Australia and the Rise of Geoeconomics

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The Centre of Gravity series

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Introduction

In early 2015 a serious disagreement developed in the Australian Cabinet. Prompted by China’s invitation to Australia to become a founding member of an Asian Infrastructure Investment Bank (AIIB), senior ministers gravitated towards two opposed positions on how to respond. Ministers in charge of economic portfolios, led by Treasurer Joe Hockey and initially with the support of Prime Minister Tony Abbott, advocated that Australia should accept Beijing’s invitation. China was Australia’s major trading partner, and several studies had pointed out the need for infrastructure building in Asia in the coming decades. Ministers in charge of security related portfolios, led by Foreign Minister Julie Bishop, argued that Australia should demur. A Chinese-dominated infrastructure fund, they argued, could be used to build strategic footholds for an expanding Chinese power footprint under the guise of economic imperatives. Chinese behaviour had become increasingly assertive, and the United States had lobbied Australia, along with other allies and partners in the region, against joining.

Cabinet could not reach a decision over two separate debates, one of them within its smaller National Security Committee. In the end, it was the announcement that the United Kingdom would join that caused a stampede of US allies to accept China’s invitation, prompting Australia to follow suit. The Australian government put a brave face on its initial indecision, arguing that its caution had allowed it the space to encourage China to improve the governance design of the new institution.

Executive Summary

- Regular geoeconomic dilemmas posed by diametrically opposed American and Chinese preferences will persist and grow more acute.
- The concept of geoeconomics draws together the three defining international trends of our age: increasing but sublimated rivalry between major powers; the ever-deepening mutual dependence of national economies; and the increasingly crucial alignments of smaller states.
- Australia stands to lose a great deal if the nascent logic of geoeconomics becomes dominant in the region. At this stage, preliminary geoeconomic rivalries, such as the Asian Infrastructure Investment Bank decision, pose uncomfortable choices.
- The Australian government must acknowledge the growing forces of geoeconomic rivalry and devise a strategy to allay it. Australia’s international economic policy should shift from its narrow focus on the self-interested promotion of Australia’s prosperity towards a more strategic focus on defending and bolstering the multilateral trading and investment order.

Policy Recommendation:

- Create a standing unit sourced from the core economic and strategic portfolios across government, located within the Department of Prime Minister and Cabinet, to serve decision-makers at Secretaries Committee on National Security (SCoNS) and National Security Committee of Cabinet (NSCC). Such a unit would also inform Australia’s international economic diplomacy aimed at reducing geoeconomic rivalries and provide an ongoing, whole-of-government discussion on the implications of the merging of economic and strategic logics.
Few commentators believed this, rather interpreting the episode as yet another occasion when Australia had been caught in a dilemma caused by the growing rivalry between its major ally and largest trading partner.¹ The case of the AIIB was not unique or even new – it joined a long list of dilemmas posed to Australia over more than a decade, giving the lie to the dogged refrain of Australian governments of both sides that Australia did not have to choose between the United States and China.² It would be a mistake to interpret the AIIB controversy as an isolated case, or to dismiss the broader trend that such uncomfortable choices, where Australia risks the censure of either its most significant trading partner or its major ally, are becoming more frequent. To believe that Australia can simply deal with these pragmatically, on a case-by-case basis, risks basing Australian policy on a framework of denial and hope.

It is time that Australia confronts this mounting challenge to its policy coherence. Regular dilemmas posed by diametrically opposed American and Chinese preferences will persist and probably grow more acute unless Australia develops a clearer understanding of why and in what form they occur, as a prelude for actively seeking to shape our international context in ways that stop such choices being posed. Australia’s alliance and its trading relationships are both crucial to this country’s future safety and welfare; to allow an attitude of denial, policy timidity and a lack of policy imagination and ambition to threaten our ability to maximise our benefits from either or both is a major dereliction of responsibility.

The purpose of this essay is to explore what I believe is an increasingly persistent trend in the dynamics of the Asia Pacific region, and the source of more and more of our troubling dilemmas; the rise of geoeconomic rivalry among the region’s three great economic powers, the United States, China and Japan. The concept of geoeconomics encapsulates three intersecting vectors – economic integration, sublimated strategic rivalry, and the importance of how groups of countries align their political, economic and security preferences – that are driving a complex regional dynamic completely new to Australia. It is a context that this country’s traditionally highly effective approaches to foreign economic policy are completely unsuited to dealing with. By developing a better understanding of what is going on, we can begin to fashion new policy frameworks in response. The essay will begin with an exploration of the concept of geoeconomics, before analysing why it has arisen so powerfully in Australia’s region in the past decade or so. The heart of the essay looks at the players and issues that are central to the dawning age of geoeconomics, and I conclude by sketching out what I believe are the policy imperatives for Australia in the geoeconomic age.

**Whatever is geoeconomics?**

Geoeconomics is a term first dreamt up by the mercurial American strategist Edward Luttwak, who was looking for ways to stay relevant after the end of the Cold War. At a seminar at the Centre for Strategic and International Studies in Washington DC in mid-1990, Luttwak argued that

> The methods of commerce are displacing military methods – with disposable capital in lieu of firepower, civilian innovation in lieu of military-technical advancement, and market penetration in lieu of garrisons and bases. States … will not disappear but reorient themselves toward ‘geoeconomics’ … the best term I can think of to describe the admixture of the logic of conflict with the methods of commerce.³

Luttwak had anticipated the zeitgeist, as states cashed in on the post-Cold War “peace dividend” and reoriented their foreign ministries and intelligence agencies towards an anticipated era of hyper-commercial competition, with globalisation taking hold, former communist states joining the world market, a new information economy limbering up, and a new “end of history” expectations of democratic peace taking flight. Since Luttwak coined the term, geoeconomics has waxed and waned in discussions of what forces are shaping the world of the 21st century.⁴
But for all of Luttwak’s prescience, geoeconomics has remained an occasional piece of analytical rhetoric rather than a serious framework to guide analysis and policy. Unwittingly, the concept of geoeconomics draws together the three defining international trends of our age: increasing but sublimated rivalry between major powers over who sets, enforces and follows international rules; the ever-deepening mutual dependence of national economies on an increasingly unpredictable outside world for their own welfare and prosperity; and the increasingly crucial alignments of smaller states in determining the future balance of leadership and advantage in the global order. Rivalry between large countries is hardly new; what is significant is how they prosecute it. Nuclear weapons, energy import-dependence and the increasing dominance of market perceptions in determining national fortunes have made the traditional way of resolving international rivalry – major great power war – dangerously pyrrhic. This century has seen a range of new forms of competition, from “soft power” to institutional proliferation to “hybrid warfare”. Globalisation has progressively deprived states of capacity to determine their own economic fates, while at the same time as they become dependent on the outside world, the international economy becomes increasingly unstable and unforgiving. Meanwhile both the logic of rivalry and the logic of economic interdependence turn increasingly on the major powers’ relationships with medium sized and smaller states.

These three considerations have subjected international economic activities to a range of pressures and expectations with which businesspeople and economic policy officials are unfamiliar. While competition and rivalry have always been integral to the operations of free markets, the geoeconomic age has shifted the nature of this competition. Market dominance is now too fragile and uncertain in the new information economy; it needs to be secured on the basis of sympathetic global economic rules and specific agreements among trading economies. Meanwhile growing strategic rivalry despite 70 years of peace has driven a search for new forms of influence and coercion, and in the world of the 21st century, none stand out as more promising than cross-border economic relationships. And both rules and influence depend less on who leads than who follows: the trick of building power and advantage in the new century centers on which great power is more effective in capturing the alignments of smaller countries than its rivals.

