

Irresistible rise of the Indo-Pacific

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We've been told for decades that Asia is rising, and that our destiny is in Asia -- if we're prepared to make the right changes. Hedley Bull, Australia's most famous and influential analyst of international affairs, wrote in 1972 that the Asian power balance was changing and Australia would need to accept it could no longer rely on its alliance with the US. Seventeen years later, economist Ross Garnaut wrote about the economic rise of northeast Asia and its transforming effect on the world economy. This presented great opportunities, Garnaut argued, but only if its society was prepared to make a demanding and unaccustomed transition: "The challenge of the northeast Asian ascendancy to Australia includes the need to comprehend northeast Asian social, economic and political institutions and languages."

For prime minister Paul Keating seven years on, a booming Asia challenged Australia: "If Australia does not succeed in Asia it will not succeed anywhere. But success clearly requires more than the traditional tools of foreign policy." According to Keating, to make its way in its region, Australia needed to become a republic. The common thread to each of these arguments, and to dozens more between, was that Asia was rising and Australians would have to change to avoid disaster or to make the most of it.

Australia has indeed done extremely well out of the rise of Asia. The past two decades have seen the economy triple in size and the average Australian's wealth nearly double. The Australian economy's growth rates have outstripped nearly every advanced economy's and it has escaped three recessions that have gripped the US, Europe and Japan. At the same time as it has become richer, Australia has become safer. Fear of invading hordes of impoverished Asians has been replaced among the bulk of the community with an acceptance of migrants, students and businesspeople from Asia. Terrorist groups in Southeast Asia that alarmed Australians a decade ago have been broken up and disrupted, and fears of Asian terrorists have subsided to the extent that the recent bombing of a police mosque in Cirebon in West Java attracted little media coverage.

Australia did very well out of the rise of Asia even though Australia didn't change, as it was repeatedly advised to. Australians kept their alliance with the US and their marked comfort with Western values and societies over Asian societies. Lowy Institute polling has consistently shown Australians overwhelmingly support the alliance with the US. They consistently feel more warmly towards Western countries -- New Zealand, Canada, France, Britain and the US -- than Asian countries. And those Asian countries they prefer are the most Westernised: Singapore and Japan.

Since Garnaut's call for Asia literacy in 1989 there has been a relative decline in the numbers of Australians studying Asian languages. While Japanese is still the most widely studied foreign language and demand has surged for Mandarin Chinese, the number of people studying other Asian languages is stagnant or declining. Schools and universities have reduced their investments in the teaching of Asian languages. Nor did Australia become a republic, with close to 55 per cent of voters rejecting the 1999 referendum proposal for an Australian head of state. During the past two decades Australian society has internationalised remarkably in terms of its dependence on global flows of people, goods, investment and ideas. By 2000, we had lower barriers to international trade and investment than any other developed economy, whereas for most of the 20th century we had some of the highest. Australia's trade, which was just over one-quarter the size of its economy in the 1960s, had grown to 42 per cent of the size of a much larger economy by 2000. The flow of investment into Australia in 2006 was 20 times as large as in 1990. The flow of investment out of Australia grew by 95 times its 1990 levels by 2006. That year the country exported twice as much capital as it imported and Australian investment abroad reached three-quarters of the amount of global capital invested in Australia.

On any given day, there are about one million Australians living in or visiting another country. In the first six months of last year, more than one-quarter of the population travelled overseas. In the past

decade, Australians were in charge of McDonald's, Rio Tinto, Pizza Hut, Santos, Dow Chemical, News Corporation, Polaroid, the World Bank, British Airways and Cambridge University, and held senior executive positions in IBM, Merrill Lynch, Kelloggs, DuPont and UBS.

By 2008 more than a half million foreign students were studying at Australian schools, colleges and universities, a 20 per cent increase from the previous year in line with the average percentage increases every year for the previous decade. By the mid-90s more than 100,000 people were migrating to Australia every year, making up more than half of the country's annual population increase for the first time since the early 20th century. More than one-quarter of Australians were born overseas, and half of all marriages each year in Australia are between people who were born in different countries.

But, paradoxically, during the decades in which Australia has internationalised, its society has become steadily more insular. Instead of investing in our capacities to understand and engage with the world, we've starved them. It is likely the federal budget next week will kill off funding for the study of Asian languages and culture in schools. This will further cut into our ability to build the intellectual infrastructure we need to understand and converse with the societies that have become so important to us.

