Notes on talk by Herve Lemahieu of the Lowy Institute on 5th March 2019

Abstract

The Lowy Institute Asia Power Index maps the distribution of power in the Asian region and allows us to think through what might happen as we move from a broadly open and consensual world order to one defined more by competition and zero sum politics between established and rising great powers. Hervé Lemahieu addressed the Probus Club on the findings from the Lowy Institute’s Index to model possible scenarios – from a new ‘cold war’ to the possibility of a hot war involving the United States and China. He illustrated which countries would stand to lose most under these new terms. He also predicted the emergence of a more hazardous variant of globalisation, dominated by spheres of economic influence. With shifts in the balance of power, Australia alongside other middle powers will have to either seek to mitigate or adapt to global geopolitical gridlock.

link to the AsiaPower Index website  power.lowyinstitute.org  (copy and paste into your web browser, eg Chrome, Internet Explorer, Firefox)

Herve’s Presentation Notes:

Premise

I’ll use this presentation to make a few observations using an analytical tool developed by the Lowy Institute over the course of two years. That will allow us to think through what might happen to the distribution of power – and even hazard some guesses about a future balance of power – as we move from a broadly open and consensual world order to one defined by competition and zero sum politics, certainly between the two biggest players China and the US.

I confess my dataset is limited to the Indo Pacific. But we can extrapolate global lessons for the discussion that follows.

Three points:

1. Under most plausible scenarios short of war, the United States will not be able to halt the narrowing power differential between itself and China.

2. Secondly, globalisation under a so-called New Cold War will still involve the US and China – though perhaps not the two countries together. That would mean the danger of a more hazardous variant of globalisation, less homogenous and dominated by spheres of economic influence.

3. In such circumstances, middle powers will be play a crucial role in the gridlock between the world’s two largest economies – and in adapting the global order to contemporary realities. In other words, we will not have hard and fixed blocs that defined the last Cold War.

GDP chart

1. Commentary.

2. First a bit of history because in 1995, top 5 were US followed by 4 treaty allies. 4 out of 5 were transatlantic.

3. Remarkable how in 20 odd years, Asia’s economic transformation has reshaped the global distribution of power.

4. China smaller than Brazil and Spain. By mid-2000s overtakes France and the UK. By 2009, overtakes Japan to become second largest economy. India a relative laggard – but experiences its own economic miracle of sorts. So much so that by 2023, IMF predicts it will enter the ranks of the top 5 largest global economies.
5. So there you go: In geostrategic terms, its relativities that matter.
6. China’s economic rise by definition imposes geo-strategic costs for the US as the incumbent world power.
7. Nevertheless, this is an America that is in relative decline, and by no means in absolute decline. This is an important distinction.

Octagon chart

- Power is what you have and what you do with what you have. Advance interests, achieve outcomes favourable to those interests.
- Not just economic resources that matter in our assessment of power. There at least 8 thematic distinctions to be made.

Distribution of power

- Immediately apparent: US and China now firmly established as peer competitors in Asia. The US may be losing its unipolar moment but maintains primacy.
- Even as China rises, and has firmly established itself as the economic engine of Factory Asia, it has liabilities and remains hobbled from taking up a greater role in key respects, not least due to the lack of trust among its neighbours.
- As such there are unique hard and soft qualities of late 20th century US power, which appear to be enduring in the early 21st century.
- These are rooted in a working system of cooperation, partnership and alliances, and are premised on the US underpinning that order as a multilateral player.

Power Gap

- Not just a two-player game. In a consensual order, second tier multilateral players are overachievers relative to their size while misfit middle powers – like Russia and North Korea – lack broad based influence.

Under strain

- Clear signs the rules based order, and US leadership within it, is coming under severe strain.
- Frustrated by US unpredictability on the one hand. Apprehensive about China’s ambitions on the other.
- Middle powers are having to work much harder to salvage their comparative advantages through plurilateral arrangements: example the TPP minus the United States spearheaded by Japan and Singapore.

Changing US posture

- We seem to be moving away from the ‘positive-sum’ ethos towards the ‘zero-sum’ logic of mercantilism and geostrategic rivalry.
- Sometimes it seems as if President Trump is hunkering down in the trenches for a prolonged economic cold war, other times it’s as if he’s prepared to call the whole thing off and resume being friends with Xi if the two sides can strike a deal at Mar-a-Lago in thelead up to the elections.
- Still reversible but let’s assume this becomes an era defining moment.
- US FP establishment is committed to a long-term, intensifying strategic competition with China on geo-economic grounds.
- Hinges on geo-economic tools – technology, financial and monetary power, trade and investment policy, sanctioning power.

Weightings Cold War

- We recalibrated our weightings strategy to see how that would affect our rankings.
- A world where the rules-based globalism matters less than raw heft seems to favour China.
- Economies (India, Indonesia) dominated by domestically-driven growth seem to do better than countries dependent on export-driven trade models (Japan, Singapore).
- Premised on three assumptions:

1. Paralysis in economic governance – SKIP Weightings calculator
   - First, a cold war will come at significant opportunity cost: Paralysis in global economic governance mechanisms.
   - There is no lowest common denominator other than an agreement to disagree. G7/APEC summits
   - Worse: The rules-based trading system built around the WTO could wither, and possibly crack, under pressure.
   - From December, the WTO will be down to one judge on its Appellate Body, which means appeals and trade law enforcement will go into limbo.