In other words, the geoeconomic age heralds the simultaneous securitisation of economic policy and economisation of strategic policy, with both dynamics being played out across a chessboard of geographic advantage and vulnerability. Fewer and fewer cross-border trade and investment decisions are taken on solely economic grounds – ie whether the financial dividends will be greater than the investment plus the prudential risk – any more. Economic and business decisions are now appraised with an eye to what strategic advantages they will bring, from making other countries more sympathetic to certain strategic positions, to tying research-industrial complexes together in particular strategic industries, to capturing markets and supply chains at the expense of direct rivals. At the same time, strategic rivalry is sublimated by the threat of self-defeating conflict, into the commercial realm. The relative market power of telecommunications, energy, education, and electronics firms is about much more than economic success – they are taken as proxies for the emerging challenge, dominance or decline of the countries in which they are based. Underlying these imperatives is a widely-shared belief that rivals will convert their economic power into political alignments; and that political and institutional advantages will be used to perpetuate and extend commercial advantages. The cycle of dominance becomes self-perpetuating unless it is challenged. All of this is underpinned by a moral rivalry, as different approaches to trade and finance are justified according to different normative frameworks: the universal applicability of capitalism and private enterprise versus the legitimate role of the state in the economy in developing societies and the right of every community to choose its own economic framework.

Geoeconomics in the Asia Pacific

Of course the interaction of strategy and economics dates back centuries and crosses all cultures. But in the Asia Pacific a new geoeconomic age is unsettling precisely because it is so unfamiliar. While geoeconomic competition emerged in the Asia Pacific between the First and Second World Wars, since the end of the Second World War, Australia’s region has been remarkably free of geoeconomic rivalry. The Cold War saw Asia’s traditional economic
centre, China, secluded behind the iron curtain, prompting the emergence of a new economic-security community around the Pacific Rim. Japan, Korea, Taiwan, the non-communist Southeast Asian states, Australia and New Zealand were all given US security guarantees, and among them developed trade and investment ties that fostered rapid economic growth. While disagreements and competition existed over trade and economic philosophies, these were bounded and ultimately resolved because of the importance of the security umbrella provided by American military power. And while economies boomed, there was far less need to question either American power or the liberal capitalist rules that the US had designed for the non-communist world.

This security-economics-ideological virtuous circle ruptured as China embarked on its course of market reforms, and especially so after it joined the World Trade Organization in 2001. China became a vast sponge for foreign direct investment as Asian and Western industry flocked to take advantage of its low wages, favourable investment terms and high labour productivity. An economy that contributed less than 5 per cent of global production in 1975 had become by 2006 the world’s largest importer of minerals and energy; by 2007 the world’s largest exporter; by 2008 the world’s largest manufacturer; by 2012 Asia’s largest economy; and by 2014 the world’s largest economy in purchasing power parity terms. Currently, China accounts for a larger share of global economic growth than the rest of Asia combined, and claims to be the largest trading partner for 130 countries. Its gravitational effect on the Asian regional economy has grown steadily; as most Asian countries’ major trading partner and the dominant investment partner of a significant and growing number, the rhythms and fortunes of China’s economy are increasingly central to the economic fortunes of most of its neighbours.

Since the start of the century, the dynamics of economic growth and integration have taken place outside of the US security umbrella in the Asia Pacific. Cross-Pacific trade and investment has been anaemic at the same time as intra-Asian trade and investment has boomed. And yet while willingly tying their economic fortunes to the Chinese economy, Pacific-rim states have simultaneously been deepening their security relationships with the United States. Since 1996, all of America’s treaty allies – Japan, Korea, the Philippines, Thailand and Australia – as well as a range of security partners, such as Taiwan, Singapore and Malaysia have all taken measures to draw themselves closer to the United States in military and intelligence collaboration. Meanwhile, the 1997-1998 Asian Financial Crisis and the Global Financial Crisis a decade later punctured the legitimacy of Western-led international economic rules and institutions among Asian states. Both crises exposed what Asian societies saw as incompetence and pro-developed country bias in the International Monetary Fund. Allies such as Korea and Thailand were shocked at American indifference to their plight during the Asian Financial Crisis, creating lingering doubts about the credibility of US commitments in Asia.

In response to the Asian Financial Crisis, the countries of Asia retreated into a new bout of regional institution-building, notably without the United States. Japan proposed an Asian Monetary Fund as a way of mitigating Asia’s reliance on the IMF as a lender of last resort; the countries of Asia came together to create the Chiang Mai Initiative, a currency-swap arrangement that would allow the countries of the region to rely on each other rather than the IMF in subsequent financial crises; and the ASEAN+3 forum, bringing together Japan, Korea, China and the states of Southeast Asia, began to meet regularly. Asia’s retreat into regionalism occurred against a backdrop of the sputtering multilateralism of the Doha round of trade liberalisation, where the proliferation of economic and financial power and the growing complexity of trade and investment conditions made coming to a final agreement look increasingly unlikely. Preferential trade agreements, in which specific concessions are traded bilaterally or plurilaterally, have become much more popular as countries worry that committing to non-specific liberalisation will benefit their competitors in an increasingly competitive global economy.
Currently there are strong signs that geoeconomic competition is on the rise in the Asia Pacific, but it is too early to pronounce the victory of geoeconomic rivalry over the usual conditions of commercial comity with which economists are more familiar. Much depends on the perceptions of policymakers and businesspeople of how other countries and companies are behaving, and therefore how they should react. Commercial comity – a shared commitment to the free play of commercial competition underpinned by an impartial, rules-based market – has been the default condition of the international economy since the end of the Second World War. What threatens comity is a growing perception among participants that some among them are seeking or exploiting unfair advantage, and a sense that others must respond in kind – if only to protect their interests. The signs of rivalry trumping comity appear in several forms, such as when parties to an economic transaction become more concerned that others are gaining relatively more from the transaction than they are – even if all involved are gaining absolutely from the transaction. Or when rivalry and suspicion in one sector spills into other sectors. Or when the authorship of market rules becomes more important than their existence and universality. Or when new rules are under negotiation, the parties are unable to acknowledge each other’s concerns as legitimate considerations in a compromise. Each of these indicators is present but none are yet dominant. However if they gain momentum and begin to reinforce one another, geoeconomic rivalry could become a dominant dynamic in the Asia Pacific.

The protagonists

Geoeconomic competition is deepening among the world’s three largest economies, the United States, China and Japan, across the region they share, the Asia Pacific. These three giant economies, comprising 25.4%, 15.5% and 5.6% of world GDP respectively, are deeply interconnected through ties of investment, technology and trade, with the economic vitality of each heavily dependent on its commerce with the other two. And yet rivalry among them – not only in strategic terms but also in economic terms – is intensifying year-on-year. The longest-standing rivalry is that between the United States and Japan, which have disagreed for decades over the role of the state in the economy, the locus of responsibility for correcting imbalances in trade and financial surpluses and deficits, and the relationship between development assistance and industrial policy. Although US-Japan economic rivalry has been sublimated by their shared strategic concerns about China, differences can flare occasionally, such as Tokyo’s proposal of an Asian Monetary Fund during the Asian Financial Crisis, much to Washington’s opposition. Economic rivalry between China and the United States has increased over the past two decades, centring on many of the same issues that motivated US-Japanese rivalry, as well as concerns over Chinese industrial espionage, labour conditions and environmental standards. China-Japan rivalry is more recent, dating from the Asian Financial Crisis, which saw Beijing and Tokyo competing to be acknowledged as providing economic leadership in those troubled times. More recently, Japanese businesses have been pursuing a “China-plus” strategy of redirecting their investment away from China towards Southeast and South Asia. China, meanwhile has shown its willingness to manipulate its near-monopoly production of rare-earth metals to Japan’s detriment, and Japanese factories in China have been subjected periodically to nationalistic rioting and vandalism.

The Asia Pacific’s triangular geoeconomic rivalry has its roots in the fears and objectives of each of the three major protagonists. The United States sees Asia as a crucial arena for American trade and investment, and is wary of any move that could be motivated by a desire to exclude American commerce from Asian markets, or American diplomacy from regional institutions. More recently, Washington has been determined to use trade, investment, and development initiatives to underscore its commitment to remain a force in the Asia Pacific, as a crucial non-military strand in President Obama’s “rebalance” strategy towards the Pacific. In this enterprise, the United States has been battling significant skepticism among Asian countries that the rebalance represents much more than hopeful rhetoric. There is a
significant domestic component to American economic objectives in the Asia Pacific also. Successive administrations have realised that maintaining costly security commitments in the region will be untenable unless the United States can correct its substantial and growing trade deficits with Asia. The key challenge for the United States, then, is how to use the growing demand for a continuing American security presence in the western Pacific to reverse the steady erosion of its economic position in the region. There is a defensive element to this calculation too. The United States worries that Asia's rising economies, and particularly China, will use their economic power to build political and strategic influence, exclude the United States, and shape the region's economic rules and institutions in their own interests. As China's economy grows, the United States has become more and more anxious to preserve the liberal rules of the regional economy, and a significant American role in formulating and defending those rules.

