISEC_a_00225.

7 "The Budget and Economic Outlook: 2023 to 2033," U.S. Congressional Budget Office, Feb. 15, 2023, https://www.cbo.gov/publication/58848.

8 Bob Bradford and Lou Yuengert, "USMA Conference Paper," United States Military Academy at West Point, February 2023, 9–10; and Brendan W. McGarry, "DOD Transfer and Reprogramming Authorities: Background, Status, and Issues for Congress," Congressional Research Service, June 17, 2020, https://sgp.fas.org/crs/natsec/R46421.pdf.

9 Bob Bradford and Jeffrey E. Baker, "Making and Implementing Strategic Choices Is Hard," *The Strategy Bridge*, March 14, 2022, https://thestrategybridge.org/the-bridge/2022/3/14/making-and-implementing-strategic-choices-is-hard; and Rosella Cappella Zielinski and Kaija Schilde, "Hatchet or Scalpel? Domestic Politics, International Threats, and US Military Spending Cuts, 1950–2014," *Security Studies* 28, no. 4 (2019): 677–709, https://doi.org/10.1080/09636412.2019.1631379.

10 Jessica Chen Weiss and Jeremy L. Wallace, "Domestic Politics, China's Rise, and the Future of the Liberal International Order," *International Organization* 75, no. 2 (2021): 645, https://doi.org/10.1017/S002081832000048X.

11 David L. Shambaugh and Joseph J. Brinley, *China's Communist Party: Atrophy and Adaptation* (Berkeley: University of California Press, 2008), chap. 4; and Sheena Chestnut Greitens, "Xi Jinping's Quest for Order," *Foreign Affairs*, Oct. 3, 2022, https://www.foreignaffairs.com/china/xi-jinping-quest-order.

12 Rosella Cappella Zielinski, *How States Pay for Wars* (Ithaca, NY: Cornell University Press, 2016); and Sarah E. Kreps, *Taxing Wars: The American Way of War Finance and the Decline of Democracy* (New York: Oxford University Press, 2018).

powers rise, borrow to expand and sustain power, and then go bust. Such concerns have long dominated debates on balancing economic and military priorities.[13] Indeed, overstretch concerns are at the heart of arguments for a more restrained foreign policy. As Barry Posen writes, "Restraint would contribute to the U.S. economy by saving significant amounts of money, which could be reallocated to restoring the fiscal health of the country, whether that is a short-term or long-term problem."[14]

Indeed, leaders face a difficult choice: pay the high political cost of raising taxes today to secure a long-term sustainable source of revenue, or borrow but risk the long-run vitality of the state. We argue that this choice should be understood as an intertemporal dilemma — leaders must balance the maximization of present welfare with costly investment that may not provide benefits for many years. States deal with similar dilemmas whenever confronted by long-term problems, from mitigating climate change to investing in infrastructure.[15] In the case of financing geostrategic competition, a state's status in the international system heavily shapes a leader's ability to navigate this intertemporal dilemma. State status provides a means for leaders to manage how citizens weigh short-term costs against long-term benefits. Leaders across regime types are constrained by the interests of domestic actors. This is especially true for taxes, which impose direct and obvious costs on citizens, regardless of the nature of their representation in the political system. We therefore focus on one tool that leaders can use to stretch constraints: the deployment of narratives to extend the time horizons of their citizens.

Rising challengers like China may have an advantage when it comes to generating sustainable revenue. Such states can reasonably expect to gain from costly efforts to bring the international system into alignment with their expanding power. Their citizens are rightfully optimistic that the future is bright. Leaders of such states can realistically frame competition within a narrative that sacrifice today will bring gains tomorrow, ranging from prestige to prosperity, that will benefit a broad coalition of citizens. This framing alters the time horizon in which citizens consider costs and benefits. When a policy is framed in a long-term time horizon, individuals tend to put more weight on future benefits and to discount immediate costs and obstacles to success. Leaders of rising challengers are therefore better able to justify new taxes as a worthwhile sacrifice for national power. Thus, rising challengers are in a better position to pay their defense bill with sustainable tax revenue.

Dominant powers like the United States, on the other hand, are concerned with maintaining what they have. They seek to preserve the *status quo* and fear that change will undermine relative state power and prosperity. This makes mobilization more difficult: Leaders of dominant powers have a much harder time framing geostrategic competition around the pursuit of grandiose collective gains achieved through changes to the international system. Citizens thus tend to consider the costs and benefits of competition within the context of short time horizons. When using short time horizons to evaluate policies, individuals tend to be less optimistic about the size of future payoffs and to focus instead on the cost and feasibility of present policy. In other words, primed to consider state policy within a short time horizon, citizens of great-power states focus more on the costs of military power than potential payoffs. Here, leaders prefer to avoid the political blowback from imposing taxes on a reluctant citizenry by financing competition with debt, ideally from abroad.

This article lays the foundation for academics and policymakers to understand how states can and do finance geostrategic competition. For academics, we add nuance to our understanding of the rise and fall of dominant powers. Financial overstretch can and does take place, but not necessarily because debt is inherently unsustainable, or because some states borrow better than others. Once a state becomes dominant, it is harder for the government to sell a sustainable finance plan — i.e., direct taxes — for geostrategic competition to the public. Rising challengers, on the other hand, have the inherent advantage of promised future gains, prompting citizens to be more accepting of short-term fiscal costs. For policymakers, we explore the various financing options and the enabling and constraining forces facing American and Chinese policymakers today. While geostrategic competition between China and the United States is relatively recent, the past few years suggest that China, despite slowing levels of economic growth, may be at a long-term financing advantage, if it is able to successfully execute its powerful narrative of

13 Paul M. Kennedy, *The Rise and Fall of the Great Powers: Economic Change and Military Conflict from 1500 to 2000* (New York: Vintage Books, 1989); and Robert Gilpin, *War and Change in World Politics* (Cambridge, UK: Cambridge University Press, 2002).

14 Barry Posen, *Restraint: A New Foundation for U.S. Grand Strategy* (Ithaca, NY: Cornell University Press, 2014), 70.

15 Alan M. Jacobs, "Policy Making for the Long Term in Advanced Democracies," *Annual Review of Political Science* 19, no. 1 (May 2016): 433–54, https://doi.org/10.1146/annurev-polisci-110813-034103.

"national rejuvenation."[16] While the United States enjoys many advantages — a flexible political-economic system, numerous close allies, and possession of the world's reserve currency — it also faces its own challenges and must grapple with domestic narratives of decline, high levels of debt, and the unending demands of global commitments.

Funding Geostrategic Competition

The ability to marshal resources over many decades without succumbing to political and economic exhaustion is the cornerstone of great-power competition.[17] Yet, marshalling such resources to sustain geopolitical competition with a near equal adversary is challenging. The decision of how to extract resources for defense reflects not just foreign policy concerns but also the preferences and power of domestic actors.[18] In times of acute emergency, such as a war, states can more easily overcome domestic constraints.[19] However, in peacetime, the choice between taxation, which places an immediate and highly visible burden on a broad subset of society, and borrowing, which defers costs to the future, often reflects a careful consideration of domestic preferences.[20] Indeed, political costs abound. Citizens do not like their hard-earned income wrested away from them via taxes. And when they are taxed, they expect something in return: To surrender revenue to the government is to contribute to the provision of general public goods.[21]

It is unclear whether democracies or autocracies are better able to navigate the short- and long-term costs and benefits of different financing strategies. To be sure, the ability of a state's citizens to voice their opinion on taxation, borrowing, and whether to prioritize present benefits or invest in the future is shaped by the state's domestic political institutions. The more open a political system is, the more likely political leaders are to be constrained by powerful societal actors or public opinion. Leaders in democratic systems face regular elections and must contend with strong political pressures to deliver short-term benefits and are rarely rewarded for investing in the future. They are thus more likely to defer costs to the future through borrowing.[22] In the early years of the Cold War, for example, U.S. policymakers feared that an autocratic Soviet regime could more effectively mobilize resources over the long term despite having a smaller economy. As one state department official expressed, "In the absence of real and continuing crises, a dictatorship can unquestionably outlast a democracy in a conventional arms race."[23]

Yet, the level of constraint is not solely a function of whether a state is a democracy or autocracy.[24] Autocracies may tax at lower rates and use less diverse forms of taxation than democracies.[25] Leaders of authoritarian states, while far more insulated from direct societal demands, face strong incentives to avoid imposing costs on powerful elites, on whose goodwill the regime depends, or on large middle and lower classes, who may take to the streets to protest or demand political representation.[26] China's leadership seems to be aware of these tradeoffs. A resolution adopted by the Central Party Congress of the Chinese Communist

16 Avery Goldstein, "China's Grand Strategy under Xi Jinping: Reassurance, Reform, and Resistance," *International Security* 45, no. 1 (July 2020): 164–201, https://doi.org/10.1162/isec_a_00383.

17 Kenneth A. Schultz and Barry R. Weingast, "The Democratic Advantage: Institutional Foundations of Financial Power in International Competition," *International Organization* 57, no. 1 (2003): 5, https://doi.org/10.1017/S0020818303571065; and A. F. K. Organski and Jacek Kugler, *The War Ledger* (Chicago: University of Chicago Press, 1991).

18 Michael Mastanduno, David A. Lake, and G. John Ikenberry, "Toward a Realist Theory of State Action," *International Studies Quarterly* 33, no. 4 (1989): 457–74, https://doi.org/10.2307/2600522.

19 Aaron L. Friedberg, *In the Shadow of the Garrison State: America's Anti-Statism and Its Cold War Grand Strategy* (Princeton, NJ: Princeton University Press, 2000), 64.

20 Cappella Zielinski, *How States Pay for Wars*, introduction.

21 Margaret Levi, *Of Rule and Revenue* (Berkeley: University of California Press, 2008).

22 Friedberg, *In the Shadow of the Garrison State*, 64–65.

23 Steven Casey, "Selling NSC-68: The Truman Administration, Public Opinion, and the Politics of Mobilization, 1950-51," *Diplomatic History* 29, no. 4 (September 2005): 655, https://doi.org/10.1111/j.1467-7709.2005.00510.x.

24 Susan D. Hyde and Elizabeth N. Saunders, "Recapturing Regime Type in International Relations: Leaders, Institutions, and Agency Space," *International Organization* 74, no. 2 (Spring 2020): 364, https://doi.org/10.1017/S0020818319000365.

25 José Antonio Cheibub, "Political Regimes and the Extractive Capacity of Governments: Taxation in Democracies and Dictatorships," *World Politics* 50, no. 3 (April 1998): 349–76, https://doi.org/10.1017/S0043887100012843; and Maria Melody Garcia and Christian von Haldenwang, "Do Democracies Tax More? Political Regime Type and Taxation," *Journal of International Development* 28, no. 4 (2016): 485–506, https://doi.org/10.1002/jid.3078.

26 Lawrence W. Kenny and Stanley L. Winer, "Tax Systems in the World: An Empirical Investigation into the Importance of Tax Bases, Administration Costs, Scale and Political Regime," *International Tax and Public Finance* 13, no. 2 (May 1, 2006): 181–215, https://doi.org/10.1007/s10797-006-3564-7; and Christopher J. Gerry and Tomasz M. Mickiewicz, "Inequality, Democracy and Taxation: Lessons from the Post-Communist Transition," *Europe-Asia Studies* 60, no. 1 (January 1, 2008): 89–111, https://doi.org/10.1080/09668130701760356.