2. Decoupling
   - Support in the US on national security grounds is building to disentangle American companies and their technologies from China’s supply chains. In effect to reverse globalisation.
   - Even allowing for that possibility, our models show decoupling would have a limited impact on China’s overall growth trajectory. The US can slow but not reverse China’s ascendancy.
   - Decoupling through investment screening and export controls, but also in a broader sense of open-ended generalised tariffs on Chinese imports and other punitive measures.
   - Would export trade worth up to 3.5% of China’s GDP in domestically-created value.
   - There would also be a continuing LT growth hit. By 2030, China would be $2.7tn smaller than forecast under current trends (-8.2%). US would be $1.1tn poorer (3.3%).
   - **Beggar-thy-neighbour**
   
   Explore data:
   - China is much less vulnerable to escalating trade tensions than many believe.
   - China has counterintuitively become the world’s largest trading nation and seen its GDP become less dependent on exports.
   - China’s trade-to-GDP ratio is 38 per cent. By comparison, Vietnam’s trade as a percentage of GDP is over 200 per cent.
   - This suggests China is less susceptible to the downsides of a bilateral trade war, but the region, which, by and large, is strategically friendly to the US, may be much more so.

Huawei:
- Domestic demand means China is already the most important market for itself today. Makes industrial scale implementation of new technologies much easier to achieve.
- Big story in a decade’s time might be the negligible importance of the US and other Western markets for the ascendency of China’s tech.

3. Middle powers assert strategic autonomy
   - Thirdly, there will be no hard fixed blocs in this economic cold war.
   - The US will be hard pressed finding regional friends willing to join it in decoupling from China.
   - China’s growth is now a major source of final demand for everyone else. China does 70% more trade with the Indo-Pacific region annually ($2.5trn) than does the US ($1.4trn).
   - For major industrialised allies like Japan and South Korea, decoupling plus “America first” might be toxic. See their economic ties with China as a lifeline to be managed, not severed.
US has carrots and sticks: on one hand, opportunities as supply chains relocate out of China.

On the other hand, we’ve seen the inclusion of the so-called “poison pill” clause in the US-Mexico-Canada agreement. Seeking to reduce China’s integration with America’s own economic partners.

The Trump administration's focus on securing bilateral trade deals and balancing trade flows one country at a time is unlikely to stem or keep pace with the growth of Chinese influence.

Far from containing China, it may ensure global supply chains remain anchored there after all.

Chart:

- Trade in value-added (as opposed to gross exports), which traces through a country’s exports to their source of final demand.
- In 2000, the US and EU together provided about half of the region’s final export demand. By 2017, about two thirds of East Asia's final export demand came from non-Western economies.
- Cases of anti-China pushback on economic grounds are diverse in scope and specifics, reflect varying national interest calculations and negotiating leverage. India / EU.
- But many middle powers may be fundamentally unwilling to resign themselves to taking sides – and will look at ways of getting around strategic gridlock. Jaishankar.

Military expenditure

- Finally, you cannot preclude the possibility of an economic cold war turning into a hot war.
- When you look at history, there are plenty of examples of confrontations in trade terms that have resulted in kinetic conflicts.
- Four of the five largest military spenders will be situated in the Indo-Pacific by 2023. The Indo-Pacific is ground zero for great power relations.
- However, for most countries defence spending as % of GDP has proven stable or has actually declined.
- Hallmark of last two decades / a rules based consensual order: governments do not appear to be increasing their defence spending more quickly than their economies are growing.

Military balance

- We think the military balance of power still works decisively in Washington’s favour.
- Beijing now has the ability to severely complicate any adversary’s operations in its near abroad. But it is not yet capable of projecting and sustaining military power over vast distances.

Defence diplomacy

- Additionally, the data suggests that China is becoming more vulnerable to a military and strategic counterweight led by other regional powers.
- China’s defence diplomacy has not kept pace with its rising military capability. If anything, it is inversely correlated. And it is easy to see why.
- One way or the other China is embroiled in Asia’s 5 flashpoints – South Asia India-China-Pakistan / South China Sea / East China Sea / Korean peninsula.
- There are also signs of creative hedging as non-aligned powers take measures against both the military rise of China and the possibility of US retrenchment.

Hot war scenario

- When we recalibrate our weightings to account for the possibility of an East Asian maritime conflict involving the United States and China taking place in the near future, the results illustrate the countries in the most favourable positions to fight and endure a confrontation. With some surprising findings. Geopolitical security on the side of the remote.
Future trends

- Under current trends, the United States could endure as the most powerful military force in Asia to 2030.
- This will be a battle of political will and defence economics.
- However, whereas US commitments are spread across the globe, China can concentrate its resources in Asia.

US/China forecast

- Here’s the snag, a period of prolonged and heightened tension could actually trigger an arms race in ways we have not seen to date.

Conclusion

- There is only so much that the United States can—or should attempt to—do to prevent China’s emergence as a potential peer.
- No reason to assume China will replace the United States as the undisputed unipolar power in Asia or elsewhere. But neither can China effectively be contained through a Cold War strategy.
- There are aggravating consequences – economically and militarily – of attempting such a strategy unilaterally through zero-sum politics.
- US will need to create an environment where the strengths of its allies and partners – those with shared security concerns about China – are maximised.
- That will mean finding a way to live with China and playing to its strengths as multilateral player.
- China will feasibly continue to chip away at America’s margin of pre-eminence. But so will India begin to chip away at China’s, which faces demographic decline.