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The United States, China, and Constructive Strategic Stability

Here at Confluence, we have long conducted deep analysis of the world's geopolitical landscape to better understand the global investment environment and craft our investment strategies. A big part of our analysis is to understand which country is currently the global "hegemon," i.e., the big, strong, dominant nation that serves as the global leader, takes the lead in providing international security, and provides the reserve currency.

We avidly subscribe to "hegemonic stability theory," which teaches that the world has typically been more peaceful and prosperous when there is a functioning hegemon. The theory teaches that the world has often suffered more frequent wars and economic disruptions when there is no functioning hegemon, or when the reigning hegemon is challenged by an upstart. In this report, we offer some new thinking on that theory and examine its implications for investment strategy.

The Classical Thucydides Trap

The "Thucydides Trap" is an idea that comes from the ancient Greek historian whose name it bears. Thucydides deeply analyzed a situation in which the incumbent superpower or hegemon of the time, Sparta, was faced with an insurgent power, Athens. The two powers ultimately ended up in a ruinous war. Thucydides therefore postulated that when an established

superpower or hegemon is being threatened by a rising one, the likelihood of war increases.

In 2017, Professor Graham Allison of Harvard University published a study of the Thucydides Trap¹ that examined 16 examples of it over the last five centuries. The study also considered what those experiences might mean for the possibility of war between the United States (the current global hegemon) and China (the current upstart power). Of the 16 historical challenges that Allison studied, he found that 12 resulted in war while four did not. His results are shown in Table 1 on the next page.

Obviously, Allison's finding that 75% of hegemonic challenges end up in war is not comforting. Allison did conduct an examination of the trap conditions that didn't result in war and tried to draw conclusions, but the concept of the Thucydides Trap has nevertheless taken on the character of a warning sign that the US and China may be destined for war in the future.

The Thucydides Trap Under Constraints

While we respect Allison's analysis of past instances of the Thucydides Trap, we are increasingly struck by signs that it may no longer be fully operative in today's world. In part, this is based on our view of modern trends in defense technology, global

¹Allison, Graham. (2017). *Destined for War: Can America and China Escape Thucydides's Trap?* Boston, MA: Houghton Mifflin Harcourt.

demographics, economic interdependencies, domestic political realities, and similar issues. Few, if any, of these modern constraints would likely be enough to preclude a war between the US and China. However, we are starting to believe that the cumulative effect of these constraints will be to reduce the risk of war between these two

great powers and their allies. In later sections, we look more closely at how these constraints seem to have forced the US and China into a kind of détente over the last year. Before that, however, we examine some of the key constraints as follows:

Table 1

The Thucydides Trap: Frequency of War in Hegemonic Transitions			
Source: Prof. Graham Allison			
Period	Incumbent Hegemon	Challenger	Outcome
Late 1400s	Portugal	Spain	No war
Early 1500s	France	Habsburgs	War
1500s to 1600s	Habsburgs	Ottoman Empire	War
Early 1600s	Habsburgs	Sweden	War
Mid-to-Late 1600s	Dutch Republic	England	War
Late 1600s to Early 1700s	France	Great Britain	War
Late 1700s to Early 1800s	UK	France	War
Mid-1800s	France & UK	Russia	War
Mid-1800s	France	Germany	War
Late 1800s to Early 1900s	China & Russia	Japan	War
Early 1900s	UK	USA	No war
Early 1900s	UK (sppt by France, Russia)	Germany	War
Mid-1900s	UK, France, USSR	Germany	War
Mid-1900s	USA	Japan	War
1940s to 1991	USA	USSR	Cold War / Proxy War
1991 to ???	USA	China	???

