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Alleviating the Thucydides' Trap through Welfare State Dependence:
How the Funding Needs of the Western Welfare State Can Influence Multilateral Relations with China

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Abstract

The dual threat of a US-China confrontation and the rise of populism in the West due, in part, to the gradual decay of the welfare state, paint an ominous picture for the future of the post-war status quo of ever-expanding prosperity. Hegemonic competition between the incumbent superpower (the USA) and the challenger (China) framed as the Thucydides' Trap and adverse demographic and financial trends are the main causes behind both crises. In this paper we argue that amidst deteriorating demographics, the sustainability of the Western welfare state could be significantly enhanced by positioning Western institutional investments in the regions across India and South East Asia - areas with strong modernization dynamics and the world's nascent most populous middle class. Such a policy could generate long-term higher risk-adjusted returns for Western pension funds, especially if Western investors look for complementarities with China's Belt and Road Initiative (BRI). The proposed geographical calibration in Western institutional investments could lead to a relationship of strong reciprocal dependence between economic and social growth in the target regions, exports of Chinese construction and financial capacity, and Western welfare state viability. We call the suggested policy the "welfare state dependence" hypothesis. The key objective of the hypothesis is the promotion of peaceful economic and geo-political co-existence in Eurasia through rational re-alignment of the incentives of Western polities with Eurasian growth. But to make this new approach feasible a number of BRI policy reforms that supports its multilateralization are required.

Keywords: Geo-economics, Institutional Investors, BRI, Interdependence, Welfare State, Infrastructure, Thucydides Trap

Policy Implications

1. A rational realignment of long-term interests and symmetric - reciprocal benefits between China and the West which places the funding of the Western welfare state at its centre has the potential to reverse heightened tensions between China and the West thus alleviating the Thucydides Trap.
2. Strong modernization dynamics in the BRI region will create the most populous middle class in the world with bustling consumption demand. Therefore, shifting investible funds to the BRI region (particularly Indochina, Indonesia and the Subcontinent) means higher risk-adjusted returns. These would alleviate demographic pressures and low investment returns for Western pension funds thus 'buying time' for a sustainable reform of the Western

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welfare state. A 1 per cent increase of returns for Western pension funds would decrease contributions by 10% providing vital fiscal space and buy political time for sustainable reform of fragile Welfare systems.

3. Offering solid policies that can shift BRI's focus from regional domination to a genuine partnership between Chinese (state) and private (Western) institutional investors based on world class soft - regulatory infrastructure. This partnership could also close the funding gap and augment debt and environmental sustainability approval tests for BRI projects.
4. Upgrade and modernize the fiduciary framework of Western Institutional Investors to enable them to take long-term bets in emerging markets. Canada's CCPP could serve as an example of a safe shift of institutional assets towards Eurasia.
5. Disincentivize a rollback 2.0 containment strategy and other forms of geopolitical confrontation which now extend to calls for a China-US financial war.
6. A grand investment forum in Beijing engaging with Institutional Investors and the world's development banks would offer a great opportunity to set networks of experts in place. This event could also provide an opportunity for China's Development bank and China's EXIM (state directed development banks) to join forces with Asian Infrastructure and Investment Bank eventually shifting focus from bilateral to multilateral development financing.

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The Geopolitical Crisis: Democratization Did Not Work

The economic and military rise of China has set geopolitical alarm bells in the West and especially in the USA, the world's pre-eminent hegemon since 1989. This had been the case even before the Trump administration framed China as a 'revisionist power'[1] (The White House, 2017) and took a more activist stance first to redress persistent trade imbalances, and second to delay China's technological advancement[2]. Since trade, finance and technology have been the weapons of choice in the atomic epoch where a conventional military conflict between nuclear superpowers could escalate to Mutual Assured Destruction (MAD) (Kahn, 1967; Schelling, 2008; Bracken, 2012; Do Nuclear Weapons Matter? 2018), the intensification of geo-economic competition between the USA and China may eventually engulf most Western powers given their defense dependency on the USA. As a learned geopolitician once put it, the logic of conflict is being transplanted into the grammar of commerce (Luttwak, 1990) and a zero-sum game about market shares, technological breakthroughs and commercial *fait accomplis* may define the Sino-US strategic competition in the 21st century (Wright, 2017).

The in-depth examination of the structural conditions that have provoked this intensification of Sino-US strategic rivalry has turned the Thucydides' trap, which refers to the ominous dynamics between a rising power and a ruling power, into the central theoretical paradigm for explaining the relationship between the USA and China (Alisson, 2018). Even the Chinese President Xi Jinping has cited the famous geopolitical riddle first posited by the Athenian historian to explain the inevitability of the confrontation between Sparta and Athens. But Xi did so to negate its fatalistic outcome and explain it, instead, as a pivotal problem of 'strategic miscalculation' (Xi, 2015). To neutralize the trap that in more recent times trapped in succession England and France, the British Empire and rising Germany, and the United States and Japan, a new stream of geopolitical thinking is required. This should cut across the teleology of 'Democratic Peace' or the dogmatism of free trade which has in reality been undermined by both the hegemonic and the contesting power.