Party in 2004 states that the collapse of the Soviet Union could be attributed to popular discontent generated by overly coercive state power, low standards of living, and overspending on defense.[27] While autocracies have greater latitude to use coercion, coercion is an expensive and ultimately inefficient means of tax collection. Both democratic and autocratic states face constraints when it comes to tax policy. It is critical to understand how state status and narratives shape the ability of leaders across regime types to stretch or overcome these constraints.

The history of dominant powers shows that debt burdens associated with the struggle to gain and hold onto power inevitably lead to financial decline.

Given that leaders in both democratic and non-democratic states seek to avoid short-term political costs, borrowing overwhelmingly looks more attractive than raising taxes.[28] Credit allows leaders to secure ample amounts of revenue without incurring the political cost of raising taxes.[29] Credit is accessible and cheap for great powers. Indeed, dominant powers do not rise without first developing new efficient forms of revenue.[30] Portugal in the 16th century, the Netherlands in the 17th century, and Great Britain in the 18th century all innovated their debt systems for maximum efficiency.[31] The Portuguese government relied on debt from select syndicates, the Dutch government relied on local, and then eventually national, debt with low interest rates, and the British government relied on institutionalized public borrowing based on the Dutch model.[32] Dominant states thus tend to have robust financial infrastructures that support borrowing the large sums that their militaries require. In addition to robust and innovative debt instruments, they have access to cheap and ample credit via their mature economies, currency status, and a robust global market for their debt.[33]

Borrowing, however, is a double-edged sword. States incur long-term economic costs as economically and socially productive spending is increasingly crowded out. Borrowing leads to lost investments in other areas of the economy, lower national savings and income, increased inequality, a growing share of government spending dedicated to interest payments, balance-of-payments difficulties, restricted fiscal flexibility (such as the ability to enact emergency stimulus packages), and overall greater risk of a fiscal crisis.[34] Additionally, the state can lose its monetary autonomy in the international arena as it becomes indebted to lenders outside its borders.[35] To continue to persuade others to hold its debt, a state may have to raise

27 Shambaugh and Brinley, *China's Communist Party*, chap. 4.

28 Tax-smoothing proponents argue that when a government faces an exogenous expenditure, tax rates should not necessarily adjust to achieve a balanced budget, as extreme tax increases distort microeconomic incentives. Robert J. Barro, "On the Determination of the Public Debt," *Journal of Political Economy* 87, no. 5, Part 1 (October 1979): 940–71, https://doi.org/10.1086/260807; and Robert E. Lucas and Nancy L. Stokey, "Optimal Fiscal and Monetary Policy in an Economy Without Capital," *Journal of Monetary Economics* 12, no. 1 (January 1983): 55–93, https://doi.org/10.1016/0304-3932(83)90049-1.

29 Matthew DiGiuseppe and Patrick E. Shea, "Borrowed Time: Sovereign Finance, Regime Type, and Leader Survival," *Economics & Politics* 28, no. 3 (November 2016): 342–67, https://doi.org/10.1111/ecpo.12081.

30 Gilpin, *War and Change in World Politics.*

31 To be sure, these states also innovated with regard to their fiscal systems, expanding the types of taxes to be collected as well as their amount. See Bartolome Yun-Casalilla, Patrick O'Brien, and Comin, Francisco Comin, eds., *The Rise of Fiscal States: A Global History, 1500–1914* (Cambridge, UK: Cambridge University Press, 2012).

32 Karen A. Rasler and William R. Thompson, "Global Wars, Public Debts, and the Long Cycle," *World Politics* 35, no. 4 (July 1983): 489–516, https://doi.org/10.2307/2010387. For Portugal, see Maria Eugénia Mata, "From Pioneering Mercantile State to Ordinary Fiscal State: Portugal 16th–19th Centuries," *Revista de Historia Económica / Journal of Iberian and Latin American Economic History* 25, no. 1 (2007): 123–45, https://doi.org/10.1017/S0212610900000070. For the Netherlands, see Maarten Roy Prak, *The Dutch Republic in the Seventeenth Century the Golden Age* (Cambridge, UK: Cambridge University Press, 2005); and Oscar Gelderblom and Joost Jonker, "Public Finance and Economic Growth: The Case of Holland in the Seventeenth Century," *Journal of Economic History* 71, no. 1 (March 2011): 1–39, https://doi.org/10.1017/S0022050711000015. For Great Britain, see P.G.M. Dickson, *The Financial Revolution in England: A Study in the Development of Public Credit, 1688-1756* (London: Macmillan, 1967).

33 For a typology of currency status and privileges associated with each status, see Susan Strange, *Sterling and British Policy: A Political Study of International Currency in Decline* (Oxford: Oxford University Press, 1971). For a discussion of the benefits the dollar receives as a "top" currency, see Jonathan Kirshner, "Dollar Primacy and American Power: What's at Stake?" *Review of International Political Economy* 15, no. 3 (July 31, 2008): 418–38, https://doi.org/10.1080/09692290801928798; and Matteo Maggiori, Brent Neiman, and Jesse Schreger, "International Currencies and Capital Allocation," *Journal of Political Economy* 128, no. 6 (June 2020): 2019–66, https://doi.org/10.1086/705688.

34 Grant A. Driessen, "Deficits, Debt, and the Economy: An Introduction," Congressional Research Service, April 15, 2019, https://sgp.fas.org/crs/misc/R44383.pdf; and David M. Andrews, ed., *International Monetary Power* (Ithaca, NY: Cornell University Press, 2006).

35 Benjamin J. Cohen, "Currency and State Power," in *Back to Basics*, ed. Martha Finnemore and Judith Goldstein (Oxford: Oxford University Press, 2013), 159–76; and Jonathan Kirshner, *Currency and Coercion: The Political Economy of International Monetary Power* (Princeton, NJ: Princeton University Press, 1997).

interest rates and, in turn, both raise the cost of borrowing and erode its macroeconomic flexibility.[36] Most notably, debt makes funding future national security spending more difficult.[37]

During the interwar period, the British Treasury was deeply concerned with increased borrowing to finance geostrategic competition with Germany. Increased borrowing, it was believed, would drive up inflation, undermining British trade. Moreover, in light of the inflationary experience of Weimar Germany and France, policymakers feared that inflation would damage the domestic economy by leading labor to demand higher wages, possibly through disruptive strikes. Richard Hopkins, a Treasury civil servant, explained,

> There is a great danger that we may find at the end of the rearmament period that we have built up our armed forces to a level that is far beyond our capacity to maintain. There is no more certain way of drifting into bankruptcy than to borrow for a temporary capital purpose and then to continue borrowing—with no end in sight—for normal current requirements.[38]

Sir Thomas Inskip, minister for coordination of defence, agreed:

> It [total to be spent on defence] is ... largely, if not entirely a question for the Treasury. I realise that the figure must be fixed with reference to the military situation—needs must when the devil drives—but except in circumstances that leave us with no alternative, I suggest that expenditure should not be contemplated on a scale which is likely to exhaust our financial resources. The question is how are we to reconcile the two desiderata, first to be safe, secondly, to be solvent.[39]

The history of dominant powers shows that debt burdens associated with the struggle to gain and hold onto power inevitably lead to financial decline.[40] Portugal declared bankruptcy and rescheduled its debt multiple times in the late 1500s. By the second half of the 17th century, military spending from wars with England and France had drained Dutch coffers. The country's debt was unsustainable. The state's ability to issue new debt dropped to record low levels as available savings dwarfed demand for capital from the state, and the Dutch parliament was unable to raise the necessary taxes to fund continual warfare.[41] As noted above, the British government, for its part, became increasingly concerned about financial overextension from debt taken on prior to World War I and during interwar rearmament.[42] In fact, borrowing dollars from the United States during World War II ensured Great Britain's financial decline. John Maynard Keynes described the drain of Britain's dollar and gold reserves as "without exaggerating and without implying that we should not recover from it, a financial Dunkirk."[43]

Conversely, states that have minimized their reliance on borrowing and relied on taxation have been able to generate military power even while sustaining economic growth and raising standards of living. A prime example is late-19th century Japan, which emerged from isolation to become a leading imperial power by the early 20th century. The reform-minded leaders of Meiji-era Japan eschewed foreign debt, which they feared might lead to colonial subjugation.[44] In their pursuit of autonomy and prestige, Meiji leaders therefore sought to build a domestic economy that could provide the revenue and production needed for national power

36 Cohen, "Currency and State Power," 163.

37 Linda Bilmes, "The Financial Legacy of Iraq and Afghanistan: How Wartime Spending Decisions Will Constrain Future National Security Budgets," HKS Faculty Research Working Paper Series RWP13-006, March 2013, https://www.hks.harvard.edu/publications/financial-legacy-iraq-and-afghanistan-how-wartime-spending-decisions-will-constrain.

38 Quoted in Robert Paul Shay Jr., *British Rearmament in the Thirties* (Princeton, NJ: Princeton University Press, 1977), 162.

39 Quoted in Shay, *British Rearmament in the Thirties,* 165.

40 Given financial overstretch caused by debt, scholars have focused on the ability to postpone debt repayment or deflect the cost of debt onto others. See, for example, Benjamin J. Cohen, "The Macrofoundations of Monetary Power," in *International Monetary Power,* ed. David M. Andrews (Ithaca, NY: Cornell University Press, 2006), 31–50.

41 On Dutch financial difficulties, see Prak, *The Dutch Republic,* chap. 5.

42 Shay, *British Rearmament in the Thirties,* 1977; and Aaron L. Friedberg, *The Weary Titan: Britain and the Experience of Relative Decline, 1895–1905* (Princeton, NJ: Princeton University Press, 1988).

43 Quoted in Cappella Zielinski, *How States Pay for Wars,* 80.

44 Marius B. Jansen, *The Making of Modern Japan* (Cambridge, MA: Belknap Press, 2002), 373. See also, Richard J. Samuels, *Machiavelli's Children: Leaders and Their Legacies in Italy and Japan* (Ithaca, NY: Cornell University Press, 2005), 78–79.

and a modern military, as encapsulated in the leading slogan of the era: "rich nation, strong army."[45] A key reform was the tax system instituted in the early 1870s, which provided the initial revenue needed to fund state-led development — an approach borrowed from Germany, another late developer.[46] By the 1880s, with the state on firmer fiscal ground, Japan began to invest in a modern navy and army. Pragmatic compromises between state leaders, military elites, and the new semi-democratic Diet enabled new and greater taxes to fund ever larger naval budgets.[47] Japan's military investments paid dividends with a seminal military victory in 1895 against a far larger China, the region's traditional great power, and, in 1905, the unprecedented defeat of Russia, a European power that ranked far ahead of Japan in almost all major measures of national power.[48] And yet, this tax-financed military investment did little to blunt Japan's economic growth. Despite enormous expenditures during the Russo-Japanese War, Japan quickly recovered and, until 1938, enjoyed annual economic growth that exceeded most of the era's great powers.[49]

Paying the defense bill for geostrategic competition will involve some combination of drawing revenue from taxes as well as debt. So, when does the balance tip to emphasize debt financing over taxation? The answer to this question is critical for understanding not just the rise and fall of dominant powers but also the timing of hegemonic power shifts.