Nuclear Weapons. Since nuclear weapons have such formidable destructive power, we think they're the biggest constraint on the type of hegemon-challenger warfare posited by the Thucydides Trap. In the US-USSR rivalry during the Cold War, the enormous nuclear arsenals held by each side promised "mutually assured destruction" if they ever got into a direct nuclear war. There were certainly close calls, and there were lots of casualties in proxy wars and clandestine CIA-KGB skirmishes, but US and Soviet leaders alike sought to avoid direct war and ultimately agreed on important arsenal reductions. In today's US-China rivalry, Beijing is rapidly building up its arsenal of nukes after decades in which it kept only a minimal number of weapons. [It is currently](#)

[estimated to have an arsenal of about 620 warheads, and it is building almost 100 additional warheads each year.](#) As shown in Figure 1 on the next page, the US military therefore estimates that China's nuclear arsenal will match the US deployed arsenal by the mid-2030s, just as Russia's arsenal does today. Of course, China's nuclear buildup complements the rapid expansion of its conventional military forces.

Demographics. Another important constraint for both the US and China is their falling birth rates, weakening population growth, and rising average ages. Since a country's overall economic output is simply the size of its workforce times hours worked times productivity, falling birth rates and

slower population growth will retard growth and limit the resources available for military investment. More directly, the total US military-age population (16 to 49 years) is now barely growing, and its share of the total population is expected to fall to just 44.3% by 2035, versus a peak of 51.9% in 1989. China's military-age population is already in outright decline and should fall to 45.0% of the population by 2035, versus its peak of 55.9% in 2007 (see Figure 2).

Figure 1

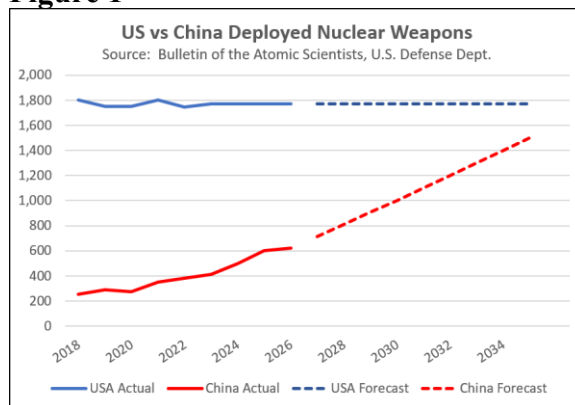
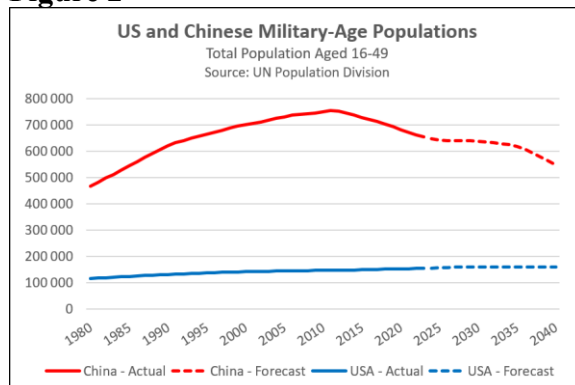


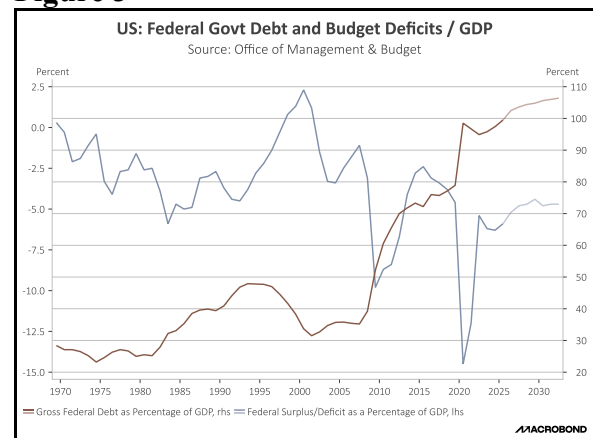
Figure 2



Fiscal Issues. In both the US and China, government fiscal issues will likely be a constraint on the two sides' rivalry into the future, but the dynamics are different in each country. Based on data from the Bank for International Settlements, total general government debt in the US in early 2026 reached 111% of gross domestic product (GDP), almost all of which was federal