While the United States has faced challenges from other rising economies since the end of the Second World War, the case of China is quantitatively and qualitatively different from those of the Soviet Union, Japan or Germany. China has already surpassed the other challengers in absolute economic size, and may have quite a bit more growth to come. Unlike Japan and Germany, it is not dependent on the United States strategically or politically; rather its growing political and strategic rivalry with the United States is feeding its economic rivalry. While the United States sees China in the aggregate as a significant economic power, China focuses on its per-capita wealth, a factor that further drives Beijing to undercut and neutralise what it sees as America's advantages in the global economy. China's economic statecraft is motivated by one central objective: to neutralise the ability of the United States and its allies to develop a containment coalition against China to cripple its economic growth. An emerging objective is to redress what China sees as the unfair treatment of Chinese interests in world institutions and markets, by increasing Beijing's capacity to speak with authority and shape the conditions of international debate more in China's favour. Beijing also sees its increasing centrality to the regional economy as creating the space to allow it to address certain "core" national interests, such as the status of the South China Sea.

More generally, China shows a paradoxical attitude towards international economic rules and institutions. One the one hand, it has benefited greatly from the global economy; it was by opening itself up to the influx of market competition, technology and managerial expertise of the liberal international economic order that China has been able to achieve such rapid institutional change and economic growth in such a short period of time. On the other, Beijing has been sharply critical of the rules and institutions of the global economy as "neither just nor rational". Despite its spectacular economic trajectory over the past four decades, China has a series of concerns about the global economy. These include the dominance of international economic institutions by the United States and its allies and the exorbitant seignorage privileges enjoyed by the United States through the position of the US dollar as the international currency of exchange. For close to two decades, Beijing has also been battling against what it sees as a moral hierarchy in the international economic order, whereby liberal market developed economies are assumed to be the best, and all other economies are judged to the degree they deviate from the ideal of the "Washington consensus". China's leaders have been at pains to reiterate that there is no best model for organising an economy, and that any given country should be able to legitimately choose the economic model that best suits its own circumstances. China also worries about the mounting instability of the global economy, as well as its ability to continue to access minerals, energy and markets for its exports. Other, more specific worries relate to China's own economic trajectory – will China be able to rebalance its economy away from investment-driven and export-based growth towards consumption-driven growth? And can China transition away from being an assembly-based manufacturing economy towards an advanced innovation and technology-driven economy?

For Japan, economic power has been central to its postwar identity and ambitions. Constitutionally and psychologically unwilling to exert power and status militarily, Tokyo has used Japan's economic dynamism to build regional leadership credentials in a non-threatening way. While the US security umbrella has allowed it to do this, Japan has competed with the United States for regional economic leadership; with much of this rivalry playing out within the Japanese-controlled Asian Development Bank. After the 1985 Plaza Accord forced Japan to revalue its exchange rate, Asia became a primary location for
the outflow of Japanese trade and investment, making the region a significant component in helping Japan weather the costs of the rebalancing of its economy in the 1990s and beyond.21 China’s rise and increasing assertiveness have challenged Japan’s sense of identity and place in the region. China has displaced Japan as the region’s largest and most dynamic economy. Since the Asian Financial Crisis, Japan has seen China as a competitor for regional leadership, a threat that has driven successive bouts of open competition between Tokyo and Beijing over alternative visions of regionalism.22 China’s strategic ambitions to push the United States out of Asia present a further challenge to Japan’s role perception, in effect forcing Japan into the unfamiliar and uncomfortable role of becoming a “normal” power, willing and able to deploy its armed forces in support of maintaining the dominance of American power in the region. For these fundamental reasons, Japan has responded competitively to China’s emergence, intent on using all levers of its influence to reestablish the conditions for its own economic leadership in the region.

Ultimately, the United States, China and Japan have mutually-incompatible preferences for where each of them fit into the regional and global economy. The United States would like China and Japan to be significant but compliant players in an American-led liberal international economic order and a regional economy that restores some balance to US trade flows. China is increasingly opposed to an American-shaped and dominated international economic order; its objectives are a substantially reduced American role in Asia and a much more subordinate Japan. Japan’s preferences are for a restored American strategic primacy and a restored Japanese economic leadership in the Asia Pacific. Within this triangular rivalry, there is little room for compromise.

Vectors of competition

The Asian regional economy has three defining features: dynamic growth, which is rapidly restructuring economies away from agriculture towards manufacturing and services; wealth and development disparities among regional economies, which fosters the spread of interdependent industrialisation; and shortfalls in infrastructure, both in terms of inadequate physical and institutional infrastructure. These features of the regional economy have gathered the moves and counter-moves of geoeconomic competition around three elements bearing on the terms of regional economic integration: the rules that govern trade and investment among regional economies; the balances of trade and investment across the region; and the infrastructures linking regional economies with each other and the rest of the world.

Rules

The rules governing international commerce have become steadily more complex and comprehensive, playing three crucial roles. They regulate permitted and prohibited behaviour; coordinate expectations around which businesses can orient their activities; and establish rights of ownership and exchange. Yet no set of rules is ever completely impartial and neutral — all regimes of rules are designed according to the particular political and social ideals their designers value and would like to see perpetuated. The central place of international economic rules to geoeconomic competition arises from sustained disagreements among the major players in the global economy over the values underpinning the existing rules, and therefore which economies the current rules are seen to provide the greatest advantages to. Under the heat of geoeconomic rivalry, rules can shift from being arbiters of commercial behavior to mechanisms for disciplining or socialising the behavior of rivals.
Since the turn of the century, the focus of rule-making in the international economy has shifted from the global multilateral level to the regional preferential level. This reflects the growing complexity of the international economy, the greater number of consequential economic powers with diverse interests, and the fear among many economies that making general liberalising concessions will advantage competitors more than one’s own economy. Consequently the 21st century has seen a profusion of bilateral or plurilateral preferential trade agreements at a regional level, in which states are able to trade carefully-calibrated concessions. In Asia, all of these elements are present in the growing geoeconomic competition over trade and investment rules. The contest over trade and investment rules, as embodied in trade agreements, has become an intense competition over values.

Speaking to a joint sitting of the Australian Parliament in November 2011, President Obama declared, in a none-too-subtle swipe at the Chinese economic model, 

No long-term strategy for growth can be imposed from above … We need growth that is fair, where every nation plays by the rules - where workers’ rights are respected and our businesses can compete on a level playing field; where the intellectual property and new technologies that fuel innovation are protected; and where currencies are market-driven, so no nation has an unfair advantage. We also need growth that is broad - not just for the few, but for the many, with reforms that protect consumers from abuse and a global commitment to end the corruption that stifles growth.

At the same time, Washington became much more invested in promoting the conclusion of the Trans-Pacific Partnership (TPP), an ambitious trade liberalisation initiative among 12 economies in the Asia Pacific – but not China. As they campaigned at home and abroad for the TPP, American leaders left little doubt about the intent of this piece of economic diplomacy. Appealing for Congressional backing for the TPP in October 2015, Obama argued, “we can’t let countries like China write the rules of the global economy. We should write those rules.” The US Trade Representative cast the TPP in even more epic terms: “The positive power of trade, and of TPP in particular, is one of our most important tools for dealing with one of our century’s greatest challenges… [to] revitalise the rules-based order and to do so at a time when there are competing visions for the global economy.” As if to underline the geopolitical significance of the trade agreement, US Secretary of Defense Ashton Carter declared, “in terms of our rebalance in the broadest sense, passing TPP is as important to me as another aircraft carrier.”