Navigating the Intertemporal Dilemma to Finance Geostrategic Rivalry

Geopolitical competition between dominant powers and rising challengers often lasts decades, if not longer. Accordingly, financing the military is necessary for a considerable amount of time. Such long time horizons present a tradeoff for leaders and their citizenry: how and when to make fiscal sacrifices today for benefits accrued in the often-distant future. When considering how to pay the military spending bill, leaders are concerned with both succeeding in the geostrategic rivalry and staying in power. As discussed above, it is politically costly for leaders to raise revenue. Taxation directly extracts money from citizens and can draw attention to the state's geostrategic strategy and the potential costs and rewards associated with it.[50] In addition to political costs, leaders must consider revenue sustainability. Such stability is critical as policymakers plan: Long-term investments in national power, such as shipbuilding plans, can last many years. Financing strategies also have implications for the long-term health of the economy. Borrowing and taxation have distributional and inflationary effects that can undermine state solvency and credit. Thus, leaders not only have to manage direct political costs in the short and long term, but also revenue sustainability and short- and long-term economic costs, which can impose indirect political costs.

The United States faced this dilemma near the beginning of the Cold War. By 1948, just three years after the end of World War II, the State Department and the military services were warning of a coming long-term competition with a rearming Soviet Union. The State Department advised the secretary of defense on the need to "maintain a permanent state of adequate military preparation."[51] The chairman of the Joint Chiefs, Omar Bradley, proposed defense budgets that would prepare the United States "for the long pull."[52] As NSC-68, a deeply influential strategic assessment delivered to the president in 1950, put it, failure to prepare now — including through an almost five-fold increase in the defense budget — would "risk the future."[53]

Foreign policy officials worried that Americans

45 Richard J. Samuels, *"Rich Nation, Strong Army": National Security and the Technological Transformation of Japan* (Ithaca, NY: Cornell University Press, 1994).

46 Andrew Gordon, *A Modern History of Japan: From Tokugawa Times to the Present* (New York: Oxford University Press, 2003), 70–72.

47 J. Charles Schencking, *Making Waves: Politics, Propaganda, and the Emergence of the Imperial Japanese Navy, 1868-1922* (Stanford, CA: Stanford University Press, 2005), 105.

48 Kennedy, *The Rise and Fall of the Great Powers*, 199–203.

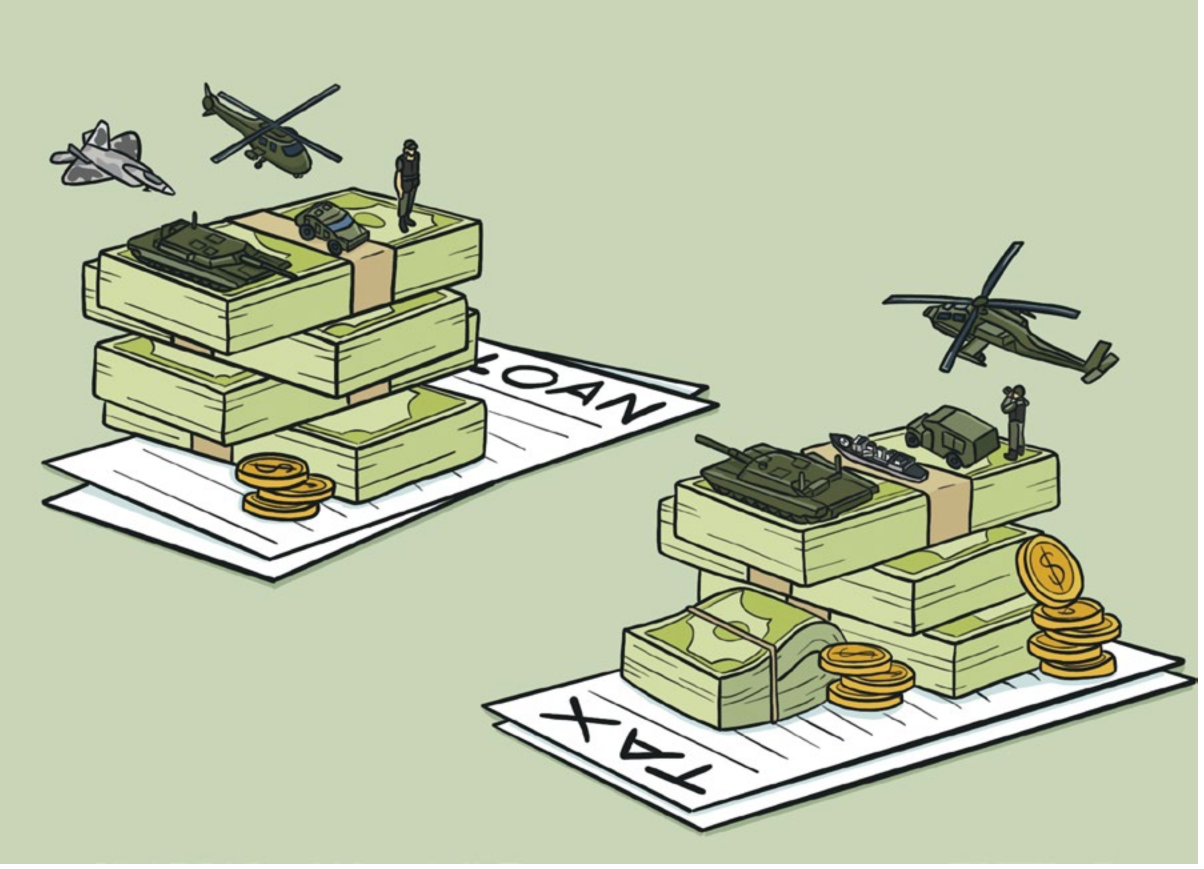
49 Takao Matsumura and John Benson, *Japan 1868-1945: From Isolation to Occupation* (Abingdon, UK: Routledge, 2014), chap. 4.

50 Stacie E. Goddard and Ronald R. Krebs, "Rhetoric, Legitimation, and Grand Strategy," *Security Studies* 24, no. 1 (2015): 5–36, https://doi.org/10.1080/09636412.2014.1001198.

51 Quoted in Warner R. Schilling, Paul Y. Hammond, and Glenn H. Snyder, *Strategy, Politics & Defense Budgets* (New York: Columbia University Press, 1962), 9.

52 Schilling, Hammond, and Snyder, *Strategy, Politics & Defense Budgets*, 9.

53 "National Security Council Report, NSC-68: 'United States Objectives and Programs for National Security,'" National Security Council, April 14, 1950, accessed at Wilson Center, Digital Archives, https://digitalarchive.wilsoncenter.org/document/national-security-council-report-nsc-68-united-states-objectives-and-programs-national; Casey, "Selling NSC-68"; and John Lewis Gaddis, *Strategies of Containment: A Critical Appraisal of American National Security Policy During the Cold War* (New York: Oxford University Press, 2005), chap. 4.



had little appetite to shift to a permanent war footing, which would have required higher taxes and curtailed social programs, and they therefore feared that the United States would be unprepared to deter a rearming Soviet Union.[54] After World War II, both the Republican and Democratic parties saw political advantage in rolling back the wartime expansion of the federal government. Republicans rode a platform of major tax cuts to take control of Congress in 1946.[55] President Harry Truman's 1950 State of the Union address was met with bipartisan applause when he proposed to balance the budget by holding "federal expenditures … to the lowest levels" possible.[56] While the shock of the Korean War initially allowed Truman to raise taxes to fund new defense spending, public support soon waned. Following his election in 1952 on a low-tax platform, President Dwight Eisenhower rejected the Truman administration's plans to ratchet up defense budgets.[57] As the new president noted, the dilemma of long-term competition was to maintain political support for fiscal sacrifice to invest in the future: "It is not easy to convince an overwhelming majority of free people, everywhere, that they should pull in their belts, endure marked recessions in living standards […] while bearing the expenses and costs of battle in more fortunate countries."[58]

As the American Cold War example suggests, an intertemporal framework is needed to understand how leaders approach the political and economic trade-offs inherent in funding competition. We argue that leaders of rising challengers have a distinct advantage in establishing sustainable revenue extraction. Rising states are at a relative disadvantage in the present but, as they grow in power, stand to reap huge rewards shared widely across the population. Leaders of these countries can frame the immediate sacrifice of taxes as an investment in

54 Friedberg, *In the Shadow of the Garrison State.*

55 Sven Steinmo, *Taxation and Democracy: Swedish, British, and American Approaches to Financing the Modern State* (New Haven, CT; London: Yale University Press, 1993), 136.

56 Casey, "Selling NSC-68"; and Harry S. Truman, "Special Message to the Congress Reporting on the Situation in Korea," July 19, 1950, accessed at the American Presidency Project, https://www.presidency.ucsb.edu/documents/special-message-the-congress-reporting-the-situation-korea.

57 "Report to the National Security Council by the Secretaries of State and Defense and the Director for Mutual Security [NSC 141]," Jan. 19, 1953, Foreign Relations of the United States, 1952–1954, National Security Affairs, Volume II, Part 1, Office of the Historian, https://history.state.gov/historicaldocuments/frus1952-54v02p1/d42.

58 Gaddis, *Strategies of Containment,* 131.

the nation's long-term future.[59] This approach aims to increase taxpayers' time horizons and increase the weight they put on potential future gains relative to short-term costs.[60] Individuals systematically engage in wishful thinking when considering the future. In particular, individuals with long time horizons tend to put more weight on the probability of future gains while ignoring the obstacles that they will need to overcome to attain them. They tend to see these distant gains as greater than they are, while discounting the present cost of pursuing them.[61] Thus, leaders of rising challengers can frame the price of geopolitical competition as a smart investment in the long term, with plentiful gains accruing to a broad swath of the state's citizens. This framing, more readily available to leaders of rising states, can lower the political cost of paying for geopolitical competition through taxation.