government debt. Indeed, federal debt as a share of GDP is now at a record level, exceeding even past wartime levels (see Figure 3, brown line). As a result, interest costs alone rival or exceed the US defense budget. In China, general government debt is now at 100% of GDP, but the large majority of it appears to be provincial and local debt, illustrating the central government's strong aversion to borrowing at the national level. In sum, actual federal debt in the US and an aversion to central government debt in China likely will be a constraint on the two countries' rivalry going forward.

Figure 3



Industrial Issues. We also think challenges in the US and Chinese industrial sectors could impose limits on the two countries. In the US, for example, decades of de-industrialization under globalization have left the country unable to source many key products domestically or even from trusted allies. In many cases, such as rare-earth mineral products, the US defense industry is dependent on supplies from China, as became clear when China throttled back shipments of rare-earth magnets in 2025 to retaliate for the US's new tariffs against Chinese goods. [That incident threatened to disrupt swaths of US manufacturing and quickly forced the US administration to ease its trade barriers.](#) More broadly, it is

increasingly clear that the US defense industry can't quickly produce the weapons and other supplies needed to replenish the US arsenal after the Iran war and prepare for a fight with China. The last few US administrations have adopted policies to encourage re-industrialization, but progress so far has been limited. On the Chinese side, the issue is different: Beijing's industrial policies have helped lead to massive excess capacity while stunting domestic consumer demand. China is therefore increasingly dependent on goods exports — exports that would likely be blocked in an outright US-China military conflict.

Diplomacy and Trade. [Another reason for the US and China to hesitate about any potential war is the global fracturing that we at Confluence have discussed so much over the last few years.](#) As we've noted, the growing US-China rivalry has helped put an end to the Globalization Era that lasted from roughly 1990 to 2020. Since then, growing frictions between the US and China have prompted countries around the world to fracture into relatively separate geopolitical and economic blocs. Nationalist populism is now threatening to further fracture the blocs as they exist today, leading to even more trade barriers, supply chain disruptions, and decreased trust and cooperation among allies. One example of this was the clear reluctance of many traditional allies to make their military bases available to the US for its war against Iran.

- Going forward, the new, more fractured state of the world will likely lead to more geopolitical tension.
- However, the potential loss of key allies could also help discourage the US and China from outright warfare.

Domestic Politics. Finally, we think US and Chinese leaders will also have to restrain

their geopolitical fight against each other because of domestic political considerations. In the US, we have long argued that the decades-long economic and social costs of global hegemony were the key source of today's nationalist populism, which is expressed in greater isolationist sentiment and the "America First" movement. Messy wars in Afghanistan, Iraq, and now Iran have only served to intensify the popular resistance to war.

Of course, Chinese General Secretary Xi Jinping has consolidated his authoritarian rule to such an extent that he probably has greater leeway to launch a military operation if he so chooses. Nevertheless, Communist Party leaders in China have long been careful to prioritize rising standards of living in order to legitimize their monopoly on power. We think a US-China conflict would be so economically disruptive that it would threaten domestic political stability in China. In sum, domestic politics on both sides are probably a lasting impediment to outright conflict.

Constructive Strategic Stability

There are likely other dimensions of the national landscape in both the US and China that could inhibit leaders' willingness to take geopolitical risks. All the same, the analysis above illustrates the constraints now operating to frustrate either side's desire for a decisive conflict. As long as each side faces the kinds of constraints outlined above, the US-China relationship is likely to remain in a kind of *stalemate*. If these constraints remain in place, political leaders in the US may have to restrain themselves in trying to preserve the country's traditional position as the global hegemon. Political leaders in China will likely need to be patient in pursuing goals such as unifying Taiwan with the mainland or eliminating US

political influence in the Western Pacific Ocean.