This deepening insularity has allowed governments from both sides of politics to systematically disinvest in the primary instruments through which Australia deals with the outside world. In March 2009, research by the Lowy Institute showed that the budget for foreign affairs and diplomacy has shrunk in real terms during the decades that Australian society has grown more and more dependent on the outside world. By 2009, Australia had fewer diplomatic missions than every other developed country with the exceptions of Finland, Luxembourg, NZ and Slovenia. Further Lowy Institute research last year showed Australia's investment in international public broadcasting was just a fraction of that invested by countries it likes to compare itself with: the US, Britain, France, Germany, South Korea and Japan.

In the US and Europe, candidates for the highest political office are viewed with scepticism by their electorates if they are seen to have little experience in international affairs. This was Barack Obama's biggest weakness in his contest with Hillary Clinton, and it affected his campaign schedule and dictated his choice of running mate. Sarah Palin's missteps on international affairs became the stuff of derision.

In Australia, neither the Prime Minister's nor the Opposition Leader's lack of experience in international affairs was commented on during the most recent election campaign or since. Kevin Rudd's international agenda during his time as prime minister was taken as another example of his lack of engagement with domestic issues. The insularity of Australian society also strikes home at an anecdotal level. The popular reaction to the jailing of Schapelle Corby in April 2005 at once displayed how familiar Australians had become with Bali but how ignorant and prejudiced they could be about Indonesian society.

Hugh Mackay has observed the decline of serious current affairs programming on Australian television and the rise of lifestyle and reality programs. "Australians are ready to leave politics to the politicians, economics to the economists and international relations to the diplomats. They want to disengage from the national agenda so they can get on with having a good life in the best, safest country on earth."

We could be forgiven for saying, "And why not? It's worked beautifully so far."

The problem is that Asia's rise is now different, very different from the benign and beneficial process we've become used to. Until about a decade ago, Asia's rise was the story of the astonishing development of a series of small countries. Each of them shared a combination of existential desperation, land and resource poverty, geopolitical fear and single-minded discipline. First Japan recreated and then surpassed the miracle that followed the Meiji restoration a century earlier; Hong Kong, Singapore and Taiwan followed close behind and in turn were followed by South Korea. All were in deep strategic alignment with the US and benefited from its armed might, open markets and freewheeling finance. Suddenly there were Asian faces among the world's wealthy, but when the novelty wore off little had changed about the basic shape of the global economy. A small,

overwhelmingly Western minority still controlled most of the world's wealth.

The difference this time is that it is China and India that are rising. The world has never seen societies of this size develop this quickly, and it will never see it again. To put their size in perspective, India and China each has a larger population than any of the earth's continents other than the one they occupy. Unlike the Asian tigers, the two giants' success has nothing to do with the quality or single-mindedness of their reforms. It has everything to do with their size. It's a question of multiplication. Even a moderately positive policy measure will have a big effect if it releases the productivity of hundreds of millions. Even a minor gain in productivity will have global effects when multiplied by hundreds of millions. To be bigger than Europe or the US, China and India need to be only one-quarter as productive per person and they are closing fast.

The scale and depth of poverty in China and India meant that, once given the chance, they would grow quickly from a low base. In 1980, the average wealth per head in China was \$US205; in India it was \$US263. The only Asian countries with lower per capita wealth than China and India in 1980 were Burma and Nepal. In 1981, 64 per cent of the Chinese population and 60 per cent of Indians lived on less than \$US1.25 a day. Given the chance to escape poverty by modest economic reforms, hundreds of millions of people grasped the chance to improve their fortunes. The ending of agricultural collectivisation and the weakening of restrictions on movement in China and the unwinding of suffocating licensing frameworks in India unleashed waves of productive forces into their economies.

Even as the aggregate size of the giants' economies surpass those of developed countries, they will remain poor societies. This means that even when they are huge, these economies will still contain within them plenty of individual-level energy that will stimulate further strong economic growth.

China and India had vast reserves of ultra low-cost labour and domestic markets potentially larger than any possible competitor. They offered international companies scale economies that had dazzled business brains for centuries, and gave Beijing and New Delhi great bargaining power over multinationals. The size of the giants means that they can afford to be less concerned about the effects of corruption, crumbling infrastructure and slothful bureaucracies on international investment. India's poor governance, bad infrastructure and high corruption are estimated to wipe nearly 2 per cent off its annual economic growth rate, and still it grows at 8.5 per cent.

The World Bank estimates that governance failures suppress foreign direct investment to China by 30 per cent, yet it remains the world's largest destination for FDI. Their countries' size has also given the giants' governments greater latitude to experiment with reforms through trial and error, without risking the performance of the whole economy.

Whatever happens to them in the decades ahead, the rise of China and India will profoundly reshape the world of the 21st century. If they continue to grow at about their present rates the global economy will re-centre on them. Even if they suddenly stop growing at these rates and lapse back to their pre-boom momentum, they will continue to be important economies whose consumption still drags the global economy this way and that. If their detractors are right, and they are headed for a serious economic and social meltdown, the fallout from their collapse will define the rest of the century.