To bolster the strategic argument, Obama linked the TPP to the “common values” shared by the participating economies, intent on pursuing “their interests and prosperity peacefully, based on common rules of the road on an open, level playing field.” From the outset, TPP has been advocated as a “WTO-plus” or “gold standard” trade agreement that seeks to liberalise “21st century” sectors of participating economies. The pact was promoted as a trade agreement that will allow the extension and deepening of the regional distributed manufacturing networks. These are increasingly becoming “trade-investment-services” networks, requiring the free flow not only of material goods, but also international investment, services and infrastructure services. Consequently, according to the TPP’s advocates, Asia’s comparative lead in distributed manufacturing can only be preserved by negotiating high-quality trade rules: “increased levels of IP protection; investment assurances including rights of establishment; and assurances on capital flows (FDI and profit repatriation), the movement of people (technical and professional support), and the provision of world-class infrastructure.”

There is a major element of coercive socialisation in the American economic statecraft embodied in the TPP. Originally, US policy had been to use institutions such as APEC and the WTO to induce a rising China to play by the existing rules. When it became apparent, however, that China was not being sufficiently socialised, a more coercive approach began to develop. The strategy here is that non-compliance should be met with a re-investment in liberal order rules, which promise substantial economic advantages to those countries willing to invest in them – and to impose relative costs on
those excluded. The benefits would include balanced and consistent economic growth, a dynamic and integrated trade and investment system, and a stable secure Asia Pacific underpinned by an American security guarantee. These promised benefits, it is hoped, will eventually force major excluded economies to buckle under and comply as a condition for joining the new, beneficial trade agreement.31

Japan has also been an enthusiastic advocate of the TPP. According to two close observers, the unifying attributes of all of Japan’s preferential trade deals so far – their focus on developing countries, avoidance rather than promotion of economic reform, and generally low quality – point strongly to their diplomatic rather than economic intent.32 Japan’s primary intent has been to use the TPP as a way of embedding American commitment to remaining in the region, while building a network of partnerships and capabilities against a rising China, including interlinked and reinforcing trade, diplomatic and defence ties. The TPP fits into a coordinated strategy of balancing against China, which includes alliance strengthening, “soft balancing” through developing economic and diplomatic ties with other countries challenged by China’s rise, and “institutional balancing”.33 Japanese strategists separate the latter into “intra-institutional balancing”, where China is brought into an organisation such as APEC and socialised to its rules by all of the other members, and “inter-institutional balancing” where institutional exclusion is used to moderate China’s behavior through imposing costs on non-compliance with rules and agreements.34 In addition to balancing China, the TPP represents for Japan a framework for embedding its own economic linkages with regional economies while easing its own and other Asian economies dependence on the Chinese economy.

For Japan, as for the United States, the TPP is cast in strongly values-based terms. As Prime Minister Shinzo Abe declared on the conclusion of the TPP, “The TPP will create a free, fair and open international economic system in the Asia Pacific with countries with which we share basic values such as freedom, democracy, basic human rights and the rule of law.”35 The implication of this values-based language is that China remains outside of the community of liberal democratic capitalist states in the region, and that only a community based on these principles can achieve sustainable, equitable and dynamic economic growth. The implicit warning to liberal capitalist democracies is that if they get too close to China economically, they will be entering an alien values-based community.

China has ranged across different approaches to the TPP. Many leading commentators denounced the TPP as a mechanism for containing China when it was first announced; several years into the negotiations, Beijing made vague references to being interested in joining the negotiations; and now China seems to have lapsed into apathy about the trade bloc. Since its hesitant entry into APEC in 1990, China has come to see regional economic institutions as useful vehicles for socialising its neighbours to its non-threatening rise. The consensus-based nature of Asian institutions has meant that Beijing has been able to deflect concerted pressure on contentious issues such as the South China Sea, while showing leadership on issues of importance to it, such as the Chiang Mai Initiative. More recently, Beijing has contemplated using the vehicle of economic regionalism to advance its objective of “Asian solutions to Asian problems” – primarily by excluding the United States from important regional mechanisms. This led Beijing to champion the ASEAN+3 idea, and Japan to counter this with a proposal for a broader grouping that eventually became the East Asia Summit, which includes the United States.

Economic regionalism offers the chance for Beijing to give institutional form to its increasing economic centrality to the region. Unsurprisingly, it seeks forms of regionalism that best reflect its own objectives. As early as 2004, China began advocating an East Asia Free Trade Area as a trade and investment zone that would map on to the ASEAN+3 grouping. The most obvious advantage of this formulation was that it excluded the United States and cast Beijing in a potential leadership role. Unsurprisingly, Tokyo countered with a proposal for a Comprehensive Economic Partnership in East Asia, in effect adding India, Australia and New Zealand to the ASEAN+3 bloc. While Beijing’s proposal just covered trade in goods, Tokyo’s included services, investment and intellectual property, and was touted by
Japanese leaders as a superior plan to China’s during the 18 months of intensive competitive lobbying of Southeast Asian countries by China and Japan that followed. Ultimately, the Japanese proposal prevailed, and negotiations were launched towards a Regional Comprehensive Economic Partnership (RCEP). Despite losing this round, China has pressed ahead with the implementation of the ASEAN-China Free Trade Area, and has become an active promoter of RCEP as a much more inclusive trade grouping. With the United States not a party to the RCEP negotiations, China will remain the largest economy in the organisation; and a concluded RCEP will play a significant shaping role on shaping a comprehensive Free Trade Area of the Asia Pacific.

Balances

Macroeconomic imbalances among major economies have long been viewed as problematic: either leading to power advantages during the mercantilist era, or more recently fostering instability in the global economy. The fundamental reason for the founding of the IMF at the end of the Second World War was to resolve the sort of macroeconomic imbalances that had caused such turmoil during the Great Depression. Yet despite clear agreement at Bretton Woods that both surplus and deficit countries should share the burden of correcting imbalances, global finance has been beset by disagreements over who should bear the costs of correcting imbalances ever since. Central to these disagreements has been the United States, which as a consequence of providing the world’s reserve currency, has of necessity run large deficits in its balance of payments. America’s open capital markets and willingness to run balance of payments deficits have in effect acted as shock absorbers for the global trading system. However, American balance of payments deficits, coupled with trade deficits, have generated political demand within the United States to pressure surplus countries to bear the burden of correcting the imbalance, mainly through allowing their currencies to appreciate. The most famous case was the 1985 Plaza Accord, when the United States pressured Japan to revalue the yen upwards as a way of reducing Japan’s large and growing trade and balance of payments surpluses.

Most previous disputes about macroeconomic imbalances have occurred within the American alliance system, and therefore have been resolved with an eye to the substantial security side-benefits accruing to American allies. But with China this condition is absent. As China’s trade and balance of payments surpluses have mounted over the past two decades, the disagreements between Washington and Beijing over which country should shoulder the burden of correcting imbalances have become more and more acrimonious. Making the situation even more difficult has been the substantial damage done to the reputation of the IMF among Asian countries by both the Asian Financial Crisis and the Global Financial Crisis. There is a widely-held belief among Asian economic policymakers that the IMF misdiagnosed the Asian Financial Crisis, and its prescriptions for the affected economies actually made the crisis worse. These hostile views were revisited after the Global Financial Crisis, as economists in China and several other Asian countries accused the IMF of concentrating too heavily on the current account surpluses and exchange rate valuations of developing Asian economies and ignoring the risks of subprime loans and misaligned macroeconomic policies in the United States. The voting dominance of developed countries in the IMF, Chinese economists claim, has led to “groupthink” among IMF economists, resulting in a bias towards neoliberal policies and a blinkered attitude towards risk surveillance.

While there is little disagreement that macroeconomic imbalances were a significant factor in the unfolding of the Global Financial Crisis, there is major contention between Washington and Beijing as to which country was most responsible for the mounting imbalances and therefore the severity of the Crisis. For almost a decade before the Crisis, there was rising anger in the United States over China’s currency valuation, widely interpreted as the primary cause of mounting US trade deficits and current account imbalances. Bills aimed at pressuring China to revalue its currency have been introduced to every session of Congress since 2003. The widespread perception in America is that China’s undervaluation of its currency exports Chinese unemployment to the United States. As the Global Financial Crisis unfolded, American policymakers and media began to sheet home the blame much more pointedly on emerging economies generally, and China in particular. In what has widely become
known as the “Bernanke hypothesis”, the then Governor of the US Federal Reserve argued that China’s domestic institutional weaknesses led to excess savings that were then exported to the United States, underpinning the over-consumption, risk complacency and low savings that contributed to the global imbalances that drove the crisis.  