The constraints discussed above and the resulting US-China stalemate were probably the key reasons why President Trump and General Secretary Xi agreed at their May 2026 summit to follow a new mode of interaction aimed at reducing tensions. [This new relationship, which has similarities to the US-Soviet détente of the 1970s, has been designated “a constructive relationship of strategic stability on the basis of respect, fairness, and reciprocity.”](#) For the US diplomats who helped craft the policy, *Constructive Strategic Stability (CSS)* implies fair economic and political interaction. For the Chinese, CSS must also include respect for each other’s sovereignty, territorial integrity, social system, and development path.

On the US side, there are already signs that CSS has modified behavior. [For example, the US’s “Operation Economic Outcast” program of increased sanctions and other measures against Iran launched in August conspicuously avoided penalizing China for buying Iranian oil or providing any other support to Tehran.](#) Separate from that, it has become clear that the US is taking a more accommodative approach to Beijing, from its ratcheting back of new technology export restrictions against China to President Trump’s unusually deferential greeting of General Secretary Xi when he arrived in the US for his September summit with Trump.

We have seen signs that CSS is also serving to restrain Chinese behavior to some extent. However, it’s notable that Beijing doesn’t seem to be pulling back from its economic, diplomatic, and military pressure against US allies. [In early autumn, for instance, the Chinese military restarted its provocative harassment of Philippine vessels in disputed](#)

[areas of the South China Sea.](#) The Chinese government has also continued to limit the shipment of rare-earth products to Japanese manufacturers, complicating their operations and forcing them to pay higher prices for needed components.

More Room for Cooperation

In fact, even beyond the constraints that may be encouraging CSS and limiting the risk of war between the US and China, our analysis suggests the two countries retain flexibility in some other key areas, creating opportunities for cooperation in a key part of today’s global economy and financial markets. Specifically, we think that flexibility in the areas of technology, industrial policy, and finance could support deeper, mutually beneficial trade and investment in artificial intelligence and other aspects of information technology.

Technological Innovation. Our read of the scientific literature suggests US researchers continue to define the frontier of AI modeling, even if Chinese open-source models aren’t far behind. However, it appears that there are clearer strengths and weaknesses in more discrete areas of the AI value chain. For example, the US and its allies remain at the very forefront of semiconductor design, production, and equipment. Meanwhile, the Chinese industrial and consumer markets are considered to be exceptionally open to adopting cutting-edge technologies. If the US and China can be confident that their intellectual property will be respected, that would provide a basis for robust trade in AI-related goods and services.

Finance. The US financial system is widely recognized for its enormous, deep, relatively well-regulated financial markets. One especially important aspect of this is the strong US venture capital system, which can