For decades, the orthodoxy within America's strategic community, was that the most viable path towards peace with an ascending China would be 'Kantian'; that is, liberal democracy would eventually conquer the heart and mind of the Middle Kingdom[3]. Inspired by a soft post-Tiananmen offensive, the United States during the Clinton era and under the influence of the Harvard professorial trinity of Joseph Nye, Kurt Campbell and Ezra Vogel, engaged China and facilitated its entry into the World Trade Organization (WTO) (Green, 2017, p. 457-473; Nye, 1995). The trinity postulated that international trade would eventually lead to cross-fertilization of governance ideas and practices. President Bill Clinton himself asserted that: '*Without the full freedom to think, question, to create, China will be at a distinct disadvantage, competing with fully open societies in the information age where the greatest source of national welth is what resides in the human mind.*' (Campbell and Ratner, 2018). Gradually, as trade would enrich China, a new middle class would be formed which would bend the long arc of authoritarianism towards a managed form of democratic pluralism (Diamond & Myers, 2001; Lipset, 1959; 1963).

The key argument was that ultimately democracies rarely go to war with each other and, if they do, they promptly reconcile. And this approach was successful up to a point. Not only the US strategy of constructive engagement or 'congagement' (Zalmay, 1999; Zamayet al, 1999) lifted hundreds of millions of Chinese citizens out of poverty but it also tied China firmly in the chariot of globalization. And while the key beneficiary from this engagement was China the benefits were eventually spread more widely. In fact, in the period after the 2008 Global Financial Crisis, which was, in fact, an existential crisis of Western capitalism, China became the steam engine of global growth (Christensen, 2015, p. 190).

Yet, ultimately, the approach championed by the Harvard professorial trinity did not work. 17 years since China's entry into the WTO, Beijing has repudiated US style liberal democracy. China's policy and ideological shift towards an assertive New Era (xinde dai 新时代) of semi-autocratic rule with a distinctive identity of Sinicized Marxism (zhong guo tese shehui zhuyi 中国特色社会主义) (Xi, 2017) has been the result of three factors. First, America's 2003 decision to invade Iraq diverged strategic capital away from China and undermined the attraction of US's global leadership. Second, the 2008 collapse of global financial markets in many ways discredited the model of neoliberal capitalism that is based on uncoordinated market forces. This came to be seen by CPC's intellectuals as the source of unmitigated destruction. Third, Beijing's economic and technological successes (see Huawei), in spite some colossal challenges (SOEs' indebtedness and a shaky shadow banking sector) have inspired a new confidence in the hybrid Chinese model of central planning and market economics – officially framed as the socialist market.

Meanwhile in the United States the triumphal euphoria of the 90's about the liberal democratic telos of history has evaporated as it was largely usurped by oligarchic neoliberal elites. In the name of liberalism, plutocratic tax-evaders made their best to undermine liberalism's very foundations by shifting the tax burden on the stagnant incomes of the middle class. Consequently, amidst 'Gilded Age' levels of inequality, demagogues rose into being a potent political force. Free trade and the US trade counterparts chiefly the PRC, the EU, Canada and Mexico have become the easy scapegoats for the forces of indignant populism. It has since not taken long for both the US congress and the executive to not only frame China as a trade threat but also keenly strategize on how to counter Beijing's ascending global influence in a 'whole of society approach' (Sutter, 2018).

It is realistic to assume that even when the toxic populist language in US foreign trade policy has been toned down the geopolitical rivalry with the PRC will remain and will eventually engulf the rest of the West, albeit in milder forms shaping mostly into a struggle for technological primacy and the case of Huawei is paradigmatic (Kaplan, 2019; Paulson 2018).

In such a turbulent geopolitical context, we see the supply to Western polities of rational economic incentives as the key route to alleviate the trap and thus the argument we advance here is based on pure 'realpolitik' premises[4]. Western pension funds, based within and outside the USA, are faced today with the dual existential challenge of anemic long-term interest rates and sharply falling support ratios. Therefore, their inexorable search for active high-value added investing could be a catalyst for a re-alignment of Western and Chinese interests and act as a counterweight to the intensifying rivalry we observe today.

Co-investment across the Indian and South East Asian region alongside the Chinese BRI can enhance the long-term viability of western pension funds. In addition, it can raise the costs of conflict and of a nascent geo-economic bifurcation to prohibitive levels leading to the devising of strategies of mutual engagement rather than mutual destruction in all scenarios averting or at least taming a new 'Cold War'. Simply put, any increase of the stakes that Western pension funds and Chinese developmental funds have in the prosperity of the non-Western (and, conversely, the non-Chinese economic sphere) could exert pressure on the American and the Chinese elites to refrain from proxy wars and the creation of exclusive spheres of influence à la Cold War.

Our focus on pension fund investment is not arbitrary theorization. As we live in the epoch of 'money managers' capitalism' (Minsky 1990; 1993), the Bank of International Settlements (BIS) prophecy 20 years ago that '*Institutional investors are a permanent feature of the financial landscape, and their growth will continue at a similar, and perhaps faster pace.*' is today's reality (Bank for International Settlements, Annual Report, 1998, p. 95).