Unsurprisingly, Chinese commentators and officials are unsympathetic to these American diagnoses. The consensus in China is that imbalances have nothing to do with the RMB’s valuation, but rather are caused by the dominance of the US dollar in global currency markets, which allows the United States to leverage disproportionate seignorage benefits that include a low savings rate, an oversupply of credit, and overspending. Zhou Xiaochuan, the Governor of the People’s Bank of China, pointed to the institutional weaknesses within the United States, rather than global macroeconomic imbalances, as the cause of the Crisis. Zhou suggested that imbalances, in the traditional Chinese view, are relative and normal, and should be worked with, rather than against. Other Chinese commentators argue that there are actually two imbalances that threaten global economic stability: financial imbalances and power imbalances in international markets and institutions, which allow Western control and perpetuate pro-Western biases in macroeconomic frameworks. A significant body of opinion warns that American pressure on the RMB’s exchange rate is a mercantilist ploy to try to kick-start growth in sluggish economies. Commentators warn against allowing Washington to pressure China into “another Plaza Accord”, referring to the 1985 agreement on increasing the yen’s exchange rate, widely seen in China as leading to Japan’s decades-long recession that ended Tokyo’s challenge to America’s global economic dominance. Chinese economists also warn that, in an era of slowing growth and rising labour costs, RMB appreciation will advantage China’s economic competitors in Asia. The solution to global macroeconomic imbalances, argue Zhou Xiaochuan and others, is to move to a “global multicurrency system”, ending the era in which the US dollar is the dominant international trading and reserve currency. China has made repeated calls for “strengthening the regulation of the issuing of reserve currencies, maintaining the stability of the exchange rate of the major reserve currencies, and … a more diversified and rational international monetary system.”  

Japan has played a smaller but significant role in the competition over macroeconomic balances in the Asia Pacific. The devaluation of the yen lies at the core of the Prime Minister’s “Abenomics” framework, aimed at restarting Japan’s economic growth after a quarter-century hiatus. A weaker yen is designed to boost Japan’s exports, stimulate domestic spending, and drive inflation. Consequently, the Bank of Japan has inaugurated a policy of “Quantitative and Qualitative Easing with a Negative Interest Rate”, a policy that facilitated a 35% fall in the value of the yen between 2012 and 2015. These moves have led to fears of a currency war among major economies, a topic that dominated the February 2016 G20 meeting. Abenomics had been challenged by China’s economic slowdown and the turmoil in China’s sharemarket, as investors who had borrowed yen to invest in emerging economies began selling their investments and repaying their loans, leading to upward pressure on the yen. These pressures worsened in mid-2015 when China devalued the RMB, further damaging Japan’s export performance and putting pressure on the Bank of Japan (BoJ) to devalue the yen. Under intense pressure, the BoJ resisted pressure to directly devalue the yen, rather relying on other measures to try to keep the currency weak.  

While all three economic powers have a shared interest in global economic stability, there are few reasons to be optimistic that they will come together to find a consensual solution to their macroeconomic imbalances. A heavily geoeconomic logic is at work here. The stance of each power is closely tied to its own specific economic interests; highly suspicious of the policies of the other major players; and founded on the belief that global financial arrangements establish conditions of dominance and subservience in international affairs. There are significant obstacles to realising real reforms in the global financial system. The “power imbalance” that Chinese commentators observe in global financial institutions looks entrenched, with just a 5% increment in the voting power of emerging economies over three decades, despite repeated attempts at comprehensive reform. Nor are the chances of a genuine global multi-currency system particularly encouraging. China presses on with the internationalisation of the RMB along several tracks: bilateral agreements to denominate trade in RMB; the negotiation of
offshore RMB trading centres; and the use of international financial centres and institutions to create
and absorb offshore pools of RMB. Yet without a complete opening of China’s capital account and the
emergence of deep and liquid capital markets in China underpinned by strong regulatory frameworks, it
is unlikely that it will become a reserve currency any time soon.

Infrastructure

The role of infrastructure as an enabling condition of economic development has long been acknowledged
as a central component of both multilateral and bilateral development assistance programs. After a
period of lower emphasis, displaced by a developed-world focus on governance and the Millennium
Development Goals, infrastructure building surged back to the centre of attention in the late 2000s.
At that time there was growing attention to new development actors – emerging economies such as
China – and their unabashed concentration on infrastructure building in their development cooperation
programs. Then in 2009 came two separate reports from multilateral development agencies highlighting
the role of infrastructure shortfalls in preventing the Asia Pacific realising its full growth potential. The Asian
Development Bank study, *Infrastructure for a Seamless Asia*, declared that “Unless it can be significantly
improved, infrastructure will continue to be a bottleneck to growth, a threat to competitiveness, and
an obstacle to poverty reduction.” It forecast that the region needed US$ 8 trillion of infrastructure
investment in the decade to 2020. The World Bank’s World Development Report for 2009 was titled
*Reshaping Economic Geography*, and argued that the conscious transformation of economic geography
through building economic density, facilitating access to economic centres, and reducing artificial barriers to economic
exchange was a key driver of rapid economic development.

The implication of the report, and a counterpart, *Reshaping Economic Geography in East Asia*, was that infrastructure is
the key to such a transformation of economic geography.

These reports found fertile soil in China. As the effects of
the US$ 600 billion GFC stimulus package worked their
way through the Chinese economy, it became apparent that
the stimulus had exacerbated the distortions that had been
building in the Chinese economy for over a decade. By
March 2013, Premier Wen Jiabao told the National People’s
Congress that China’s domestic economy was “unstable,
unbalanced, uncoordinated and ultimately unsustainable”. By
2015 China registered its third straight year of declining trade
performance. The economy’s supply of low-cost labour was
dwindling, with manufacturing wages rising by 309% in the
decade to 2014, creating an urgent need to reorient supply
chains.

As it approaches the end of its fourth decade of
“reform and opening” the challenges of reform in China are
becoming more difficult and intractable, and threatening ever
higher costs in social disruption, reform fatigue and disruption
of powerful vested interests. This coincides with a new status
of unprecedented international economic power, presenting
the Chinese government with the opportunity of shifting the
site of economic adjustment from painful domestic reforms to
less costly international activism.

Prominent economists in China read the ADB and World Bank Reports closely. Tsinghua University’s
Hu Angang wrote enthusiastically about the role of infrastructure in creating a “revolution that recreates
economic terrain.” Citing China’s domestic use of infrastructure building, coupled with investment
to transform first the coastal and then the inland provinces, Hu argued a new infrastructure building
program would drive the “recreation of the Chinese economic terrain while expanding outwards to
recreate the global economic terrain.” His colleague at Tsinghua, Feng Xinke, argued that infrastructure
crossing China’s borders would add further to the economic development of China’s inland regions.
It was not only economists who were thinking hard about the direction of China’s statecraft. Chinese
strategists generally interpreted the US rebalance to the Asia Pacific as an aggressive American

A new status of unprecedented international economic power, [presents] the Chinese government with the opportunity of shifting the site of economic adjustment from painful domestic reforms to less costly international activism.
move that seeks to constrain China’s rise and deepening integration with the other economies in the Asia Pacific. In an important October 2012 article, China’s leading strategic commentator, Wang Jisi, argued that China should avoid confrontation with this newly aggressive American posture, and instead “march westwards” in deepening its political, economic and strategic relations with Central and South Asia and the Middle East. The proposal set off a flurry of feasibility studies and conferences among China’s constellation of official think tanks.57

All of this ferment culminated in President Xi’s announcement of a “Silk Road Economic Belt” through Eurasia in a speech at Nazarbayev University in Kazakhstan on 7 September 2013, and a “New Maritime Silk Road” in a speech to the Indonesian Parliament on 3 October 2013. The initiative envisages a program of infrastructure-building to create integrated terrestrial and maritime economic corridors connecting China with the economies of Central Asia, Southeast Asia, South and West Asia and Europe. In late 2014, Xi announced the creation of a $40 billion Silk Road Fund to finance the necessary infrastructure; it is likely that the AIIB and the BRICs Bank will also finance some of the infrastructure for the scheme.