We return to the example of Meiji-era Japan, a rising power that was able to break into the ranks of the great powers in part because of the effectiveness with which it extracted resources from its domestic economy. As discussed above, aware of the nation's military and economic vulnerability, "the major preoccupation of the Meiji government was to create a sound fiscal base for its needs."[62] Although the country was a constitutional monarchy, Meiji leaders notably paid heed to public opinion. In 1890, the creation of a weak national Diet that nonetheless held real budgetary power meant that Meiji leaders could not afford to ignore the elite segment of the public that could vote.[63] So, while coercion played an important role in early Meiji state-building — including the suppression of farmer protests and samurai rebellions — the government also sought to motivate fiscal sacrifice in the name of broad-based national prosperity by building a shared national identity. As Richard Samuels writes, Meiji leadership intentionally constructed a "shared dominant memory" and a "'national essence' (*kokusai*)," or "the symbolic order that would unite the archipelago and enable Japan to achieve parity with the West."[64] Personal sacrifice was encouraged in the name of the emperor, and the government's founding documents promised a more prosperous, meritocratic, and internationally secure state.[65] Whenever new revenue was needed, the government could justify taxes as an investment in the nation's future. Industrialization and military power would enable Japan to catch up to the West and pursue the benefits of empire: prestige, security, and long-term prosperity.[66]

Military spending increased eight-fold between 1873 and 1903, from ¥10.4 to 83 million, and grew from one-eighth to one-third of total national expenditure.[67] The vast majority was paid for with tax revenue. Starting in the early 1870s, the Meiji state implemented a series of taxes. In 1873, the state introduced a "remarkably equitable" nationwide, standardized tax on land.[68] Between 1873 and 1893, as military spending doubled as a share of the national budget, the government introduced new taxes on alcohol, tobacco, sugar, and other luxuries, as well as on imports.[69] Victory over China in 1895 reinforced the value of these sacrifices. Fukuzawa Yukichi, the era's leading intellectual, encapsulated the national response to Japan's victory: "the one thing none of us Western scholars expected, thirty or forty years ago, was the establishment of Japan's imperial prestige in a great war. … When I think of our marvelous fortune, I feel as though in a dream and can only weep tears of joy."[70] Building on this success, the government increased taxes to support further investment in military power. Between 1895 and 1904, on the eve of Japan's victory over

59 Jonathan Renshon, *Fighting for Status: Hierarchy and Conflict in World Politics* (Princeton, NJ: Princeton University Press, 2017); Steve Wood, "Nations, National Identity and Prestige," *National Identities* 16, no. 2 (April 3, 2014): 99–115, https://doi.org/10.1080/14608944.2014.897315; and Deborah Welch Larson and Alexei Shevchenko, "Status Seekers: Chinese and Russian Responses to U.S. Primacy," *International Security* 34, no. 4 (April 2010): 63–95, https://doi.org/10.1162/isec.2010.34.4.63.

60 Ronald R. Krebs and Aaron Rapport, "International Relations and the Psychology of Time Horizons," *International Studies Quarterly* 56, no. 3 (September 2012): 530–43, https://doi.org/10.1111/j.1468-2478.2012.00726.x.

61 Krebs and Rapport, "International Relations and the Psychology of Time Horizons," 532; Philip Streich and Jack S. Levy, "Time Horizons, Discounting, and Intertemporal Choice," *Journal of Conflict Resolution* 51, no. 2 (April 2007): 199–226, https://doi.org/10.1177/0022002706298133, 204–205.

62 E. Sydney Crawcour, "Economic Change in the Nineteenth Century," in *The Cambridge History of Japan: Volume 5: The Nineteenth Century*, ed. Marius B. Jansen (Cambridge, UK: Cambridge University Press, 1989), 606.

63 Schencking, *Making Waves*.

64 Samuels, *Machiavelli's Children*, 34.

65 Jansen, *The Making of Modern Japan*, chap. 12.

66 W. G. Beasley, *Japanese Imperialism 1894-1945* (Oxford: Clarendon Press, 1991), 78–79.

67 Schencking, *Making Waves*, 47 and 104.

68 Samuels, *Machiavelli's Children*, 80.

69 Cappella Zielinski, *How States Pay for Wars*, chap. 5.

70 Quoted in Samuels, *Machiavelli's Children*, 102–03.

Russia, tax revenue had doubled.[71]

By dint of their position in the international system, dominant states have little to gain and much to lose from changes to the *status quo*. Such states struggle to finance competition through direct taxation. The challenge is that the fact of relative decline means that the future is unlikely to be as bright as the present. Leaders of dominant powers have a harder time convincing citizens that taxes are a worthwhile investment: Further investment in military power may be necessary to preserve the state's status in the immediate term, but it is unlikely to increase relative prestige or prosperity over the long term. In short, leaders in dominant states are at a disadvantage when attempting to extend taxpayers' time horizons. With these shorter time horizons, citizens tend to be less optimistic about future payoffs, more skeptical that the state can achieve its aims, and more focused on immediate costs.[72] Moreover, analyses of long-term policymaking suggest that domestic interest groups often seek to shift short-term burdens onto other segments of society rather than pay to invest in a long-term solution.[73] Taken together, these dynamics generate political incentives for leaders to avoid the high cost of competition for as long as possible.[74] Less likely to successfully extend their citizens' time horizons, leaders in dominant states tend to resort to lower-salience debt to pay for military power. While this reduces the political costs leaders face in the short term, it also undermines the political and economic sustainability of competition over the long term.

There are many well-known examples of great powers declining due to an unsustainable reliance on external debt. Take, for example, the economy of 18th-century France, which was marred by the country's intervention in the American Revolutionary War. Although France took on far less debt than Great Britain to finance its involvement, it borrowed at much higher rates. Whereas Great Britain quickly took measures after the war to bring its fiscal house into order, France entered a cycle of ever-growing deficits, declining credit, and rising interest payments, generating insolvency and instability that contributed to the collapse of the French monarchy.[75] Or consider Austria-Hungary, which never established an economic base strong enough to resource its many security challenges. The state financed war and competition with external debt and, consequently, throughout the 18th century interest payments "typically accounted for a volume of state expenditure … second only to the army." This debt "constrain[ed] strategic options and require[d] military retrenchment in peacetime."[76]

Sixteenth century Imperial Spain is perhaps the most emblematic case of this phenomenon. Spain became "the most powerful nation in the Western world since the Roman empire" in the mid-16th century, as precious metals poured in from its colonies in the New World.[77] Even as the flow of resources began to slow in the early 17th century, Spain continued to wage wars to defend and expand its empire. As Paul Kennedy writes, "a long slow decline was inevitable" as Spain "consistently spent two to three times more than ordinary revenues provided."[78] Spain borrowed to finance its wars, devoting as much as two-thirds of state revenue to interest payments in the late 1600s. By the end of the century, Spain's ratio of debt to state revenue stood at roughly "ten to one."[79] Saddled by this enormous debt, Spain faded from the ranks of the great European powers.

U.S.-Chinese Competition and Fiscal Sustainability

The United States: A Dominant Power Faces a New Challenger

Over the past half-decade, a consensus has emerged in Washington that the United States is entering a period of long-term competition with a revisionist China. Following the assessments of the Trump administration, the Biden administration has identified the Indo-Pacific as its "priority

71 Cappella Zielinski, *How States Pay for Wars*, chap. 5; and Schencking, *Making Waves*, 2016.

72 Krebs and Rapport, "International Relations and the Psychology of Time Horizons," 532.

73 Paul Pierson, *Dismantling the Welfare State? Reagan, Thatcher and the Politics of Retrenchment* (Cambridge, UK: Cambridge University Press, 1995), 19–20; and Alan M. Jacobs, "The Politics of When: Redistribution, Investment and Policy Making for the Long Term," *British Journal of Political Science* 38, no. 2 (April 2008): 194, https://doi.org/10.1017/S0007123408000112.

74 David M. Edelstein, *Over the Horizon: Time, Uncertainty, and the Rise of Great Powers* (Ithaca, NY: Cornell University Press, 2017).

75 Kennedy, *The Rise and Fall of the Great Powers*, 84.

76 A. Wess Mitchell, *The Grand Strategy of the Habsburg Empire*, reprint (Princeton, NJ: Princeton University Press, 2019), 67–69.

77 Douglass C. North, *Institutions, Institutional Change and Economic Performance* (Cambridge, UK: Cambridge University Press, 1990), 115, as quoted in Michael J. Mazarr, *The Societal Foundations of National Competitiveness*, (Santa Monica, CA: RAND Corporation, June 21, 2022), https://doi.org/10.7249/RRA499-1, 64, fn116.

78 Kennedy, *The Rise and Fall of the Great Powers*, 48.

79 Mazarr, "The Societal Foundations of National Competitiveness," 64.

theater" and the People's Liberation Army as the "pacing challenge" that must guide military planning.[80] Washington plans to simultaneously recapitalize its air, naval, and ground forces; strengthen capabilities in the space and cyber domains; adopt new technologies, like advanced computing, artificial intelligence, and robotics; and modernize almost all elements of the U.S. nuclear force.[81] The bill for these plans will be daunting. There is a growing consensus among defense analysts that, under current projections, future budgets will not provide the funds necessary even to meet current planned spending, let alone these new projects.[82]

Defense analysts recognize that aligning defense spending with current priorities is complicated by U.S. fiscal challenges.[83] While the United States has sustained borrowing at low interest rates for decades, U.S. sovereign debt and net interest payments are on track to increase exponentially in the coming years. In 2023, U.S. sovereign debt reached 98 percent of GDP. The Congressional Budget Office projects that debt will increase to 118 percent of GDP by 2033 and to 195 percent in 2053, or more than $100 trillion.[84] While net interest payments in 2022 were below U.S. average net interest payments since 1973, the Congressional Budget Office projects interest payments to rapidly increase to 2.7 percent of GDP ($739 billion) in 2024 and 3.6 percent in 2033 ($1.4 trillion). By 2033, net interest payments will be the single largest line item in the national budget.[85]

How will these bills be paid? Taxes — and progressive direct taxes in particular — provide a sustainable source of revenue, have the added benefit of reducing economic inequality, and are ideal for financing sustained military geopolitical competition. The easiest political choice is to ignore the rising U.S. debt burden and continue to finance competition through borrowing. Doing so may be cheap in the short run, but in the long run is likely to lead to overstretch. Unless the current or future administrations are willing and able to dramatically scale back U.S. foreign policy or domestic spending, they will have to convince Americans to accept higher taxes. Is this possible?

There is certainly capacity for higher tax rates. The United States ranks 32nd out of 38 Organisation for Economic Co-operation and Development countries in tax-to-GDP ratio.[86] Yet, it has become increasingly hard to raise taxes in the United States. Few, if any, Americans favor higher tax rates. A Gallup opinion tracker has found that, since 2003, about 50 percent of Americans consider taxes to be too high, while 46 percent of Americans consider them to be about right.[87] There is growing support for increasing taxes on the rich, but opposition to any new taxes is still high, especially among conservative Americans.[88] More importantly, Americans would rather reduce government services than pay more taxes.

The Biden administration recently signaled that it wants to raise progressive direct taxes on the

80 *Summary of the 2018 National Defense Strategy*, Department of Defense, 2018, https://dod.defense.gov/Portals/1/Documents/pubs/2018-National-Defense-Strategy-Summary.pdf; *National Security Strategy*, The White House, October 2022, https://www.whitehouse.gov/wp-content/uploads/2022/10/Biden-Harris-Administrations-National-Security-Strategy-10.2022.pdf; and *National Defense Strategy*, Department of Defense, 2022, https://media.defense.gov/2022/Oct/27/2003103845/-1/-1/1/2022-NATIONAL-DEFENSE-STRATEGY-NPR-MDR.PDF.

81 Eaglen, *The 2020s Tri-Service Modernization Crunch*; "FACT SHEET: President Biden's Budget Keeps America Safe and Confronts Global Challenges," The White House, March 9, 2023, https://www.whitehouse.gov/briefing-room/statements-releases/2023/03/09/fact-sheet-president-bidens-budget-keeps-america-safe-and-confronts-global-challenges/.

82 The Congressional Budget Office projects that the Department of Defense's existing spending plans will require "inflation-adjusted budget growth of 10 percent between 2026 and 2035," "with nearly 70 percent of that increase dedicated to O&M [Operations and Maintenance] and further funding of military personnel." Cancian, *U.S. Military Forces in FY 2021*, 9.