Institutional investors as the most long-term money managers and especially pension funds have already become pivotal players in international political economy. According to the World Economic Forum, institutional investors managed assets exceeded $50tn in 2015, compared to $30tn in 2007 – a sum higher than the combined GDP of China and the USA. Admittedly, an increasing proportion of household savings are managed today '*by professional portfolio managers instead of being directly invested in the securities markets or held in the form of bank deposits*' (Davis and Steil, 2001). Institutional investors often participate in corporate decision making and manage assets which are central to the operation of the Welfare state, which explains the ever-growing size of their asset base. Just by a mere investigation of Institutional investor's funding sources (pension funds, insurance and sovereign wealth funds), their unhindered operation is synonymous to the viability of the Western welfare state and as such they have become pivotal to the stability of social order across the world. [5]

The Welfare State Crisis

At the epicenter of the current welfare state crisis in the West is the inability of liberal republics to sustain rising welfare expenses as societies mature and demand higher benefits – a relationship captured in Wagner's Law (Musgrave, 1973; Gilpin 1982, p164). Inversed population pyramids (Schwarz, 2014) and the consequent declining inversed dependency ratios also called support ratios (number of independent workers supporting a dependent person) have added dynamic complexity into welfare systems designed under a static hypothesis about economic fundamentals (demographics, discount rates and economic growth) and have thus significantly exacerbated the welfare crisis (Harper, 2014; European Central Bank, 2018.

The Welfare state - an invention of the post-WWII baby boomers and early Generation-X era - has been built upon the premises of temporal economics with an underlying hypothesis of sufficient support and asset return ratios. Yet current demographic trends, turbulent markets and anemic growth in Total Factor Productivity (TFP) signal serious trouble ahead. According to the UN population database (medium variant population projection), by mid-century retirees (aged more than 65) will account for more than 40% of the working age population in most G7 nations with the ratio in Japan reaching 70% (United Nations, 2017). Meanwhile the adage about China has been that the country will grow old before growing rich and its support ratio will decline by more than 50% by mid-century. China's support ratio will have by then become worse than that of the United States while Beijing will still be at an inferior per capital income level (Caixin, 2018).

From all the macro-trends that economists usually take into consideration looking into the crystal ball, demographics tend to be among the most credible and thus the expectations about faltering support ratios could be taken as a key input to shape our understanding of a 'pensions time bomb'. Not only pensions will be adversely affected by slow growth and ageing but also public finance as '*higher age-related primary deficits are expected to contribute to higher government debt-to-GDP ratios.*' (European Central Bank, 2018).

To be sure, the impact of unhealthy demographic trends on Welfare and pensions could partly be addressed either by changing the macroeconomic conditions (increase productivity, raise the discount rate) or by a technocratic regulatory reform (raise retirement age, cut retirement benefits, increase migration). For instance, if TFP was to ascend strongly thus significantly boosting GDP growth in the West or if Western constituencies were to accept lower retirement benefits or retirement age was to become indexed to rising life expectancy then the crisis would not be as severe. In addition, a shift from defined benefit systems to defined contributions along with a mixed pay-as-you-go and funded approach would also help lessen the impact of ageing (Maestas, Mullen and Powell, 2016).

Unfortunately, a high productivity scenario is highly unlikely and the term 'secular stagnation' has often been used to describe the limited conventional capacity of monetary and fiscal mechanisms in the West to boost productivity and achieve real GDP growth higher than 3%[6]. In fact, as many investors have extrapolated past returns into the future - returns which were achieved at a time when growth was strong - their return projections may be overly optimistic (Saft2009). A rule of thumb is that a 1% decline in asset returns requires an extra 10% in annual funding just to break even. In addition, the technological explosion that is upon us via the 4th industrial revolution and the expected widespread job losses across the spectrum (McKinsey Global Institute, 2017)[7], make an increase in annual funding highly unlikely. Therefore, with significantly lower returns than expected the pension time bomb may be ticking faster and most states lack the fiscal capacity to fill in the gap resulting from inferior investment returns.

Furthermore, the high levels of inequality and political polarization make it increasingly difficult for politicians to legislate drastic welfare cuts or allow significant migratory inflows. As Kahneman and Tversky's prospect theory suggests, individuals become rather attached to status quo and thus extremely adversarial when they lose benefits that have long been taken for granted. Then, while an increase of retirement age could alleviate a pressing crisis it cannot by itself keep the system alive in the long term. Increasing the retirement age may also be socially unfair. As Nobel Laureate economist Paul Krugman has put it, affluent and well-educated Americans have seen their life expectancy rising and thus could retire late but poor Americans have hardly seen any rise in life expectancy at 65 and in fact for some groups life expectancy has declined. Raising retirement age *'amounts in effect, to the notion that we can't let janitors retire because lawyers are living longer'* (Krugman, 2013). Hence a focus on increasing the real annual returns of pension funds could become the pivotal strategy to buy time and gain fiscal space for a fairer reform of Western pension and welfare state systems.