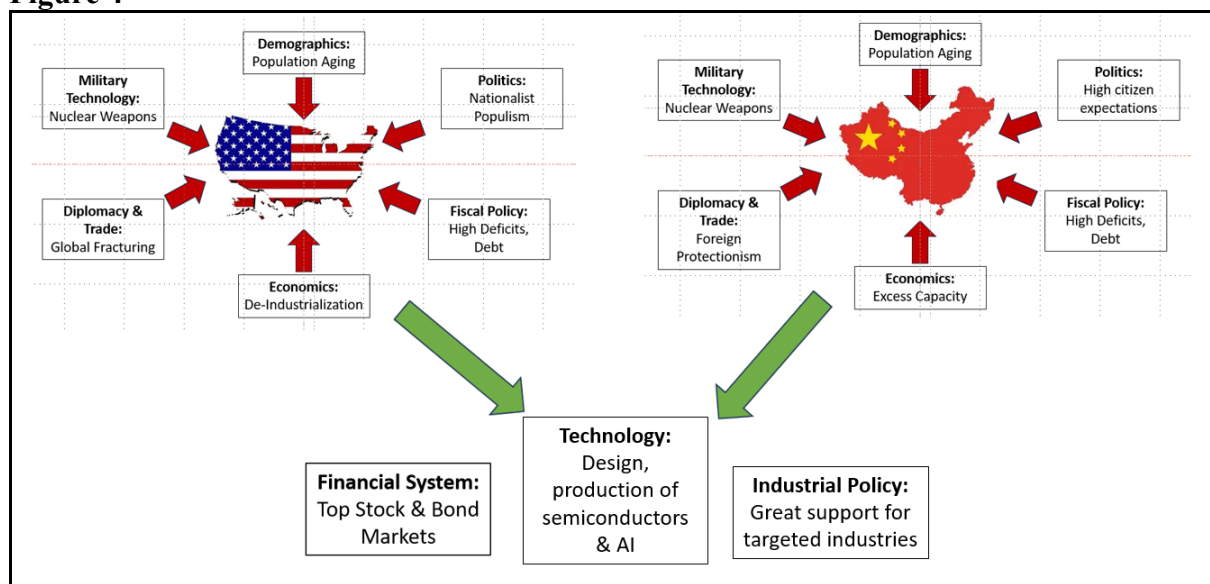
raise the large amounts of financing needed for today's AI infrastructure investment. China's financial markets are much less developed, despite the government's new goal of making the country a "financial superpower." It's therefore reasonable to assume that the US's important financial sector and China's own economic development imperatives would have much to gain from increased AI cooperation.

Industrial Policy. Finally, both the US and China are currently embracing what might be called a renaissance of industrial policy, especially when it comes to supporting the development of technology industries. In the US, the federal government is working hard

to support the information technology sector and the energy and critical minerals industries that support it. This effort even extends to the government taking equity stakes in tech and critical minerals firms, setting price floors to benefit them, and imposing trade barriers to protect them. In addition, the Chinese government has long supported its target industries with trade barriers, subsidies, and other tools.

Taken together, the relative flexibility that the US and China have in their technology, industrial policy, and financial market arenas could be a fruitful area of cooperation for the two sides (see Figure 4).

Figure 4



Investment Implications

We have argued recently that China is having considerable success as it works deliberately to build its comprehensive power — military, diplomatic, economic, technological, and cultural. In fact, in our [Bi-Weekly Geopolitical Report from October 27, 2025](#), we argued that the overall balance of power between the two countries is shifting noticeably in favor of China. If that trend continues, China could eventually

become the unquestioned predominant player in the relationship. *Because of the current balance of power and the trends in Beijing's favor, we want to stress that today's geopolitical, economic, and technological tensions between the US and China will likely continue for some time to come. They could even increase.*

Nevertheless, what we're showing in this report is that the constraints on each side's

behavior could reduce the likelihood that their leaders would take a military risk that might spark a war. Our central argument here is that the risk of a US-China war may currently be less than might be implied by the Thucydides Trap theory. There are also potential areas of mutually beneficial cooperation, such as in AI.

For investors, that means that today's global investment environment may be somewhat more benign than it might have appeared a couple of years ago, especially at the height of the Biden administration's get-tough approach to China. While one could argue that it would be better for the US to take a tougher stance against China to preserve its relative power and deny China the advantage, the near-term reality is that a world less at risk of a major war is probably better for risk assets, all else being equal. In fact, it may well be that the heretofore unarticulated assessment that war risks are lower than previously thought could be one

element supporting the global AI investment boom.

More specifically, the relative US-China stalemate, tension-reducing CSS policy, and potential for cooperation in technology investing all suggest that Chinese stocks may face fewer geopolitical headwinds than investors realize. (Of course, Chinese equities still face other issues, such as Beijing's willingness to adopt policies that squeeze corporate profits.) Moreover, reduced war risks are probably at least marginally beneficial for the stocks of US and allied companies that sell or produce in China. This doesn't necessarily argue for a stampede into China-related stocks, but it is one argument for being more open to them than otherwise would be the case.

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