83 Edelman, *Providing for the Common Defense*, 63.

84 "The Budget and Economic Outlook: 2023 to 2033," U.S. Congressional Budget Office, Feb. 15, 2023, https://www.cbo.gov/publication/58848; and Brian Riedl, "Behind CBO's $100 Trillion in Projected Deficits Over 30 Years," Manhattan Institute, Nov. 19, 2020, https://media4.manhattan-institute.org/sites/default/files/behind-CBOs-100-trillion-projected-deficits-BR.pdf.

85 U.S. Congressional Budget Office, "The Budget and Economic Outlook: 2023 to 2033."

86 "Revenue Statistics 2022 - the United States," Organisation for Economic Co-operation and Development, Centre for Tax Policy and Administration, 2022, https://www.oecd.org/tax/revenue-statistics-united-states.pdf.

87 "Taxes," Gallup, April 13, 2007, https://news.gallup.com/poll/1714/Taxes.aspx; and Lydia Saad "Half in U.S. Think Their Taxes Too High, but Also 'Fair,'" Gallup, May 6, 2021, https://news.gallup.com/poll/349541/half-think-taxes-high-fair.aspx. In 2019, a Pew research survey found a similar result. When asked to consider their own tax burden, 51 percent of adults said that they pay more than their fair share in taxes, considering what they get from the federal government. Fewer adults (40 percent) said that they pay about the right amount. Just 8 percent said that they pay less than their fair share in taxes. "Domestic Policy: Views of Taxes, Environment, Health Care," Pew Research Center - U.S. Politics & Policy, Dec. 17, 2019, https://www.pewresearch.org/politics/2019/12/17/7-domestic-policy-taxes-environment-health-care/. To be sure, Americans are not in favor of tax cuts either. The Trump administration tax cuts, known as Tax Cuts and Job Acts, were unpopular. Approval peaked in April 2019 at 40 percent. See Gallup, "Taxes."

88 Frank Newport, "Americans' Long-Standing Interest in Taxing the Rich," Gallup, Feb. 22, 2019, https://news.gallup.com/opinion/polling-matters/247052/americans-long-standing-interest-taxing-rich.aspx; and Pew, "Domestic Policy."

wealthy and corporate taxes to reduce deficits, fund social programs, and invest in defense.[89] As White House Senior Adviser Anita Dunn wrote in a memo for her White House associates, "The President believes that we need to restore basic fairness to the tax code, and in the process generate revenues to invest in our competitiveness, children, and economy. And, the American people agree."[90] But, the Biden administration backed away from most of its proposed tax increases in 2022.[91] The president's latest tax-heavy budget proposal is unlikely to pass a Republican-held House of Representatives.[92]

With little public appetite for increased taxes, the Biden administration will have to convince Americans that they have something to gain from any proposed fiscal sacrifice. To be sure, Americans see China as the greatest threat to U.S. interests. A recent Gallup poll found that Americans view China as America's "greatest enemy [more] than any other nation by a wide margin."[93] In March 2023, more than two-thirds of respondents considered China to be a "critical" military and economic threat to the United States over the next decade and over 90 percent saw China as at least an "important" threat.[94] In regards to economic power, since 2000, Americans have alternated between choosing China or the United States as the leading economic power, often influenced by the current health of the U.S. economy. A separate question in the survey asks Americans which country they think will be the leading economic power in 20 years. The public's views are more evenly split on this question, with 46 percent choosing China and 40 percent choosing the United States.[95] In a Pew Research Center Survey, among the roughly one-fifth of Americans who mentioned the economy when thinking about China, many described the country as a manufacturing powerhouse, highlighted the quality of products made there, or discussed other facets of its economy, including trade policies, working conditions, intellectual property, and the ways in which China is a global economic leader.[96] Despite these concerns, popular support for more defense spending has remained largely unchanged over the last decade.[97]

But is the public's keen awareness of the threat that China poses enough to lower the political costs of raising taxes to finance competition? Framing sacrifice today as an investment in future gains could help reduce the political cost of taxation. However, as the leader of a dominant power, President Joe Biden is at a disadvantage in making this argument: It will be hard to convince U.S. citizens that staving off China can do anything beyond maintain the *status quo*. In fact, a narrative of national decline has become prevalent in the national discourse, as exemplified by President Donald Trump's January 2017 inaugural address.[98] The Biden administration has attempted to extend time horizons by framing competition as a path to "a brighter future" and arguing that choices today will affect the country's competitive position "long into the future."[99] But in public statements, the administration has also struggled to avoid framing U.S. geostrategic competition as a battle to reverse American decline. In his most recent budget proposal, Biden promised to "restore American leadership on the world stage."[100] In April 2021, he

89 Erica York, Garrett Watson, and Alex Durante, "Biden's FY2024 Budget Would Result in More than $4.5 Trillion in Gross Tax Increases," *Tax Foundation*, March 9, 2023, https://taxfoundation.org/biden-budget-taxes/.

90 Frank Newport, "U.S. Public Opinion and Increased Taxes on the Rich," Gallup, June 4, 2021, https://news.gallup.com/opinion/polling-matters/350555/public-opinion-increased-taxes-rich.aspx.

91 Jeff Stein, "Democrats' Lofty Tax Agenda Imperiled by Resistance from Within," *Washington Post*, Nov. 11, 2021, https://www.washingtonpost.com/us-policy/2021/11/11/billionaire-tax-democrats-wyden/; and Lauren Fedor and James Politi, "Democrats' Proposed Billionaires Tax Collapses After Resistance from Moderates," *Financial Times*, Oct. 28, 2021, https://www.ft.com/content/38770267-8fed-49a9-a85a-1b9cc2e45d60.

92 *Budget of the U.S. Government: Fiscal Year 2024*, Office of Management and Budget, The White House, 2023, https://www.whitehouse.gov/wp-content/uploads/2023/03/budget_fy2024.pdf.

93 Megan Brenan, "Record-Low 15% of Americans View China Favorably," Gallup, March 7, 2023, https://news.gallup.com/poll/471551/record-low-americans-view-china-favorably.aspx.

94 Brenan, "Record-Low 15% of Americans View China Favorably."

95 Mohamed Younis, "New High in Perceptions of China as U.S.'s Greatest Enemy," Gallup, March 16, 2021, https://news.gallup.com/poll/337457/new-high-perceptions-china-greatest-enemy.aspx.

96 Shannon Schumacher and Laura Silver, "In Their Own Words: What Americans Think About China," Pew Research Center, March 4, 2021, https://www.pewresearch.org/fact-tank/2021/03/04/in-their-own-words-what-americans-think-about-china/.

97 "Military and National Defense," Gallup, accessed March 13, 2023, https://news.gallup.com/poll/1666/military-national-defense.aspx.

98 Donald Trump, "Full Text: 2017 Donald Trump Inauguration Speech Transcript," *Politico*, Jan. 20, 2017, https://www.politico.com/story/2017/01/full-text-donald-trump-inauguration-speech-transcript-233907.

99 The White House, *National Security Strategy* (2022).

100 The White House, "FACT SHEET: President Biden's Budget Keeps America Safe and Confronts Global Challenges."

stated that "China and other countries are closing in fast."[101] When promoting his plans to invest in infrastructure, the Biden administration framed the legislation around avoiding loss. Biden stated, "somewhere along the way, we stopped investing. And we're at risk of losing our edge as a nation to China and the rest of the world that's catching up and surpassing us in some areas."[102]

To be sure, there are gains to be had for the American people, but they have been framed as regaining what has been lost and ensuring prosperity, rather than as new riches to be acquired. As Biden emphasized in a November 2021 speech,

> [W]e'll also take on directly the challenges posed by our prosperity, security, and democratic values by our most serious competitor, China. . . . We will compete from a position of strength by building back better at home, working with our allies and partners, renewing our role in international institutions, and reclaiming our credibility and moral authority, much of which has been lost.[103]

The best possible outcome is a return to the *status quo*:

> If we invest in ourselves and our people, if we fight to ensure that American businesses are positioned to compete and win on the global stage, if the rules of international trade aren't stacked against us, if our workers and intellectual property are protected, then there's no country on Earth — not China or any other country on Earth — that can match us.[104]

The United States is in the beginning of a potentially decades-long geostrategic competition with China. Retrenchment of U.S. international commitments or social spending is unlikely. Shifting funds within the U.S. defense budget would also run up against entrenched interests and a sclerotic, reform-resistant acquisition process. To fully fund U.S. defense strategy on a sustainable basis, it is therefore vital that the Biden administration raise taxes. Continued borrowing will add to a level of U.S. debt that will increasingly crowd out discretionary spending and may become unsustainable over the next decade. Even without increased defense spending, U.S. debt will continue to grow: Spending on mandatory programs, like Social Security, the largest government program, as well as Medicare and Medicaid, is set to explode over the next decade. And the Trump administration's signature tax cuts are expected to add roughly $1.8 trillion to the debt over the next decade.[105] And yet, U.S. politicians continue to seek to avoid the political cost of raising taxes: The current administration succeeded in only minor — and potentially reversible — revenue expansion. Framing competition as necessary to simply stall America's decline is not likely to motivate the American people to sacrifice their hard-earned income. As U.S. presidents seek to mobilize the country for long-term competition, they should make the case that present sacrifices can lead to a brighter, more prosperous future.

The People's Republic of China: Financing Competition Amid Slowing Growth

Wary of U.S. intentions and power, China's leadership sees the country as locked in a long-term competition with the United States.[106] In 1989, Chinese leader Deng Xiaoping stated that "it appears one Cold War has come to an end but that two others have begun." His successor, Jiang Zemin, predicted that the contest with the United States would be "long-term and complex."[107] The United States was identified as the main foreign obstacle to the long-sought aim of achieving "national rejuvenation," or "the nationalist dream of rebuilding a prosperous

101 "Remarks by President Biden in Address to a Joint Session of Congress," The White House, April 29, 2021, https://www.whitehouse.gov/briefing-room/speeches-remarks/2021/04/29/remarks-by-president-biden-in-address-to-a-joint-session-of-congress/.

102 "Remarks by President Biden on the Bipartisan Infrastructure Law," The White House, Dec. 1, 2021, https://www.whitehouse.gov/briefing-room/speeches-remarks/2021/11/30/remarks-by-president-biden-on-the-bipartisan-infrastructure-law-3/. Similar remarks have been made regarding the supply-chain crisis and U.S. industry. See "Remarks by President Biden on Increasing the Supply of Semiconductors and Rebuilding Our Supply Chains," The White House, Jan. 21, 2022, https://www.whitehouse.gov/briefing-room/speeches-remarks/2022/01/21/remarks-by-president-biden-on-increasing-the-supply-of-semiconductors-and-rebuilding-our-supply-chains/.

103 "Remarks by President Biden on America's Place in the World," The White House, Feb. 5, 2021, https://www.whitehouse.gov/briefing-room/speeches-remarks/2021/02/04/remarks-by-president-biden-on-americas-place-in-the-world/.

104 The White House, "Remarks by President Biden on America's Place in the World."

105 James McBride and Anshu Siripurapu, "The National Debt Dilemma," Council on Foreign Relations, Oct. 1, 2021, https://www.cfr.org/backgrounder/national-debt-dilemma.

106 Andrew Scobell et al., *China's Grand Strategy: Trends, Trajectories, and Long-Term Competition* (Santa Monica, CA: RAND Corporation, July 24, 2020), https://doi.org/10.7249/RR2798, 8–9.