The case of the US Social Security fund could be didactic and highlights the key tradeoffs. As Martin Feldstein put it:

> *since 2016, the benefit payments have exceeded the combination of the tax funds and the interest, causing the trust fund balance to decline. Looking ahead, the Social Security Administration's actuaries estimate that the annual decline in the trust fund will continue, until the balance is zero in 2034* (Feldstein, 2018a).

Feldstein argued that the tax hikes needed to replenish the trust fund were extremely expensive and thus politically hard to reach. He argued instead for the fund to shift from a passive investment strategy to active; from treasury bills to a mix of bonds and stocks.

> *A typical US private pension has 60% of its assets in equities and the remaining 40% in high quality bonds, providing a real rate of return of about 5.5% over long periods. In contrast, taxes collected for a PAYG system produce a real rate of return of about 2% without investing in financial assets, because real wages and the number of taxpayers rise.*' (Feldstein, 2018a).

To be sure, as the US trust fund would buy less treasury bills the cost of refinancing US debt would be subject to some market discipline but more demand for stocks would also raise the price of US stocks in terms of price to earnings and EBITDA. Thus, and this is one of the crucial points, to achieve lower risk profiles, diversification in investments outside of the US would also be essential.

A drive towards more active investing would alleviate a substantial part of the fiscal and political troubles of the West that are premised on projected pension fund shortfalls. Pension funds have not failed to observe the shock to their portfolios provoked by declining support ratios and slow GDP growth. According to CITIGPS estimates, '*the total value of underfunded government pension liabilities for twenty OECD countries is a staggering $78 trillion, or almost double the $44 trillion published national debt number.* (Citi GPS, 2016).

The BRI Region: *Higher-risk Adjusted Returns Could Buy Time for Sustainable Reform of Welfare Systems*

To recuperate and preempt future disruption some of the world's largest pension funds have already looked towards a more active approach for 'added value' thus investing an increasing share of their portfolios in emerging economies, particularly in South East Asia. Simply put, long-term returns across Southeast Asia outrank returnin mature markets in Europe and North America offering intuitional investors ample opportunities to sustain long positions with higher risk-adjusted returns. *In a longer-term context, international investment in countries with a relatively young population may be essential to prevent battles over resources between workers and retirees in countries with an aging population'* (Blake, 1997).

Indeed, as an ECB report notices:

> '*Several studies have found evidence of capital flows from "older" countries to countries with more favourable demographics. The downward pressure that ageing exerts on the labour force can be expected to reduce the price of capital relative to labour. Such capital deepening will exert downward pressure on returns to capital. However, in open economies with no capital controls, savings do not have to be invested domestically and can be absorbed by capital exports, which will reduce the pressure on domestic returns to capital.*' (ECB, 2018)

The CPPIB - Canada's leading pension fund with half a trillion Canadian dollars in assets, for instance, has already allocated 19% of its investment portfolio to Asia with China and India accounting for 40% (Wiseman and Kim, 2017). CPPIB is looking for new opportunities across Asia and expects its exposure to Asian markets to double by 2030. Similarly, Blackrock, the worlds' largest asset manager with more than $6 trillion of managing assets, has also expanded its positions in Asia and now employs 2.500 officers in 25 offices across the region (Wiseman and Kim 2017).

This number, however staggering, is not sufficient if one considers that China, the Indian Subcontinent, and ASEAN will account for more than 65% of the global population by mid-century. Forecasts predict a 4 billion people-strong middle class in South and South East Asia with burgeoning consumption habits and growth in peak spender generations: millennials and post-millennials. Thus provided that the region is stable and peaceful, the inevitable outcome will be rapid economic growth and sustained modernization dynamics. Hence, the potential of the region for active investment is tremendous[8]. In our view, there is, still, a key opportunity for the attraction of a larger pie of the Institutional investors' assets to Eurasia (mostly subcontinent and ASEAN) particularly through a cooperative effort with the Belt and Road Initiative (BRI)[9].

The BRI has often been framed as a 'debt trap' and certain projects within the initiative have indeed followed suboptimal fiduciary and governance standards. Overall however, the ambition and financial pool of the BRI offers an attractive direction for investors particularly if Western and Chinese institutions engage in regulatory harmonization along with credible and impartial dispute resolution mechanisms. The long established expertise of Western institutional investors could be employed to optimize financial leverage and promote the development of soft infrastructure (standards and modes). With higher risk-adjusted returns springing from societies with younger populations and strong modernization dynamics, a partnership between Western institutional investors and BRI institutions could facilitate a new global social contract of peace and prosperity. More realistically, such partnership could complement the now faltering 'Democratic Peace Hypothesis' with a 'Welfare State Dependence Hypothesis'. The vibrancy of the Western welfare state will be, in part, dependent upon the outcome of a joint Sino-Western effort (BRI & institutional investors) to catalyze the economic development of Eurasia which could sufficiently boost financial returns to pension funds and mitigate the social pain and political upheaval resulting from a sharp decline in social benefits[10].