China’s leaders have promoted One Belt-One Road as a “new wave of opening” of the Chinese economy: whereas the first wave after 1978 saw China open itself to the influx of investment and expertise, now China is promoting the outflow of its investment, technology and skills – to the benefit of both China and the developing economies of Asia.58 A chain of integrated economic corridors is seen as ideal for China to boost export performance, stabilise its access to energy and resources and relieve overcapacity in capital goods and construction.59 The initiative aims to combine trade-enabling infrastructure with tariff reductions, simplified customs procedures and “enhanced economic policy coordination” between China and its One Belt-One Road partners, using China’s advantages in finance, markets, technology and production capacity to shift distributed supply chains to Central, South and Southeast Asia’s developing economies. In describing the initiative as helping Chinese companies improve their “capacity for transnational operations” and “establish foreign trade strongholds and production bases”, many observers have argued that the scheme has an unmistakably strategic feel about it.60

While Chinese leaders and commentators have been at pains to allay fears that One Belt-One Road has any geopolitical intent, and have stressed the consultativeness and openness of the proposal, questions persist about the effect the completed scheme would have on China’s economic surrounds. An array of smaller economies joined to a larger, more dynamic Chinese economy via infrastructure and distributed supply chains would place Beijing in an extremely powerful position. Such a network of trade and financial integration could effectively convert many regional economies into satellites of the Chinese economy, highly dependent on that core economy’s health and rhythms – not to mention continued access to the core economy – for their own economic wellbeing. Economic geographers have demonstrated that infrastructure exerts powerful agglomeration effects on an economy, as industry and labour are attracted to regions where infrastructure provides greater and cheaper access to markets and inputs.51 Over time, this has structural effects, expanding economic activity in trade-dependent industries close to enabling infrastructure, and impeding the development of other sectors of the economy. As economic historians have shown, infrastructure-led integration with dominant economies was crucial to British and then American dominance in many regions of the world through an “imperialism of free trade” – where the reorientation of an economy towards a core economy then leads to the rise of powerful economic and political elites who further align the satellite’s policies towards the preferences of the core state.52 As Albert Hirschman demonstrated in his classic study of trade and power, the greater the economic dependence of a smaller upon a larger economy, the greater the influence the larger country will have over the policies of the smaller.63
China’s infrastructure activism has touched off defensive reactions in Japan and the United States. Japan’s leaders have been quick to read geopolitical intent into China’s One Belt-One Road plans. Abe’s foreign policy adviser, remarking on the recent influx of Japanese aid and investment into Myanmar, said, “we are very interested in Myanmar because Japan does not want to see Myanmar becoming over-dependent on China.”64 Tokyo has developed a coordinated infrastructure development strategy to directly counter what it sees are the geo-economic objectives motivating China’s transnational infrastructure plans. Japan’s infrastructure plans in continental Southeast Asia have been conducted horizontally (East-West), promoting economic integration between the Mekong economies and with the global economy, as a deliberate counter to China’s “vertical” (North-South) infrastructure projects, which seek to integrate Southeast Asian economies singly with the Chinese economy.65 In addition to refusing to join the AIIB, Tokyo announced its own $110 billion Asian infrastructure fund soon after the announcement of China’s version.66 In increasingly tense Sino-Japanese infrastructure competition in Asia, Tokyo has emphasised the quality, dependability and willingness to use local labour and build skills, in clear contrast to China’s infrastructure projects in the region.67

The United States has also reacted competitively to China’s grand infrastructure plans. There is a strong correlation between Xi’s announcement of China’s One Belt-One Road plans and Washington’s renewed push to complete the TPP. Both TPP and One Belt-One Road have been touted as conferring direct economic benefits to the United States and Chinese economies respectively, and both countries’ leaders have raised the likelihood that they will strengthen political relations between their countries and their partners in these respective schemes. Economist Andrew Elek has twinned the two as competing trade liberalisation proposals in arguing that China’s infrastructure-building is likely to be a much more effective and economically efficient way of increasing cross-border trade and investment in the Asia Pacific.68 The depth of Sino-American rivalry over their respective schemes for regional economic development and integration was perhaps best illustrated by Washington’s campaign to prevent allies from signing on to become founding members of the AIIB, and Beijing’s obvious delight at the failure of the American campaign.

Imperatives for Australia

The forces of geo-economic competition have already begun to buffet Australia. The divide between this country’s economic and security imperatives looks set to increase inerorably. Australia’s economic complementarity with China means that the logic of our trade and investment imperatives will draw us ever closer to the Chinese economy and make us increasingly dependent on its rhythms. In 2009, China became this country’s largest trading partner, a condition that is likely to last for a very long time. In terms of flows, between 2007 and 2014, Australia was the second largest recipient of aggregated Chinese direct investment, after the United States; in terms of stocks, China is now Australia’s fifth largest investor.69 By one estimate, the Sino-Australian economic relationship now accounts for 5% of Australia’s GDP.70 The fortunes of the Chinese economy are a major influence on the day to day operation of the Australian economy, with Australian share prices increasingly correlated to the fortunes of the Shanghai and Shenzhen bourses. The market will pull more and more sectors of the Australia’s economy in China’s direction: not only resources and energy, but education, services and agribusiness. It would take a colossal act of state intervention to halt or reverse this trend.

On the other hand, this region’s security dynamics are likely to see Australia cleave ever more closely to the alliance with the United States and to security partnerships within the US alliance system with countries such as Japan and Singapore. The rising pattern of strategic rivalry and arms acquisitions in Asia means that Australia is losing its strategic advantages in relation to its near neighbours, even as the fulcrum of strategic competition comes closer to Australia,71 making its alliance with the US much more central to its security. At the same time, it is apparent that American strategic primacy in Asia is waning in the face of a determined Chinese challenge and the regional arms race, making Australia’s security partnerships with regional powers a crucial part of its defence policy.72
If this is Australia’s medium-term future, it stands to lose a great deal if the nascent logic of geoeconomics becomes dominant in the region. At this stage, preliminary geoeconomic rivalries pose uncomfortable choices for Australia, such as the AIIB decision. If geoeconomic rivalry increases, these dilemmas will become bigger and more enduring, forcing choices on Australia that will carry significant costs for our prosperity, our security, or both. There are several ways in which geoeconomics could start to reshape the regional and global economies in ways deeply damaging to Australia’s interests. First, as some commentators have predicted, geoeconomic rivalry could result in the splitting of the regional economy into competing blocs. American strategist Aaron Friedberg has predicted the division of the region into a “continental” bloc of state-dominated economies deeply integrated with China’s, and a “maritime” bloc of free market economies integrated with the American and Japanese economies. As in the 1980s, when there were grave fears of the world economy dividing into European, American and Asian economic blocs, this would be a disastrous outcome for Australia. The Australian economy depends on a diverse array of trading and investment relationships; the rise of exclusive blocs would restrain the free play of comparative advantage and competition, and hobble Australia’s economy and way of life.

Second, geoeconomic rivalry could drive the forces of protectionism in the global economy, leading to de-integration and de-globalisation. The years since the Global Financial Crisis have seen subdued international trade and investment flows, a rise in protectionist policies, and a modest reversal in global production sharing. The response of companies such as GE to the uncertainty and instability in the global economy has been to localise production. In the words of CEO Geoff Immelt:

> We will localise. In the future, sustainable growth will require a local capability inside a global footprint... We used to have one site to make locomotives; now we have multiple global sites that give us market access. A localisation strategy can’t be shut down by protectionist politics.