All of this holds irrespective of what happens in the rest of the world. The US may be headed for a renewed spurt of innovation-led growth, similar to what happened in the early 90s. Europe may find new sources of dynamism. Japan may too. But none of this will change the fact China and India have arrived as significant shapers of how the world works, and their preferences, enthusiasms and allergies will affect the choices other societies face. The tidal effects of the growth rates of the Asian giants reach further, faster and deeper in an increasingly globalised world. Emerging economies -- particularly very large ones -- are almost always more volatile than established ones, making their fate much more central to the fortunes of the global economy than their absolute economic size would suggest. Their scale and rate of change within an increasingly seamless global economy enables, displaces and reshapes economic activity and its social and political consequences far beyond Asia. For example, at their present rates of growth, China and India are adding more than 40 million workers to the global economy annually, the equivalent of the arrival of a France in the world economy every year.

This has relentlessly undercut employment rates and wage growth in the rest of the global economy, hitting first and hardest in those parts of the world with the highest paid workers. The result has been high and growing structural unemployment, growing inequality, burgeoning pressure on the welfare state and deepening intergenerational and political conflict within societies whose ageing and shrinking populations would otherwise have eased the employment creation pressures on sluggish economies.

But the tides have not been all negative. China and India have driven down prices of manufactured products and services, contributing in a big way to the very low rates of inflation in most countries during the transmillennial decades, while China's surplus in savings financed the consumption boom in the developed world.

China's and India's growth has already begun to reshape Asia. Two decades ago, the most important trade and investment flows and most crucial security alignments and rivalries stretched across the Pacific, between northeast Asia and North America. This was the era of the Asia-Pacific, a regional construct that has become embedded in the Australian psyche.

But during the past 20 years trade within Asia has quickly outstripped trade across the Pacific. In the 1990s East Asia's trade with North America was just slightly less than its trade with the rest of Asia. As the prophets of the Asia-Pacific century would have predicted, East Asia's trade with North America grew by 325 per cent between 1990 and 2007. But during the same period East Asia's trade with the rest of Asia grew by 625 per cent. And the trends have been accelerating. Intra-Asian trade grew by 240 per cent during the 90s, but by 280 per cent in the following decade. By the end of the first decade of the supposedly Asia-Pacific century Asia's internal trade was more than 2 1/4 times the size of cross-Pacific trade.

Energy forms a large and growing proportion of the traffic. The Asian giants are responsible for more than half of the growth in global energy demand since 1990. Between 1990 and 2007, China's oil consumption tripled and India's increased by doubled. The International Energy Agency estimates that by 2030 China's demand for oil will have doubled again, and India's will have grown by almost 2 1/2 times. By 2030 India will be dependent on imports for more than 80 per cent of its oil, and China will rely on imported oil for more than 60 per cent of its needs. Asian energy importers (add Japan and South Korea to India and China) get more than 80 per cent of their oil from the Persian Gulf, and two-thirds of its natural gas. And because energy is so central to the ability of modern societies to function, governments and energy companies have been investing in their suppliers and markets. Japanese, Chinese and Indian financing has increased markedly in energy production in the Persian Gulf, while the Gulf sheikdoms have been eager to finance the growing network of giant oil refineries along Asia's southern and eastern coastlines.

And, as always occurs in international affairs, security rivalries and alignments have overlaid trade and investment flows. An emerging pattern of power alignments and competition is emerging in Asia, a pattern that increasingly resembles a pyramid. At the apex of the pyramid is Asia's primary power, China.

China is Asia's largest country by population and the second largest by land area. The regional economy is increasingly centred on China. It has the continent's largest and best-equipped military forces. But China is surrounded by other large countries that don't trust it and that have enduring civilisational rivalries with it: Japan, Vietnam, Indonesia, India. Increasingly these countries are reaching out to each other and to the US to balance the rising power and centrality of China.

But these secondary powers in turn are surrounded by tertiary powers that are deeply distrustful of them. Japan is beset by memories of its historical aggression, as is Vietnam. India's neighbours in South Asia get on very well with each other but eye New Delhi with suspicion. Indonesia has long been suspected by its neighbours of being little more than a vehicle for Javanese dominance of Southeast Asia.

To balance the secondary powers, the tertiary powers are reaching out to each other -- and to China, the primary power, as well as the US. Pakistan has long had close relations with China. China's trade with the countries of South Asia stood at \$19.4 billion in 2004, almost four times the value of India's trade with its closer neighbours. China's closest relationships in Southeast Asia are with countries that

have long lived in Vietnam's shadow: Cambodia, Laos, Burma and Thailand.