According to a report by the Asian Development Bank (ADB), across Eurasia, infrastructure financing does not match the optimal funds needed based on the region's population and macroeconomic fundamentals. Even the cumulative capital provided by the Asian Infrastructure & Investment Bank (AIIB), the World Bank, the European Investment Bank (EIB), the Asian Development Bank and other governmental or intergovernmental financial institutions does little to cover a financing deficit of about $459 billion per year (Ra and Li, 2018). In narrowing this deficit, the investment firepower of western Institutional investors is therefore essential. With long-term liabilities and a constant flow of subscription cash to cover immediate re-financing needs, pension funds in particular can afford adopting long-term investment horizons. Therefore, they can take investment positions in relatively illiquid assets thatprovide sufficient long-term returns to compensate for this illiquidity. Given the nature of their investment priorities: higher risk-adjusted returns in projects with longer maturities, pension funds could naturally complement BRI's goal for infrastructure connectivity and Eurasian economic integration. Funding provided by development banks (AIIB or ADB for instance) syndicated with Institutional investors could offer high-risk-adjusted returns and help inspire a new international financial paradigm towards long-term financing and socially productive investments.

Committing institutional investors' funds and skills in this type of investment would also signal a broader (and very welcome) paradigm shift for the global investment community in accordance with the World Bank and UN pronouncements about the urgent need to shift financial market resources towards sustainable investment. Arguably, one of the key failures of the neoliberal economic model in the past 30 years has been its inability to promote long-term investments as key economic stakeholders focus on short-term speculation and neglect investments conducive to productivity and long-term infrastructure (Kay Review, 2012). The prevalence of this so-called 'Quarterly Capitalism' has created a large infrastructure investment gap and was one of the key reasons behind the 2008 great recession. As a learned economist put it reflecting on the theory of Hyman Minsky,

> *When the capital development of a country becomes the by-product of the activities of a casino, the job is likely to be ill-done. Thus, Government action—public policy—is the final key element in Minsky's theory of capitalist economic development. Policy decisions shape the institutional framework that conditions economic activity*' (Whalen, 2012).

To be sure, it has to be stressed that Institutional investors and pension funds will not shift funding to Eurasia and engage with the BRI philanthropically. Extra-financial reasons such as

China-US peaceful engagement or poverty alleviation unfortunately fall outside the fiduciary duties of money managers or pension funds. Thus we in our argument here frame the realistic and pressing need of those managers to look for higher risk-adjusted returns which are at the core of their operations. In the next section we highlight some necessary reforms in the BRI which could decrease regional risk, provide a more open and transparent regulatory environment and further motivate institutional investors to engage with the region.

Multilateralizing the BRI and Upgrading Soft Infrastructure

Human agency and creative leadership that can catalyze institutional reform will be a prerequisite to pave an attractive investment environment across the BRI. With a highly restrictive fiduciary responsibility to secure their assets first, institutional investors will not play politics unless there are clear-cut financial incentives mainly though the provision of optimal risk-adjusted returns. As one knowledgeable observer has put it, '*the development of properly structured projects, with risks and returns distributed in accordance with stakeholders' incentives is essential to attract infrastructure investment. Inadequate coverage of risks is one of the most common reasons projects do not reach financial close*' (Canuto, 2017).

Furthermore, a complex and rigid regulatory environment across the BRI region and varied contractual structures demotivate investors.[11] China should therefore engage with key institutional players, for instance, along the lines of its paradigmatic memorandum with CPPIB, and design credible contractual structures for BRI infrastructure projects (Wiseman and Kim 2017). In the same context, China in partnership with BRI countries should double down on efforts to promote a regulatory framework which protects investors along the lines of World Bank's ICSID or the New York Convention arbitration standards. Providing institutional investors with adequate protection from sovereign, political and country risk should be seen as a top priority for BRI's soft – normative infrastructure. It is therefore a significant step to the right direction that in August 2018 China established its first international experts committee which aims '*to ensure operation and promote adjudication of the International Commercial Court, and support to resolve international commercial disputes through arbitration, mediation, litigation and other diversified commercial dispute settlement methods*. (China International Commercial Court, 2018).

On a more technical level, Chinese development banks could design insurance policies, operationalize projects bonds and advance other hedging mechanisms ingrained in key BRI initiatives. To match its commitment for an open BRI, China should also provide more openness for investors to acquire Chinese assets. The preference of institutional investors (particularly pension funds and insurances) towards projects with long-term maturity will not negatively affect China's capital account– a key policy objective of the CPC. Thus the promotion of Bilateral Investments Treaties (BITs) with the EU and the U.S. should become a priority stressing Beijing's commitment to financial openness.

Chinese openness to institutional investors is one of the core prerequisites for facilitating the welfare state peace hypothesis. As Larry Summers has put it, secular stagnation with its glacial GDP expansion and anemic real interest rates in the West could be associated with declining real exchange rates in OECD economies and this would increase competitiveness and export demand only if capital was allowed to flow freely to emerging markets. Hence, if China retains its marked reluctance towards investment openness domestically or through draconian procurement restrictions along the BRI, this would hinder investment flows from the West. Chinese intransigence would offer additional fuel to populists in the West to frame China as a fundamental economic and societal threat. This finding makes it all the more important for China to mulilateralize the BRI, complete bilateral investment agreements, and furher its cooperation with institutional investors.