Neo-protectionism, propelled by political populism, environmental concerns and vague national security justifications, is on the rise inside Australia as well. Australia has the second-most restrictive regime regulating foreign investment in the OECD, and still major foreign investment decisions become heavily politicised. Allowing geoeconomics to add momentum to the forces of neo-protectionism would cause major damage to Australia’s and other trading economies.

Third, competition over trading currencies could lead to significant instability in the global financial system. China’s determination to end the dominance of the US dollar as the world’s preferred trading and reserve currency could introduce significant instability into international finance. Beijing has been determined to promote the use of the RMB as an international trading currency, through bilateral agreements to denominate trade in RMB; the negotiation of offshore RMB trading centres; and the use of international financial centres and institutions to create and absorb offshore pools of RMB. As a result, the supply of RMB available outside the mainland has risen rapidly, and there are significant opportunities for China to use its substantial size and market dominance in certain sectors to drive further and less risky internationalisation. Economist Huw McKay argues that China’s complete and likely long-standing dominance in international commodity markets provides it with a real opportunity to re-denominate a significant proportion of global commodity trade in RMB. Once supplies of the currency are available in sufficient amounts outside of the mainland, McKay argues that “China’s onshore commodity exchanges (based in Shanghai) where prices will be quoted in RMB and trades settled in RMB, could become the locus of world trade in resources.” Economist Paul Tucker has warned that bipolar currency competition, if entangled with geopolitical rivalry, would destabilise an already volatile international financial system:

> In this world, the dollar’s status would be reduced, and there would be rival claims in financial regulation. The main currency issuers would reward allies with currency swap lines, and would seek to keep others tied to them by encouraging wide use of their currency. It would be a world of fierce competition for placements and patronage within the main global institutions.
It goes without saying that Australia, not only because of its external trade and investment dependence, but also because of its reliance on global commodities markets, would be profoundly affected by currency competition.

Neither Australia's international economic policy nor its strategic policy has even begun to contemplate these challenges. The government’s economic diplomacy framework, unveiled in 2014, is intended to promote trade, encourage growth, attract investment and support Australian business. Neither this nor any other element of Australia’s international economic policy acknowledges the potential rise of geoeconomic competition in Asia and its likely effect of Australia. Similarly, Australia’s strategic policy remains clearly focused on military competition and security, though the many references to “defending the rules based order” in the 2016 Defence White Paper at least acknowledging that rivalry in Asia has spilled into non-military domains.

The rise of geoeconomics carries several imperatives for Australia. The preferred strategy must be to try to reverse the logic of rivalry and help reassert the conditions of commercial comity in the global economy. The time to act is now, before the logic of geoeconomics becomes all-consuming. Australia has several advantages in working to reduce geoeconomic rivalry in Asia. It is a close economic and security partner of the United States and Japan, and a significant trading and investment partner of China’s. It is a member of a number of the key institutions of the global and regional economic orders: the WTO, IMF, World Bank and the G20; APEC, the ADB and the East Asia Summit. And Australia has a strong history of activist international economic statecraft in the interests of stable and open global and regional trade and investment regimes: from APEC and the Cairns Group to the post-GFC G20 reform agenda.

The first imperative for the Australian government must be to acknowledge the growing forces of geoeconomic rivalry among three of its close security and economic partners, and devise a strategy for working to allay these. Australia’s international economic policy should shift from its narrow focus on the self-interested promotion of Australia’s prosperity towards a more strategic focus on defending and bolstering the multilateral trading and investment order. As a negotiating partner in both the TPP and RCEP, it should be Australia’s strategy to eventually build these and other preferential trade agreements into an inclusive, region-wide trade and investment liberalisation agenda. Canberra’s support for China’s push at the 2014 APEC Summit for a Free Trade Area of the Asia Pacific (FTAAP) incorporating existing trade agreements in the region, is a positive step in this direction. But there is much to be done to bring a meaningful FTAAP into existence. The United States and China have very different interpretations of the bindingness of trade agreements: Beijing seeks to maximise their flexibility while Washington is impatient with trade rules that are more or less discretionary. Australia can rely on its well-developed playbook of economic diplomacy here, building coalitions of like-minded partners with shared interests in open and stable economic conditions, to build momentum for an inclusive regime, and more importantly to stymie geoeconomically-motivated policies from the big three.

In relation to financial competition, Australia has already played a part in China’s efforts to internationalise the RMB, with Sydney emerging as a significant RMB trading hub, and a small number of commodity contracts being denominated in RMB. Given the likely growth of China’s economy and trading status, and its desire to become the centre of Asian commodity trading, the use of RMB as a vehicle currency will probably increase also. That said, it is unlikely that without significant financial sector reform in China, the RMB will threaten the US dollar’s status as the world’s predominant reserve currency. One study argues that the internationalisation of the RMB will be only effectively achieved through further liberalisation of China’s trade and investment regimes; improving the depth, sophistication, and liquidity of China’s financial markets; and building confidence in the RMB through more transparent monetary policy-making. China must also liberalise its exchange rate regime in such a way that governments, investors and traders can accumulate, invest and hedge in the RMB at sufficient scale to start to lower the transaction costs of using that currency. But recent efforts to prop up the RMB show how difficult such measures are for a leadership highly averse to the risks of financial instability; as sinologist Christopher McNally observes, “Chinese leaders view the exchange rate not as a price to be determined by the market but rather as a tool in China’s broader development strategy.” Australia should work to ensure that this limited shift away from US dollar dominance is a peaceful and market-led process, rather than one that is forced – and destabilised – by geoeconomic imperatives.
Australia acknowledges the need for infrastructure in Asia, and recognises the key role that development banks and funds play in helping offset risk and deploy the abundant capital currently available toward these tasks. Yet Canberra must also admit that there is growing infrastructure competition between China and Japan, which at a certain level can be a positive thing, but can be destructive when it crosses a certain threshold. When rivalry becomes the driver of infrastructure building, duplication and economic inefficiency, rather than complementarities, are the likely result. Australia is well placed to play a creative mediating role in the infrastructure domain. As a member of the World Bank, the ADB and the AIIB, as well as its development partnerships with Japan and China, Canberra has an entree into the development communities in both countries. Making sure that infrastructure building is economically efficient as well as mutually complementary, should be a watchword of Australia’s development diplomacy.

The second imperative that the rise of geoeconomics presents to Australia is to re-examine the structures for integrating our international economic and strategic decision-making. Currently there are structures such as the National Security Committee of Cabinet (NSCC) and the Secretaries’ Committee on National Security (SCoNS) which bring together key decision makers in these two domains. Yet the deadlock over joining the AIIB suggests that we need to go further. The NSCC and SCoNS are transactional structures, which meet periodically to make decisions, but are clearly not underpinned by an ongoing, whole-of-government discussion on the implications of the merging of economic and strategic logics. A standing unit sourced from the core economic and strategic portfolios across government, located within the Department of Prime Minister and Cabinet, would better serve decision-makers at Secretaries Committee on National Security (SCoNS) and National Security Committee of Cabinet (NSCC), in effect preparing them for difficult choices. Such a unit would also inform Australia’s international economic diplomacy aimed at reducing geoeconomic rivalries.

Bringing economic and strategic conversations together becomes even harder when one contemplates taking them beyond government to the business, civil society and academic sectors. A string of controversies in recent years shows that the business and the security communities are largely talking past each other, particularly on questions of foreign investment in Australia. The media plays a role in amplifying the uncompromising voices on each side of the debate, making the prospect of common perspectives appear remote, and therefore not worth pursuing. It is here that peak industry bodies, such as the Minerals Council, the Business Council, the IA Group and the Chamber of Commerce and Industry can play a facilitating role. They have convening power to promote a calm, informed discussion of the economics-security policy nexus, away from the sensationalising glare of the media. Such deliberations could enrich discussions within government.