107 Rush Doshi, *The Long Game: China's Grand Strategy to Displace American Order* (Oxford: Oxford University Press, 2021), 47–54.

and powerful China."[108] National rejuvenation entails ambitious goals to bring the international system into greater alignment with China's national interests. Central to these aims is the development of a "world-class" military capable of dominating the Western Pacific and projecting power across the globe to protect China's expanding overseas interests.[109] The Chinese Communist Party has recently abandoned Deng Xiaoping's dictum that China "hide its capabilities and bide its time" in favor of the more active pursuit of power. This shift has contributed to increased U.S.-Chinese tensions. As Chinese leader Xi Jinping declared in March 2023, "Western countries led by the United States have implemented all-around containment, encirclement, and suppression of China."[110]

The ample revenue provided by the 1994 tax reform allowed the [Chinese] government to translate economic growth into military power without extensive borrowing by the central government. Indeed, defense spending has increased at an average rate of 14 percent since 1990.

Three decades of military modernization financed by an overhauled tax system have given China a strong foundation for competing with the United States. In 1994, China revamped its fiscal system, providing the central government with ample revenue with which to fund military modernization. Over the course of the decade, the defense budget increased at a double-digit average annual rate.[111] Under Xi, the Chinese Communist Party has accelerated reforms for the People's Liberation Army. In 2014, the party kicked off a broad reform of the army to cut waste and prepare it for the rigors of modern warfare.[112] The official defense budget reached $230 billion in 2022. Actual military-related spending is estimated to be 30–40 percent higher.[113]

And yet, Chinese officers, policy officials, and defense analysts consistently warn that the People's Liberation Army does not have the resources it needs.[114] Gaps remain between army capabilities and China's ambitions. The former must remedy shortcomings in the quality of its personnel, in its ability to project power, and in its ability to carry out modern joint operations.[115] Modernization remains incomplete: China plans to build a blue-water navy, possibly including nuclear-powered aircraft carriers, to secure overseas access and bases, to develop expeditionary capabilities, and to invest in a larger and more diversified nuclear arsenal.[116] The cost of military modernization is only likely to rise as China turns to these more technology-intensive capabilities and seeks to attract better educated and more skilled personnel to manage increasingly complex equipment.[117] As one prominent Chinese official has stated, "relying solely on state finances for defense investment, we are already unable to support major advances in the development of our

108 Goldstein, "China's Grand Strategy Under Xi Jinping," 167.

109 Goldstein, "China's Grand Strategy Under Xi Jinping," 188; and Isaac B. Kardon, "China's Global Maritime Access: Alternatives to Overseas Military Bases in the Twenty-First Century," *Security Studies* 31, no. 5 (2022): 885–916, https://doi.org/10.1080/09636412.2022.2137429.2021

110 Keith Bradsher, "China's Leader, with Rare Bluntness, Blames U.S. Containment for Troubles," *New York Times*, March 7, 2023, https://www.nytimes.com/2023/03/07/world/asia/china-us-xi-jinping.html.

111 Michael S. Chase et al., *China's Incomplete Military Transformation: Assessing the Weaknesses of the People's Liberation Army (PLA)* (Santa Monica, CA: RAND Corporation, 2015), https://www.rand.org/pubs/research_reports/RR893.html, 14; and Thomas J. Christensen, "Posing Problems Without Catching Up: China's Rise and Challenges for U.S. Security Policy," *International Security* 25, no. 4 (2001): 5–6, https://doi.org/10.1162/01622880151091880.

112 Phillip C. Saunders et al., eds., *Chairman Xi Remakes the PLA: Assessing Chinese Military Reforms* (Washington, DC: National Defense University Press, 2019).

113 Jon Grevatt and Andrew MacDonald, "China Increases 2022 Defence Budget by 7.1%," *Janes*, March 7, 2022, https://www.janes.com/defence-news/news-detail/china-increases-2022-defence-budget-by-71. On the gap between official and actual defense spending, see China Power Team, "What Does China Really Spend on Its Military?" *China Power*) April 19, 2022, https://chinapower.csis.org/military-spending/; and Adam P. Liff and Andrew S. Erickson, "Demystifying China's Defence Spending: Less Mysterious in the Aggregate," *China Quarterly*, no. 216 (December 2013): 805–30, https://doi.org/10.1017/S0305741013000295.

114 Lafferty, "Civil-Military Integration and PLA Reforms."

115 Chase et al., *China's Incomplete Military Transformation*.

116 *Military and Security Developments Involving the People's Republic of China 2021*, Department of Defense, 2021, https://media.defense.gov/2021/Nov/03/2002885874/-1/-1/0/2021-CMPR-FINAL.PDF.

117 Office of the Secretary of Defense, *Military and Security Developments Involving the People's Republic of China 2023*, 36–37; Gilli and Gilli, "Why China Has Not Caught Up Yet," 2019; and Brooks and Wohlforth, "The Rise and Fall of the Great Powers in the Twenty-First Century."

defense."[118] Perhaps recognizing this gap between the means and ends of military modernization, Xi has promoted greater integration of civilian and defense industries to broaden the pool of resources available to the military.[119]

As a rising power, China has relied almost entirely on tax revenue to fund its military modernization. The 1994 reforms thus had two key purposes: First, the reforms increased the share of revenue controlled by the central government from 22 percent in 1993 to 56 percent in 1994.[120] Second, the reforms jump-started growth in government revenue as a percentage of GDP. Beijing established a new national tax administration and introduced a business tax, corporate income tax, an individual income tax, and taxes on property and land transactions.[121] This replaced the older, disaggregated, unwieldy system, which relied in part on profit remittances from state-owned enterprises, and helped to disentangle government finances from those of major state-owned enterprises.[122] Over the next decade, tax revenue grew at almost 1.5 times the rate of the economy.[123] By this measure, government extractive capacity reached a nadir in 1995 of revenue equal to 10.2 percent of GDP. In the following two decades, revenue increased steadily and peaked at over 22 percent of GDP in 2015.[124]

While the reforms overhauled some aspects of China's fiscal system, they also left certain core features in place. First, China remains, by quantitative measures, among the most decentralized political systems in the world.[125] Local governments — starting at the provincial level and working down to prefectural, county, township, and village governments — account for 50 percent of government revenue and almost 85 percent of expenditures. In Organisation for Economic Co-operation and Development countries, the averages are 20 and 33 percent, respectively. China's central government commands just 15 percent of total government expenditure, compared to the Organisation for Economic Co-operation and Development average of 66 percent.[126] Second, China continues to rely almost entirely on business taxes, collected through a value-added tax on business-to-business transfers and a corporate income tax. Since 1990, these business taxes have made up between 60 and 75 percent of tax revenue. Consumption taxes (7 percent) and individual income taxes (6.3 percent of total revenue in 2021) are relatively unimportant. The remaining 15 percent of government revenue comes from central and local fees.[127]

The ample revenue provided by the 1994 tax reform allowed the government to translate economic growth into military power without extensive borrowing by the central government.[128] Indeed, defense spending has increased at an average rate of 14 percent since 1990.[129] Official data reveals a strong correlation between economic growth and defense budget growth from 1990 to 2020.[130] Between 2001 and 2010, China's GDP grew at a nominal average annual rate of 15.3 percent and defense spending at a rate of 16.1 percent. Between 2011 and 2020, these rates fell in tandem to 9.5 percent and 9.3 percent, respectively.[131] Increasing at an average annual rate of 14 percent since 1990, China's

118 Liu Yasu, Head of the National Defense University's China Institute of National Defense Finance Studies, quoted in Lafferty, "Civil-Military Integration and PLA Reforms," 631.

119 Lafferty, "Civil-Military Integration and PLA Reforms"; and Elsa B. Kania and Lorand Laskai, "Myths and Realities of China's Military-Civil Fusion Strategy," Center for a New American Security, January 2021, 23, https://www.cnas.org/publications/reports/myths-and-realities-of-chinas-military-civil-fusion-strategy.

120 "Annual Data," National Bureau of Statistics of China, accessed March 30, 2023, http://www.stats.gov.cn/english/Statisticaldata/AnnualData/.

121 Arthur Kroeber, *China's Economy: What Everyone Needs to Know* (New York: Oxford University Press, 2020), 147; Christine Wong, "Budget Reform in China: Progress and Prospects in the Xi Jinping Era," in *Value for Money: Budget and Financial Management Reform in the People's Republic of China, Taiwan and Australia*, ed. Andrew Podger et al. (Canberra: Australian National University Press, 2018), https://doi.org/10.22459/VM.01.2018, 67.

122 Wong, "Budget Reform in China."

123 Wong, "Budget Reform in China."

124 National Bureau of Statistics of China, "Annual Data."

125 Kroeber, *China's Economy.*

126 Kroeber, *China's Economy,* 143; National Bureau of Statistics of China, "Annual Data."

127 National Bureau of Statistics of China, "Annual Data."

128 M. Taylor Fravel, *Active Defense: China's Military Strategy since 1949* (Princeton, NJ: Princeton University Press, 2019); Liff and Erickson, "Demystifying China's Defence Spending"; and Dennis J. Blasko, *Chinese Army Today: Tradition and Transformation for the 21st Century*, 2nd ed. (New York: Routledge, 2012), 6–7.

129 SIPRI Military Expenditure Database, https://www.sipri.org/databases/milex, accessed May 6, 2022.

130 National Bureau of Statistics of China, "Annual Data."

131 National Bureau of Statistics of China, "Annual Data."

defense budget has grown into the second largest in the world.[132] Even so, defense spending has remained well below two percent of GDP throughout this period, even when using higher-end estimates of the defense budget. Defense spending has also fallen as a percentage of total government expenditure from a peak of almost 17 percent in the early 1990s to less than five percent in 2020.[133]

However, the ease with which China paid its military spending bill via tax revenue may be coming to an end. Three trends suggest a poor outlook for defense spending: slowing economic growth, declining revenue as a percentage of GDP, and increasing domestic spending as a share of total expenditures. China's economic growth has gradually slowed over the past decade, from around 10 percent in real terms between 2000 and 2010 to 6.5 percent between 2011 and 2020. While predicting future growth rates is difficult, most observers acknowledge that China faces immense hurdles if it hopes to maintain high levels of growth. These include a shrinking and under-educated workforce;[134] mounting public and private debt;[135] slowing productivity growth;[136] a stagnant state sector;[137] an exhaustion of easy growth opportunities;[138] and economic, technological, and trade challenges from the United States, Japan, and the European Union. A compilation of projections finds that a majority of analysts believe that "China's economic growth could average around 5 percent a year or higher to 2030 and about 3.5-4 percent a year from 2020-2050."[139]

China also faces fiscal pressure from a concurrent decline in revenue as a percentage of GDP and continued expansion of spending, particularly on social programs. Starting in 2015, revenue fell from a post-reform peak of 22 percent of GDP to around 18 percent in 2020.[140] This is primarily due to a series of cuts to the value-added tax and agricultural and construction taxes. Beijing also cut individual income taxes in 2018 and 2019, with revenue from income tax projected to fall by 25 percent.[141] At the same time, non-defense spending is growing at a much more rapid rate than defense spending. Between 2007 and 2020, spending on social programs rose from five to 9.5 percent of GDP.[142] The introduction of numerous and massive public services and the expansion of the social safety net under the banner of creating a "harmonious society" — including free rural education for 100 million students, a rural cooperative medical scheme with as many as 830 million participants, and the addition of more than 500 million people to a basic pension scheme — has driven this rapid growth.[143] China is very clearly shifting resources toward social spending on pensions, healthcare, transportation, housing, and education, as well as on environmental and resource management, and, in a relative sense, away from defense. These developments have contributed to a widening budget deficit. Cash-strapped local governments have taken on enormous debt through unsanctioned land-based financing schemes.[144] While still just accounting for four percent of total expenditure, payments on central government debt have doubled since 2007,

---

132 National Bureau of Statistics of China, "Annual Data."

133 SIPRI, "SIPRI Military Expenditure Database," accessed May 8, 2022, https://www.sipri.org/databases/milex; and National Bureau of Statistics of China, "Annual Data."