Furthermore, other infrastructure initiatives could augment the quality of public private partnerships across the spectrum of BRI projects and contain the risk of mutual cheating. A good example here is the building up of a market platform that will act as both a locus for raising BRI finance and the trade of stakes in various BRI projects or other forms of securitized debt using fully transparent Distributed Ledger Technology (DLT). Western institutional investor supply of liquidity will always gravitate towards the more transparent and best governed projects where due diligence can take place without state-imposed obstacles. (Avgouleas Kiayias 2019, Avgouleas2019b). This form of essential market infrastructure would create powerful incentives for all state and private sponsors of BRI projects to infuse a culture of openness, transparency and good governance in order to attract liquidity, gradually eliminating market of lemons types of problems, which are today rife in the context of BRI investment.

A grand investment forum in Beijing engaging with institutional investors and the world's development banks would offer a great opportunity to promote all these goals mentioned here simultaneously and set the networks of experts in place. The forum should explore best practices and build linkages between institutional investors and multilateral development banks. This event could also provide an opportunity for China's Development bank and China's EXIM (state directed development banks) to join forces with AIIB and follow more transparent standards thus providing a clear signal to the West on BRI's mulilateralization.

Institutional Investors as Agents and Builders of Peace Infrastructure and the Pluralism of Influence

Expected financial benefits for Western institutional investors participating in the BRI would inevitably spillover to the realm of economic influence shifting perceptions of the BRI across the Eurasian region and bringing concrete geopolitical gains for the West. Pouring in substantial amounts of Western savings into what has been so far a project based on Chinese vision and money could allay fears of Chinese domination (Shi, 2019). For example, partner financing from Western institutional investors would have an instant impact on procurement rules diluting the monopoly of Chinese construction and technology firms. In a way, not only institutional investors would be buying early in the creation of vast new vibrant markets, but also they would be given the chance to influence the shape and direction of these new markets thus peacefully counterbalancing China's geo-economic sway over recipients of BRI funding [12]. This would offer an antidote to what Elizabeth Economy has framed as a key challenge for the West; that is, to '*deal with China's wherewithal to accept suboptimal economic and efficiency outcomes generated by non-market practices in the near-term to try to ensure market dominance in the long-term'* (Economy, 2018, p. 236*)*.

In addition, such Western involvement would encourage countries that are currently reluctant to participate in BRI projects fearing Chinese economic domination to do so by borrowing cheaply from Western institutional investors. The potential for building lasting ties of peace across the BRI becomes even bigger by the fact that Western engagement and funding would, at least, in the beginning, be welcomed by the PRC leadership. Beijing has declared that the BRI is premised on expectations of partnership and is not a geopolitical project to concretize PRC's influence through the creation of captive markets and indebted nations (debt trap). Given widespread suspicion of Chinese influence across the Eurasian plateau it is right to assume that China would not lose this opportunity to 'mulilateralize' the BRI, welcome new partners and demonstrate its openness. As Chinese leaders are acutely aware of the fact that a new Cold War could have dire implications for China's economic development, Beijing would be tempted to join forces with Western institutional investors (Zhou, 2019) to implement BRI objectives. After all the Chinese president himself declared in 2015 that the BRI will bring 'a real chorus comprising all countries along the route, not a solo for China.'

Conclusion: The Welfare State Peace Hypothesis and the Limits of Economic Interdependence

Theorizing on how to reconcile staunch geopolitical competitors by fostering economic interdependence has long been a pivotal undertaking both in academic and foreign policy circles (Gilpin, 2009; Copeland 2014; Mearsheimer 2018). Since the end of the Cold War many scholars have asserted that China and the United States are so economically interdependent that a conflict between them would lead to 'Mutual Assured Financial Destruction' (RAND, 2011). Yet, as the father of structural realism Kenneth Waltz had authoritatively put it, '*interdependence, is more a dependent than an independent variable. States, if they can afford to, shy away from becoming excessively dependent on goods and resources that may be denied them in crises and wars.*' (Waltz, 2000, p.15).

It hence comes to no surprise that colossal Chinese investment in the US economy including China's status as the biggest creditor of the federal government has not been enough to avert a trade war. '*When it seems that we will sink or swim together, swimming separately looks attractive to those able to do it*" (Waltz, 2000, p. 15). And this is exactly what is happening today as Chinese President Xi Jinping have urged Chinese businesswomen to become technologically self-sufficient and as the US is looking to ostracize Chinese technology providers from its military spply chain and telecommunication infrastructure. As two scholars recently asserted, when interdependence is asymmetric it can even become weaponized as some states can 'leverage interdependence to coerce others'. (Farrell and Newman, 2019).

In this paper we argue, that a joint investment future to alleviate the costs of the Western welfare state could soften the sever crisis of interdependence for one pivotal reason: Western saver/voter support. The Western middle class would have immediate benefits from a gradual transition of pension systems to sustainability without a sharp cut of welfare. While the scheme advocated here may not be a panacea it is nonetheless a pragmatic alternative to the nightmarish future that is developing before the dazzled eyes of the largely misinformed about trade US electorate and thus worth trying. It abides to Hippocratic policy principle and it makes no harm.