A third imperative is to make the most of our advantageous economic and security relationships while preparing for the worst. While Australia has been able to weather making difficult choices up until now, we need to be prepared for the likelihood that at some time in the future, we may not be able to avoid aggravating an important partner to the extent that it imposes costs on Australia. It is not a trivial question as to whether the Australian economy has the resilience to endure a prolonged downturn in our trading relations with China as a result of Beijing choosing to “punish” Australia over an action that has displeased it. It certainly was willing to do so to Australia in 1996, and has done so to countries such as Canada, Britain and Norway since that time. The key question here is whether the Australian economy has the flexibility to adjust to a major trade shock, as well as it did 20 years ago during the Asian Financial Crisis. With the stalling of major microeconomic reform in Australia over the past decade, there must be serious questions over whether the Australian economy is as flexible now as it was then. That a major geoeconomics-driven trade shock is a distinct possibility in the coming years should add to the imperative for Australian governments to renew a drive for microeconomic reform.
We also need to question whether we are prepared for a major disruption to our alliance as a result of irritating the United States. Just 30 years ago, Washington was prepared to exclude New Zealand from the ANZUS alliance because of a decision that Wellington had made. At that time Australia enacted a major change in its defence policy, inaugurating the policy of defence self-reliance within the alliance. At the base of the concept of self-reliance was a realisation that in certain contingencies, Australia may have to take on the burden of defending itself without relying on its major alliance partner’s help. In the three decades that have elapsed, Australian defence policy seems to have drifted away from that stance of limited self-reliance towards greater integration into the alliance. It is a legitimate question whether this trend is wise given the significant tensions that may occur between Canberra and Washington as Australia draws economically closer to China. It may be time to reassess, as we did from the late 1950s to the 1980s, whether there may be occasions in which America’s alliance commitment weakens – and what Australia needs to do to prepare for such contingencies.

Perhaps the greatest weakness however, is how well Australia’s political system handles external shocks. A rise in geoeconomic competition holds out the real possibility that one or more great powers will try to exert leverage to force Australia to comply with its wishes. These occasions will be fundamental tests of Australia’s independence and will. When key economic sectors, investment projects, or defence industries are threatened, will the Australian political system have the fortitude and solidarity to stand firm? This is perhaps the area in need of the greatest work and scrutiny. Because amid a rise in geoeconomic competition, the preferred strategy must be to try to deflate those rivalries; but ultimately it may be a test of Australia’s ability to stand firm as the winds of geoeconomics buffet and test us.

**Policy Recommendation:**

Create a standing unit sourced from the core economic and strategic portfolios across government, located within the Department of Prime Minister and Cabinet, to serve decision-makers at SCoNS and NSCC. Such a unit would also inform Australia’s international economic diplomacy aimed at reducing geoeconomic rivalries and provide an ongoing, whole-of-government discussion on the implications of the merging of economic and strategic logics.

**Endnotes**


2 For example: in 1996, the Coalition government of John Howard angered China by supporting the US Navy’s intervention in the Taiwan Straits Crisis; his and two successive (Labor and Coalition) governments refused to allow Chinese company Huawei to bid for the National Broadband Network due to American warnings that it would compromise Australia’s communications infrastructure; two senior Coalition Ministers (Foreign Minister Alexander Downer in 2004 and Defence Minister David Johnston in 2014) stated publicly that the ANZUS Treaty would not necessarily apply to a Sino-American conflict over Taiwan; in 2011 the Gillard Labor government announced it would enable US marines to rotate through Darwin; in 2016 the Coalition government aroused American concern when it approved Chinese firm Landbridge’s lease of Darwin port.


6 Shang-jin Wei, “China’s Slowdown and Asia’s Economies” Project Syndicate, 20 January 2016, https://www.project-syndicate.org/opinion/china-slowdown-asian-economy-by-shang-jin-wei-2016-01?barrier=true, argues that commodities producers and intermediate component manufacturers have been most affected, but direct industrial competitors may gain from China’s slowdown, while Samdeh Deorukkar and Le Xia, “Gauging the Impact of China’s Growth Slowdown on Emerging Asia”, Asia Economic Watch, 2 March 2016, https://www.bbwaresearch.com/wp-content/uploads/2016/03/02022016_Eco-Watch_China-Impact-on-EM-Asia.pdf, disagree, arguing that Taiwan and Korea are the most affected by the contraction in Chinese imports, while, the Philippines, Indonesia and India are least affected
According to the United Nations ESCAP Trade and Investment Report 2015, http://www.unescap.org/sites/default/files/Asia-Pacific%20Trade%20Brief.pdf, “The share of intraregional exports has increased during recent years, rising from 45.5% of total exports in 2002 to 53.8% in 2014. The increase was mainly driven by exports to China which rose from 6.7% to 12.9% of the total; exports to other Asia-Pacific economies rose from 38.8% to 41.0% (figure 2). For merchandise imports, 51.4% of total imports in 2014 were from regional sources (figure 3). Developing economies in the region are the destination for 45.8% of total exports, up from 35.7% in 2002. Correspondingly, the shares of exports going to developed markets outside the Asia-Pacific, principally the United States and the European Union, has declined from 54.5% in 2002 to 46.1% in 2014.”

Such moves include bases, such as Changi in Singapore, Darwin in Australia and perhaps Cam Ranh Bay in Vietnam; joint exercises such as PacPir, Cobra Gold and Malabar; intelligence exchange agreements with a range of countries, and participation in US-supplied anti-ballistic missile shields by several countries.

Heath, China’s New Governing Party Paradigm, p. 119
For example: Ma Zhengang, “Behind the Propoagation of ‘China Model’ by the West”, People’s Tribune, No. 24, 2008, pp. 28-9
The authoritative Chinese Academy of Social Sciences warned of the ongoing instability in the global economy and the challenges this posed for the Chinese economy, requiring “higher demand for China’s strategic decisions in international politics and economy”; “Chinese Academy of Social Sciences Predicts China’s Economic Growth Will be 7.3% This Year and 7% Next Year, China Economic Net, 11 October 2014
Justin Lin, "Why Did I Say the Growth of China’s GDP Would Be Aimed at 7%-7.5%?" Xinhua News, 27 October 2014
Steinfeld, Playing Our Game, op. cit., pp. 141-174
“Statement by the President on the Trans-Pacific Partnership”, White House Office of the Press Secretary, 5 October 2015, https://www.whitehouse.gov/the-press-office/2015/10/05/statement-president-trans-pacific-partnership
Michael Wesley, “Trade Agreements and Strategic Rivalry in Asia”, Australian Journal of International Affairs., Vol. 69, No. 5, 2015, pp. 479-495
Jeffery J. Schott, Barbara Kotschwar and Julia Muir, Understanding the Trans-Pacific Partnership, Washington D.C: Peterson Institute for International Economics, 2013, pp. 3-4
Michael Wesley, “Trade Agreements and Strategic Rivalry in Asia”, Australian Journal of International Affairs, 69:5, October 2015
Aurelia George Mulgan, “Securitising the TPP in Japan”, Asia Policy, National Bureau of Asian Research, forthcoming
Quoted in Mulgan, “Securitising the TPP in Japan”, p. 23
Shintaro Hamanaka, “TPP Versus RCEP: Control of Membership and Agenda Setting”, Journal of East Asian Economic Integration, 18:2, 2014
ibid., p. 572
STST8013 China’s Defence and Strategic Challenges

Course Convenor: Dr Amy King

China’s re-emergence as a significant economic and political actor is a geopolitical development of the first order. It has been a century since the international system has had to accommodate a wholly new major power with the potential to rival even the weight of the US. Assess the trajectory of China’s current rise to prominence and its probable implications, as well as China’s political, economic and military policies and capabilities, and the development of China’s relations with other key actors.

STST8002 The New Power Politics of Asia

Course Convenor: Professor Hugh White

Asia is in the throes of a major power-political revolution, as a radical change in the distribution of wealth and power overtakes the old order and forces the creation of a new one. Explore three areas of the new power politics of Asia: the nature of power politics as a mode of international relations; the power politics of Asia today, what is happening and where it is going; and concepts that can help us better understand power politics.

STST8010 Strategic Studies Concepts and Methods

Course Convenor: Professor Evelyn Goh

Explore inter-disciplinary concepts, theories and methods that inform Strategic Studies academic research. Using the overarching empirical theme of the Cold War, investigate three areas: understanding critical developments during the Cold War; historiographical and methodological debates in the study of the Cold War; and theoretical and conceptual methods employed by scholars in the most influential works in Strategic Studies.

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