134 Scott Rozelle and Natalie Hell, *Invisible China: How the Urban-Rural Divide Threatens China's Rise* (Chicago, IL: University of Chicago Press, 2022).

135 Antonio Graceffo, "Could China's Massive Public Debt Torpedo the Global Economy?" *War on the Rocks*, Dec. 2, 2021, https://warontherocks.com/2021/12/could-chinas-massive-public-debt-torpedo-the-global-economy/.

136 "China's Future Economic Potential Hinges on Its Productivity," *The Economist*, Aug. 14, 2021, https://www.economist.com/briefing/2021/08/14/chinas-future-economic-potential-hinges-on-its-productivity.

137 Nicholas R. Lardy, *The State Strikes Back: The End of Economic Reform in China?* (Washington, DC: Peterson Institute for International Economics, 2019).

138 Rozelle and Hell, *Invisible China,* chap. 1; George Magnus, *Red Flags: Why Xi's China Is in Jeopardy* (New Haven, CT: Yale University Press, 2019), chap. 7; and Daniel H. Rosen, "China's Economic Reckoning," *Foreign Affairs*, Nov. 10, 2021, https://www.foreignaffairs.com/articles/china/2021-06-22/chinas-economic-reckoning.

139 Roland Rajah and Alyssa Leng, "Revising Down the Rise of China," Lowy Institute, March 15, 2022, https://www.lowyinstitute.org/publications/revising-down-rise-china.

140 National Bureau of Statistics of China, "Annual Data."

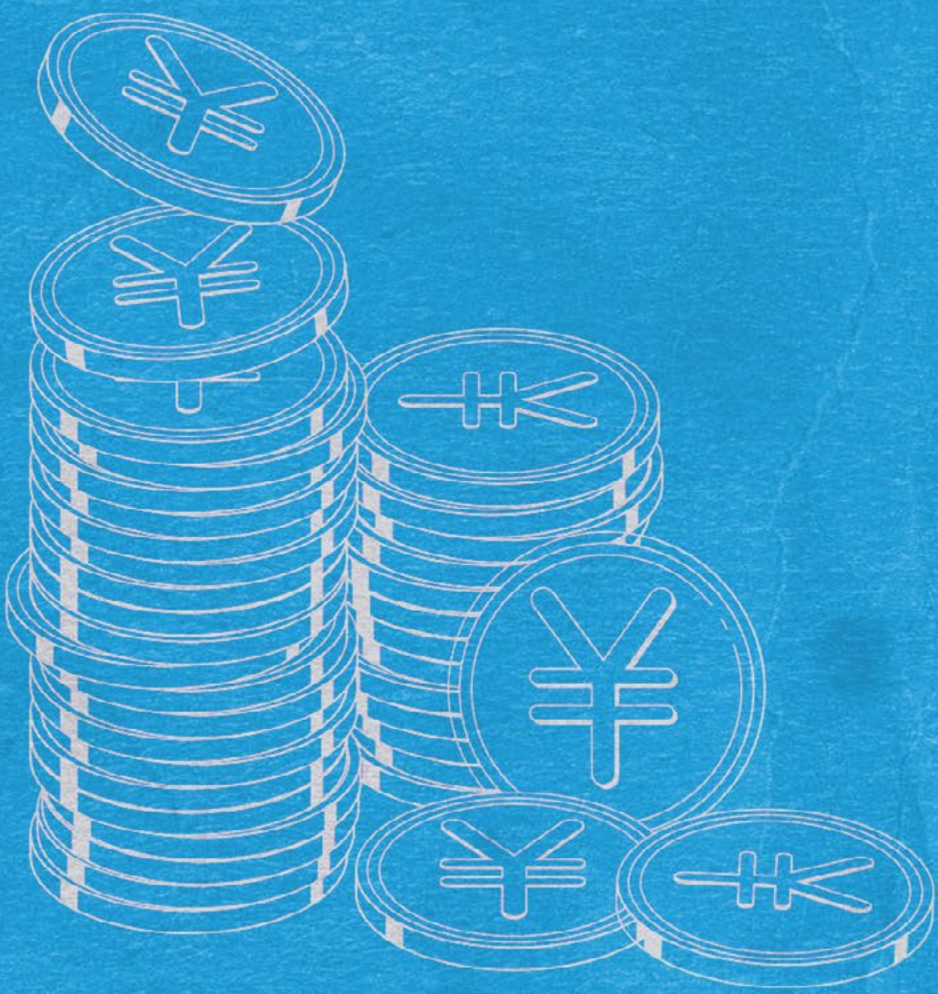
141 Christine Wong, "Plus Ça Change: Three Decades of Fiscal Policy and Central-Local Relations in China (Working Paper)," *East Asian Institute*, Aug. 14, 2021, 20–21.

142 National Bureau of Statistics of China, "Annual Data.".

143 Christine Wong, "An Update on Fiscal Reform," in *China's 40 Years of Reform and Development: 1978–2018*, ed. Ross Garnaut, Ligang Song and Cai Fang, 1st ed. (Canberra: Australian National University Press, 2018), 274.

144 Meina Cai et al., "Government Debt, Land Financing and Distributive Justice in China," *Urban Studies* 58, no. 11 (August 2021): 2329–47, https://doi.org/10.1177/0042098020938523; and Wong, "An Update on Fiscal Reform," 274.

CHINA'S STRUGGLE TO GENERATE NEW TAX REVENUE AS ITS BORROWING INCREASES RAISES THE QUESTION OF WHETHER IT STILL ENJOYS THE ADVANTAGES OF A RISING POWER. LIKE THE UNITED STATES, CHINA IS CLEARLY CONSTRAINED — IF IMPLICITLY AND INDIRECTLY — IN ITS ABILITY TO GENERATE SUSTAINABLE REVENUE.



while local government debt service costs almost doubled between 2019 and 2022.[145]

All told, there appears to be a growing imbalance between the Chinese Communist Party's international ambitions and the resources available for China's military. As economic growth slows, tax revenue declines, and domestic spending rises, maintaining or increasing current levels of defense spending will require Beijing to either generate new tax revenues or borrow at a greater rate. In stark contrast with local governments, Beijing has a strong balance sheet. According to a recent analysis by Nicholas Borst, the central government has a debt-to-GDP ratio "significantly lower than that of any other major economy." As Borst points out, the Ministry of Finance can raise funds at lower interest rates than the U.S. Treasury and could likely take on substantially more debt without increasing borrowing costs.[146] However, Beijing's robust balance sheet is somewhat misleading: The central government has little debt in part because 85 percent of total government expenditure is handled by local governments — almost three times the average for Organisation for Economic Co-operation and Development countries — which finance social and stimulus spending with debt or land sales. Shifting this debt to the central government or allowing local governments to manage a greater share of revenue would not solve the misalignment of China's spending patterns and revenue generation. Of course, while the Chinese Communist Party has more options to ramp up revenue in a crisis — including through the sale of massive state assets or coercion — these would risk undermining the long-term economic viability of the state.

Like the United States, if China wants to maintain high levels of defense spending growth, it will have to choose between higher levels of borrowing or increasing taxation to finance competition. Past actions suggest, however, that Beijing is reluctant to prioritize "short-term military needs at the expense of economic imperatives."[147] The lessons of the Soviet collapse remain vivid for Chinese leaders.[148] Whether the government can convince the Chinese people to make fiscal sacrifices now for future gains will be crucial to the outcome of the coming competition. It will also be an important test of whether rising powers have an advantage in sustainable revenue extraction.

Efforts to increase government tax revenues as a share of GDP have ground to a halt.[149] Xi has floated the possibility of new, progressive taxes to raise additional revenue and to combat rising inequality under the banner of "Common Prosperity."[150] Proposals have included a nation-wide property tax, increasing the number of people who pay income taxes, and an inheritance tax.[151] Imposition of these taxes on individual wealth would represent a sea change in China's fiscal system. As discussed above, most of the government's tax revenue is generated by levies on corporations. Few individuals pay direct taxes: In 2022, according to a report by *The Economist*, as few as 2 percent of Chinese citizens paid the individual income tax, in part due to rampant tax evasion.[152]

The reasons for this breakdown are multiple. Reliance on corporate taxes is a legacy of China's fiscal system prior to the 1994 reform, a time when all state revenue came from state-owned enterprises. Moreover, as some analysts have suggested, Beijing may fear that citizens, once taxed, may demand a larger voice in policy discussions.[153] The party may see new taxes as a violation of its social contract that could lead to pushback from regime elites and a relatively poor, cash-strapped public. Opinion polls have found that Beijing is indeed sensitive to the views of wealthy urbanites,

145 National Bureau of Statistics of China, "Annual Data."; and Sun Yu, "China's Local Governments Boost Revenue by Selling Land to Their Own Entities," *Financial Times*, March 8, 2023, https://www.ft.com/content/f68a301a-cdd5-4d9b-aca2-492c6561ebbf.

146 Nicholas Borst, "China's Balance Sheet Challenge," *China Leadership Monitor*, March 1, 2023, https://www.prcleader.org/borst-spring-2023.

147 Lafferty, "Civil-Military Integration and PLA Reforms," 631.

148 Shambaugh and Brinley, *China's Communist Party*, chapter 4.

149 Wong, "An Update on Fiscal Reform," 272–73; "Fiscal Affairs: Fiscal Policy Reform," *The China Dashboard* (Winter 2021), https://chinadashboard.gist.asiasociety.org/winter-2021/page/fiscal-affairs.

150 National Bureau of Statistics of China, "Annual Data."

151 "Xi's Toughest 'Common Prosperity' Test Is Raising China's Taxes," *Bloomberg*, Oct. 26, 2021, https://www.bloomberg.com/news/articles/2021-10-26/xi-s-toughest-common-prosperity-test-is-raising-china-s-taxes.

152 In 2020, 85 percent of government revenue was generated by taxes and 15 percent by an assortment of administrative fees. The majority of government revenue is generated by two business taxes: the value-added tax, which covers the manufacturing and service industries, and the corporate income tax. National Bureau of Statistics of China, "Annual Data." "Why Only 2% of Chinese Pay Any Income Tax," *The Economist*, Dec. 1, 2018, https://www.economist.com/china/2018/12/01/why-only-2-of-chinese-pay-any-income-tax. Shuanglin Lin, "Reforming the Fiscal System," in *China 2049: Economic Challenges of a Rising Global Power*, ed. David Dollar, Yiping Huang, and Yang Yao (Washington, DC: Brookings Institution Press, 2020), 257.