Our argument, which seconds the declaration that 'Chimerica' is headed for divorce (Ferguson and Schularick, 2011; Trigkas 2015), is that institutions and the current degree of economic interdependence do not make conflict between Beijing and Washington prohibitively expensive as swimming separately may look attractive. One reason of that is the failure of WTO negotiators to curb regulatory arbitrage by the introduction of environmental protection and wage and currency safeguards into trade liberalization treaties (Avgouleas 2019a). This has created the impression that China and other emerging economies such as Mexico took advantage of trade liberalization which resulted in millions of job losses especially in the USA. This is a key factor in the de-coupling of the rational incentives of the respective polities that today fuels populism in the West and secures the necessary votes for the proponents of trade wars and increasing belligerence towards China.

In our formulation of the 'Welfare State Dependence Hypothesis' key Western and Chinese constituents acquire powerful incentives for peaceful economic and geo-political co-existence in Eurasia. In this formulation we see Western powers as capable to play the role of an equal partner to China by mobilizing their private investment resources. In the epoch of money manager capitalism, pouring funds and expertise in the emerging Eurasin economies will make the sustainability of the Welfare state in Western republics partly dependent on the success of this (non-Chinese) region 20-30 years down the road. Hence our 'Welfare State Peace Hypothesis' could to some degree bind the long-term societal interests of major powers together in a reciprocal manner. If China fosters regulatory predictability and engages institutional investors to its market and more importantly across an inclusive and multilateralizedBRI, then Beijing's economic future will be strongly tied to the future of the Western welfare state as a flourishing Eurasia would optimize returns for Western pension funds. A 1 per cent increase of returns for Western pension funds would decrease contributions by 10% providing vital fiscal space and buy political time for sustainable reform of fragile Welfare systems.

This rational re-alignment of incentives of the Western polities with respect to securing the stability of the BRI region and the avoidance of strategic miscalculations that can lead to conflict, should be able to act as a strong rebalancing factor in international relations. The Western saver/voter who so far has been solely preoccupied with declining real income, due, in her perception, to globalization and unfair international trade agreements can this way turn into the key supporter of initiatives that bind together the long-term socio-economic goals of the two blocs. In addition as experts from the Carnegie-Tsinghua Center for Global Policy have put it:

> There is nothing inherently wrong about infrastructure investment or promoting global connectivity in the developing world. Indeed, the United States has an interest in supporting both of these goals. If Washington is to form a coherent response to the BRI, it must acknowledge where the initiative may align with U.S. interests. (Feng Yujun et al, 2019).

These views need to enter into the public debate particularly now that some analysts foresee a coming financial war with the US congress potentially banning US pensions funds and money managers from investing in assets held by Chinese SOEs. (Howie and Garside, 2019).

As we make a case for a liberal yet realistic argument we are not unalloyed optimists. We recall Will and Ariel Durant's 1968 work that in 3,421 years of historical human existence only 268 years have been without war - a fact captured in Thucydides' 5th century prophetic declaration that his essay was not made to win the applause of the moment but was a possession for all time. As strategic communities in both Beijing and Washington calculate their next move and plan for 5th generation jets, conventional prompt strike vehicles, autonomous weapons, quantum encryption satellites and swarms offensives, economics – the dismal science whose prediction on the pension time bomb are however accurate – may offer some guidance to downsize the risk of war be it cool, cold or warm.

With institutional investors part and parcel of Eurasia's future, governments and voters (pensioners are among the most committed voters) would not have trouble to see the 'long shadow of the future', read its contours and realize that the survival of the Western welfare states lies in integration rather than disintegration and zero-sum geo-economic antagonism. Swimming separately would be less attractive. Perpetual peace may never arise but any Hippocratic policy narrative (Miskimmon, O'Loughlin and Roselle, 2017) which is based on realistic foundations and fosters creative reform towards interdependence makes no harm[13].

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[1] President Barrack Obama's pivot to Asia – later reframed rebalancing was the beginning of US's effort to balance China's rising influence in the Asia-Pacific. See: The White House (2015). *Fact Sheet: Advancing the Rebalance to Asia and the Pacific*. [online] Available at: https://obamawhitehouse.archives.gov/the-press-office/2015/11/16/fact-sheet-advancing-rebalance-asia-and-pacific [Accessed 21 Jan. 2019].

[2] The Trump administration has interpreted China's Made in China 2025 project as a strategic effort by Beijing to channel massive state resources towards emerging technologies, leapfrog Western corporation and eventually encroach their market shares both in China and globally. Therefore, the US and its western allies should try their best to block it.