The consequence of this pyramidal power structure is that strategic linkages and counter linkages now run between the Indian Ocean and Pacific coasts of Asia. These emerging trade, investment and strategic linkages means that it no longer makes any sense to describe Australia's region as the Asia-Pacific. Australia must recognise that it lives in a new Indo-Pacific era and that this ushers in a completely unfamiliar world.

The Asia that is emerging will not conform to a neat logic, either of willing acquiescence in being tributaries of a resurgent Middle Kingdom or coalescing around a new bipolar stand-off between Beijing and Washington. Asia's future will be one of elaborate and overlaid geometrical patterns of alignment and enmity, enmeshment and balancing. The growth in power and economic centrality of the giants will be offset by those close to and enmeshed with them seeking to balance their exposure by building relationships with other countries. It will be a world of complex calculations and strategies. It means that, for however fast and long they grow, none of Asia's giants will open up a power lead over all the others of anywhere near the scale the US had after World War II. India and China may grow very big, but so will the countries around them. Asia's power terrain will be very crowded.

The giants, well aware of their vulnerabilities and the jealousies of others, will be paranoid about being isolated and tied down. This means that if military, financial and gravitational might form the skeleton of the Indo-Pacific order, it is countries' capabilities to establish and block coalitions and partnerships that will form the muscles, the moving parts, of the region.

The dynamics of gigantism and rivalry are putting a greater premium on offsetting coalitions and understandings among the giants' neighbours. The deepening of these offsetting alignments only increases the worry of the giants about being surrounded and isolated, and leads them to redouble their efforts in building linkages that block or undercut that possibility. More and more countries in the Indo-Pacific will face a common dilemma: a national economy that is increasingly tied into China's but a set of diplomatic and security commitments that are oriented away from China.

These diverging national interests, and the sheer fluidity of the power dynamics of the Indo-Pacific, mean that the formal regional organisations will become less and less relevant. Their meetings will become increasingly stage-managed and formulaic, while the real business of alignment, rivalry, adjustment and confrontation will take place outside them.

The present pattern of regionalism places ASEAN at the centre because none of the big powers trusts the others with leadership, but Southeast Asian countries, increasingly drawn apart by the region's power dynamics, cannot hope to play a meaningful role in mediating relations among the giants.

The new regional order will be plurilateral, a complex tapestry of overlapping agreements among its countries and with big external players. Countries' economic and security interests will pull in different directions, making clear sets of alignments and confrontation impossible. The sinews of the Indo-Pacific will be formal agreements and informal understandings managed flexibly and always under construction or modification as countries calibrate and recalibrate their advantages and disadvantages in the evolving regional dynamic.

All these changes will leave Australia in a strange and paradoxical position. On the one hand it will wield progressively less strategic weight in the regional power dynamic. On present growth rates by the end of this decade China's economy will be nearly 10 times as large as Australia's; India's will be 2 1/4 times as large; Japan's 4 1/3 times as large; and Indonesia's three-quarters as large.

Projected military spending will see Australia's defence budget at just over one-tenth of China's, one-third of India's and half of Japan's by 2020. It is more than likely that all of the attributes Australia used to compensate for its small population and economy -- technological strength, sophisticated and significant armed forces, alliance with the US, educated population and relatively large economy -- will decline in importance relative to the countries of Asia during the coming century. Even if the Asian giants' resource hunger doesn't peak until the later 2020s, as some optimistic estimates suggest, new sources of supply under development will see Australia's resource production become less important to the region in the medium term and drop dramatically in importance within a couple of decades. As Europe and North America become less dominant in global economic and strategic terms, as their

substantial educational and technological leads are closed, Australia's mystique as a Western country in Asia will erode.

On the other hand Australia will increasingly be in a part of the world in which the great powers will compete for influence. The long peninsula and archipelago of Southeast Asia will increasingly become a cockpit of economic, diplomatic and strategic competition among China, India, the US and Japan.

Their ability to tip its countries towards their own spheres of influence and away from the clutches of their rivals will assume great significance. For a country such as Australia, a growing number of its choices will be watched jealously by a range of powerful neighbours. Already India believes its difficulties with Australia stem from Canberra's ties with China. China thinks the US has too much sway over our thinking. The US worries about our growing trade relationship with China.

This is a new and complex world. It can't be dealt with on autopilot or with tools we've used since the end of World War II. It will challenge Australia to throw off its insularity and invest seriously in the infrastructure of its engagement with the emerging Asia. This is a challenge bigger than any domestic reform agenda that we face.