153 Jay C. Kao, Xiaobo Lü, and Didac Queralt, "Do Gains in Political Representation Sweeten Tax Reform in China? It Depends on Who You Ask," *Political Science Research and Methods*, Nov. 18, 2022, 1–20, https://doi.org/10.1017/psrm.2022.58. See also Kroeber, *China's Economy*, 158.

who both form the base of the party's support and would bear the brunt of Xi's proposed taxes.[154] And recent research indicates that the party gathers information on and responds to public opinion and has taken steps in the past to reduce tax burdens on individuals.[155] In 2006, farmer protests led to a reduction in unpopular agricultural taxes.[156] More recently, the proposed property tax faced stiff resistance from connected elites, local governments, and the urban middle class.[157] Local government officials and other party insiders, many of whom are both landowners and dependent on land sales to finance government operations, fear that a property tax would drive down land values.[158] Finally, Beijing appears to have abandoned income tax expansion in favor of cuts in the short term to counter recent economic slowdowns.[159]

Another core issue is China's growth outlook. Given the state's strong commitment to building external power, it should be able to maintain the strong relationship between economic growth and defense budget growth. Indeed, the government announced defense spending increases that exceeded growth during COVID-19-related slumps in 2021 and 2022.[160] If, as many observers expect, China's economic growth slows to around five percent a year over the next decade, will an annual defense spending increase of 5 percent be sufficient to meet China's defense needs?[161] Slowed growth in living standards could also further reduce the willingness of the Chinese people to pay more in taxes.

China's struggle to generate new tax revenue as its borrowing increases raises the question of whether it still enjoys the advantages of a rising power. Like the United States, China is clearly constrained — if implicitly and indirectly — in its ability to generate sustainable revenue. Certainly, Xi has attempted to convince the Chinese people of the long-term benefits that will accrue from his assertive foreign policy. He has noted with greater frequency since 2017 that the world was entering a "new era" of "great changes not seen in a century" — the decline of the United States and the rise of China. China, as Xi put it at the Chinese Communist Party's 19th Party Congress, has a chance to reclaim its rightful role at "the world's center stage."[162] As if girding the Chinese people for long-term competition, Xi argues that taking advantage of this window of opportunity would not be easy. The United States has adopted a "Cold War mentality of encirclement, constraint, and confrontation," according to a 2019 Chinese Communist Party white paper. As Xi stated in 2017, the closer China drew to national rejuvenation, "the more arduous the task" was becoming: "The great rejuvenation of the Chinese nation cannot be achieved with great ease or simply playing drums and gongs. A great struggle must be waged to realize this great dream [...] the various struggles we face are not short-term but long-term." But, in a 2021 speech, Xi expressed confidence that "time and momentum are on our side."[163]

Whether this framing will be enough to compel the Chinese people to accept greater sacrifice remains to be seen. Economic growth is slowing and tax revenue is falling. Efforts to reform the fiscal system have faltered. There appears to be little public support for higher tax rates or other forms of financial sacrifice that would support higher defense spending, at least in the short term. Facing resistance and declining economic growth, the party has tabled efforts to expand revenue. Rather, it remains focused on the immediate needs of the economy and the expansion of social services. This aligns more closely with our expectations of great-power behavior. China is, however, as Xi has noted, in the beginning stages of a decades-long competition. If the current means of financing the military is no longer viable, Beijing will face the prospect of reducing its international ambitions, finding new ways to finance defense, or scaling back military competition

154 Ilaria Mazzocco and Scott Kennedy, "Public Opinion in China: A Liberal Silent Majority?" Center for Strategic and International Studies, Feb. 9, 2022, https://www.csis.org/features/public-opinion-china-liberal-silent-majority.

155 Rory Truex, *Making Autocracy Work: Representation and Responsiveness in Modern China* (New York: Cambridge University Press, 2016).

156 John James Kennedy, "From the Tax-for-Fee Reform to the Abolition of Agricultural Taxes: The Impact on Township Governments in North-West China," *The China Quarterly*, no. 189 (March 2007): 43–59, https://doi.org/10.1017/S0305741006000798.

157 Christine Wong, "Reforming Public Finance for the New Era," in Frank N. Pieke and Bert Hofman, eds., *CPC Futures: The New Era of Socialism with Chinese Characteristics* (Singapore: National University of Singapore Press, 2022).

158 Edward White and Thomas Hale, "China Expands Property Tax Trials in next Step of 'Common Prosperity' Drive," *Financial Times*, Oct. 24, 2021, https://www.ft.com/content/d4b2c109-75dd-4c04-8291-ae4a5016063b;

159 Iori Kawate, "China Delays Property Tax Trials, Stressing Stability Over Reform," *Nikkei Asia*, March 18, 2022, https://asia.nikkei.com/Politics/China-delays-property-tax-trials-stressing-stability-over-reform; and *The China* Dashboard, "Fiscal Affairs: Fiscal Policy Reform."

160 Office of the Secretary of Defense, *Military and Security Developments Involving the People's Republic of China 2023*.

161 Rajah and Leng, "Revising Down the Rise of China."

162 Jude Blanchette and Seth G. Jones, "Beijing's New Narrative of U.S. Decline," Center for Strategic and International Studies, July 2021, https://opensource.csis.org/features/beijing-narrative-us-decline/; and Doshi, *The Long Game*, 262.

163 Quoted in Doshi, *The Long Game,* 272–73.

with the United States to focus more narrowly on the security of China's own region. Smaller defense budgets could entail a retreat from investment in expensive aircraft carriers and other tools for power projection. Much will depend on whether the party can successfully frame sacrifice as necessary to supporting future gains.

Conclusion

Geostrategic competition between great powers demands high levels of sustained military spending. The strain of meeting such financial obligations often results in economic collapse or retrenchment from geostrategic aims and international commitments. The United States is often seen as having avoided this trap. Its strong domestic institutions and robust network of allies and partners, along with the status of the dollar, have provided it with such unique advantages that the country appears to have the ability to float unlimited debt at near-zero interest rates. Yet, this advantage may be coming to an end. In addition to democratic backsliding, multiple near debt defaults due to political brinksmanship, and rising interest rates, the U.S. debt-to-GDP ratio is likely to become increasingly unsustainable over the next decade. As debt increases, America's fiscal advantages — its ability to borrow at low interest rates and to quickly and cheaply ramp up spending in times of crisis — will narrow.[164]

To put its house in order, the United States should raise taxes. It is critical for the Biden administration, as well as future administrations, to extend time horizons when framing geopolitical competitions in order to lower the short-term political costs of raising taxes. With longer time horizons, citizens will be more apt to believe that competition can secure future gains to be reaped by large swaths of the population. Top U.S. officials have made the case for such framing in the past. Paul Nitze, director of the State Department's policy planning staff during the Truman administration and chief author of NSC-68, advocated that framing competition as a means to a better future would increase the odds of success.[165] As he confided to another U.S. official at the time, the top-secret NSC-68 and public declarations by administration officials calling for dramatic increases in defense spending might have exaggerated the stakes, but the American people had to be convinced of the need for sacrifice: "If we had objectives only for the purpose of repelling invasion and not to create a better world," he argued, "the will to fight would be lessened."[166] This is not to say that political leaders should lie or obfuscate to drum up support for their preferred policies. Rather, if sustainable competition is seen as critical to the nation's future, political leaders should make their argument in a compelling and convincing way. This can be done by arguing that victory will not only improve security but also will create a better future for all.

Since the early 1990s, China has avoided having to make difficult choices when it comes to financing its military. Decades of rapid economic growth provided the state with ample tax revenues to finance the fast expansion of the defense budget and the development of the People's Liberation Army into one of the largest and most advanced militaries in the world, laying the foundation for competition with the United States. Although China does not need to match the United States in overall defense spending, slowing economic growth rates, stalled fiscal reforms, and expanding social spending are straining state finances. If economic growth slows further or remains low, China may not be able to sustain defense spending increases through tax revenue alone. Annual increases in defense spending have already fallen in tandem with economic growth, while the defense budget has declined as a share of total spending. Moreover, budget deficits have grown due to successive years of pro-growth tax cuts. China must either raise taxes or accept a larger deficit and public debt burden, if it wants to maintain spending growth.

As a rising power, China established a sustainable source of tax revenue in the mid-1990s in the name of national rejuvenation. To sustain and expand its military power over the long run, Beijing will need to convince its people to accept higher taxes in the name of future gains. Framing financial sacrifice today as necessary to secure the gains that will flow to all Chinese citizens from successful "national rejuvenation" is one tool available to party leaders. The Chinese Communist Party has argued that the present moment of "great changes not seen in a century" is the time to take advantage of U.S. decline and secure China's rise. As a rising power, this framing should allow China to successfully reform its fiscal system and develop a sustainable, tax-based foundation for long-term competition.

Domestic constraints shape the ability to extract revenue to finance great-power competition. Our research suggests that a state's internation-

164 Mazarr, "The Societal Foundations of National Competitiveness," 293.

165 National Security Council, "National Security Council Report, NSC-68."

166 Quoted in Gaddis, *Strategies of Containment*, 106.

al status can either exacerbate or alleviate these constraints. Dominant states must contend with a skeptical public that is reluctant to pay higher taxes, complicating efforts to build a sustainable fiscal foundation for geostrategic competition. Rising challengers, on the other hand, enjoy an advantage in selling competition to the public: These states can make credible promises that sacrifice today will bring future gains in power, prestige, and prosperity. While these constraints are not determinative — the United States has faced challengers before — they do suggest that U.S. policymakers should take seriously the framing and narrative associated with the fiscal challenges of geostrategic competition in order to raise taxes and put the United States on sounder fiscal footing at the outset of what may prove to be a decades-long competition.

Rosella Cappella Zielinski *is an associate professor of political science at Boston University and non-resident fellow at the Brute Krulak Center for Innovation and Creativity at Marine Corps University. She is a former senior visiting fellow at the Clements Center for National Security at the University of Texas at Austin. Her book* How States Pay for Wars *(Ithaca, NY: Cornell University Press, 2016), is the winner of the 2017 American Political Science Association Robert L. Jervis and Paul W. Schroeder Best Book Award in International History and Politics. Her other works can be found in a variety of academic journals as well as in* Foreign Affairs *and* War on the Rocks.

Samuel Gerstle *is a Ph.D. student in political science at Boston University, where he researches the political economy of security, national security organizations, and Asian security. Prior to beginning his Ph.D., Sam worked at The Asia Group, the Center for Strategic and International Studies, and the Office of the Secretary of Defense for Policy. He holds a Master of Science in Foreign Service and a Bachelor's in history and Japanese, both from Georgetown University.*

Acknowledgements: *We would like to thank Avery Goldstein, Joseph Fewsmith, Michael Beckley, Rachel Tecott Metz, William Wohlforth, participants in workshops in the Speaker Series at the Department of Government at the University of Texas at Austin, and the faculty development seminar at the Krulak Center for Innovation & Future Warfare at Marine Corps University, as well as the anonymous reviewers for their helpful comments and suggestions on earlier drafts of this article.*

Image: MeanieHyaena (CC BY 4.0)[167]

167 For the image, see https://commons.wikimedia.org/wiki/File:Us-treasury-building.jpg. For the license, see https://creativecommons.org/licenses/by/4.0/deed.en.