[3]The democratic Peace Hypothesis remains one of the most contested themes in international politics. In its weak version the hypothesis supports that democracies rarely fight with each other. In its strong version it argues that democracies win wars against non-democracies. The foundation of the theory goes back to Aristotle and it was introduced in modern political science by the exemplary work of S. M. Lipset (1959). 'Some Social Requisites of Democracy: Economic Development and Political Legitimacy. *American Political Science Review*, *100*(04), pp. 69-105. For a recent discussion see: Bruce Russet (1993) *Grasping the democratic peace: principles for a post-Cold War world,* Princeton, NJ: Princeton University Press; for a critical appraisal see Ido Oren (1995) 'The subjectivity of the "democratic" peace: changing US perceptions of imperial Germany', *International Security* 20 (2),pp. 147–84; also see Christopher Layne, (1994) 'Kant or cant: the myth of the democratic peace', *International Security* 19 (2); David E. Spiro (1994) 'The insignificance of the liberal peace', *International Security* 19 (2), pp. 50–86. For a contrarian and prophetic view on the failure of democratic peace to socialize China into the liberal democratic norms see: J. Mann (2008). *The China Fantasy: How our Leaders Explain Away Chinese Repression*. New York, N.Y.: Penguin Books.

[4] We frame this issue as an issue of realism; for without a viable welfare state, Western societies would face a serious social and political crisis which could undermine their global authority. Furthermore if the BRI remains a closed project seeking solely to build markets for China to export its overcapacity then it could incentivize the United States to act against the BRI and even disrupt it covertly or overtly. Thus the most viable strategy for China to avoid such a scenario would be to support the multilaterilization of the BRI and invite participation of Western investors. On a theoretical perspective in the literature of international relations one may argue that our argument assumes that the benefits to China and the West would be reciprocal and would not alter the 'relative power balance'. On the issue of relative VS. absolute gains and great powers relations see: Sebastian Rosato, (2015) 'The Inscrutable Intentions of Great Powers' *International Security,* 39 (3), pp. 48-88.

[5] A similar Western private sector duty was implied in the 2019 letter of Larry Fink the CEO of BlackRock, the biggest institutional investor in the world, to the CEOs of investee companies. 'One thing, however, is certain: the world needs your leadership… Companies cannot solve every issue of public importance, but there are many – from retirement to infrastructure to preparing workers for the jobs of the future – that cannot be solved without corporate leadership. Retirement, in particular, is an area where companies must re-establsh their traditional leadership role . . . nearly all countries are confronting greater longevity and how to pay for it. This lack of preparedness for retirement is fuelling enormous anxiety and fear, undermining productivity in the workplace and amplifying populism in the political sphere.'

[6] For an important yet non-conclusive debate on the theory of Secular Stagnation see (Project Syndicate, 2018). For more technical discussions, see: Eggertson, G. and Mehrotra, N., (2014). A model of secular

stagnation" *NBER Working Papers*, No 20574. Rogoff, K., (2016) "Debt supercycle, not secular stagnation", in *Progress and Confusion: The State of Macroeconomic Policy*, MIT Press, pp. 19-28; Summers, L., "Reflections on the new secular stagnation hypothesis", in *Secular stagnation: facts, causes and cures*, Vox, 2014, pp. 27-40.

[7] A two-year study from McKinsey Global Institute suggests that by 2030, intelligent agents and robots could eliminate as much as 30 percent of the world's human labour. McKinsey reckons that, depending upon various adoption scenarios, automation will displace between 400 and 800 million jobs by 2030.

[8] As Davis and Steil noted: '*The puzzle for finance theorists is that global diversification is not pursued to its logical extreme; instead, institutions tend to invest at least 60% of their assets in the home market, and in most, the figure is over 90%. Enormous differences is expected yields would be needed to account for such portfolios in the context of the theory of efficient markets'*. (Davis and Steil, 2001).

[9] For theoretical and practical insights on how economic geography is affecting asset management and the way pension funds are affected see: (Clark, 2000).

[10] We say in part for this is not a panacea. Higher risk adjusted returns must be complemented by structural reforms in Western economies including fairer distribution of income and the build up of social capital along with stronger democratic participation.

[11] For a comprehensive list of risks associated with infrastructure investments see: OECD, (2015). Infrastructure Financing: Instruments and Incentives. Available at: http://www.oecd.org/finance/private-pensions/Infrastructure-Financing-Instruments-and-Incentives.pdf; https://www.bis.org/publ/work454.pdf

[12] According to the CSIS Reconnecting Asia database: 89 percent of contractors participating in Chinese-funded projects are Chinese companies. Only 7.6 percent are local companies, with 3.4 percent non-Chinese foreign companies. For projects funded by multilateral development banks, by contrast, 29 percent of contractors are Chinese, 41 percent are local firms, and 30 percent are non-Chinese foreign firms. Port investments and upgrades involve finance, design, construction and servicing, which are all activities Chinese firms provide at lower prices given the domestic advantages and assistance offered to them by Beijing.

[13] As (Miskimmon, O'Loughlin and Roselle, 2017) put it in their excellent work: Policy narratives explain '*why a policy is needed and is normatively desirable and how it will be successfully implemented or accomplished. Issue narratives set political action in a context with an explanation of who the important actors are, what the conflict or issue is, and how a particular course of action will resolve the underlying issue*'. In our case for instance the policy narrative explains why higher risk adjusted returns are essential for the sustainable reform of the Western welfare state and then the issue narrative focuses on the catalytic actors to undertake such goal, mainly pension funds, money managers and Chinese funds across the BRI.