

LOWY INSTITUTE
FOR INTERNATIONAL POLICY

CANBERRA LECTURE 2009

**ECONOMIC CRISIS AND POLITICAL
CONFLICT**

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THE CANBERRA LECTURE

The Canberra Lectures recognise those individuals who, in their professional careers, have been able to bridge the worlds of academe and international policymaking. The lecture series reflects the key objective of the Lowy Institute to produce original research that combines academic rigour with policy relevance.

The 2008 lecture was delivered by Professor the Hon. Kim Beazley. The inaugural lecture was delivered by Dr Coral Bell AO, whose career epitomises the successful union of international policy theory with its practice. Having begun her career as an Australian diplomat, Dr Bell became a major figure in the scholarly study of international policy as a Reader in International Relations at the London School of Economics and Political Science, as Professor of International Relations at the University of Sussex, and as an early and prominent member of the International Institute of Strategic Studies. She is now a visiting fellow at the ANU's Strategic and Defence Studies Centre. Her contribution is reflected not just in the great body of original research she has produced, but in her tutelage over many years of Australian diplomats, soldiers and strategic policy professionals. Dr Bell is author of Lowy Institute Paper 21, *The End of the Vasco da Gama Era*.

THE LOWY INSTITUTE FOR INTERNATIONAL POLICY

The Lowy Institute is an independent international policy think tank based in Sydney. Its objective is to generate new ideas and dialogue on international developments and Australia's role in the world. Its mandate is broad. It ranges across all the dimensions of international policy debate in Australia – economic, political and strategic – and it is not limited to a particular geographic region.

Economic crisis and political conflict

Professor Sir Lawrence Freedman

It is a great privilege to be asked to lecture in a series inaugurated by Coral Bell. Like so many of Australia's great students of international affairs, and there have been many, you were kind enough to share Coral with Britain. Coral has always managed to combine commentary on the affairs of the day with a sense of the big picture, of the interaction of diplomacy with its context, of the shifting relations between the big powers and the socio-economic conditions with which they must cope, against the backdrop of new challenges arising from long-term trends, such as climate change.

Coral has spoken of her work as part of a tradition, with its own simple but clearly understood concepts and language, rather than as an expression of a theory. At a time when international relations are expected to show extraordinary methodological sophistication, she deploys the two most undervalued heuristic devices, thought and reflection. At a time when the study of international relations is so often confused with quantitative models designed to identify scientific laws of timeless validity, with scant interest in the singular features of any particular conflict, Coral understands that whatever such 'laws' might lead one to expect it is the actual choices made by often flawed and sometimes inspired human beings, working with the information they have and the assumptions of the time, that determines actual outcomes. Governments need not be the playthings of structures and trends but have a capacity and a responsibility to influence the environment of which they are a part. It is this theme that I want to pick up in today's lecture, because we seem to have entered a period when the choices for governments seem suddenly to have become more difficult than most can remember, and there is a sense that events are moving out of control, taking us into a global economic calamity that is bound to produce extraordinary political turmoil.

'You do realise', said Adam to Eve as they left the Garden of Eden, 'that we are now entering transitional period'. Two decades ago there was much talk of a transition. During the cold war we had come to expect a certain stability. The superpower confrontation had its uncomfortable features, but over time it had acquired a sense of permanence and durability. As the confrontation could not be resolved through war, it seemed safest to assume that the stalemate would continue. So once the cold war came to an end there was relief coupled with some anxiety at what was hoped to be only a temporary loss of stability. Hence the talk of a New World Order. The optimistic view was that the

major powers would now work together amicably and make the United Nations work like it should. This new order could match the cold war in durability and stability, but score higher on democracy and economic growth. The objective was reflected in the metaphors with which it was discussed. Words like 'system', 'structure' and 'order' conveyed a comforting sense of regularity and design. The aspiration of an engineered stability was reflected in the idea of a 'security architecture' to be constructed, with firm 'foundations' and strong 'pillars'. Hence the transitional period, to last no longer than was necessary for the plans to be drawn up and the new order constructed. Yet it was soon clear that this was not a transition but more likely a continuing instability, with its own creative opportunities as well as dangers. Policies and institutions needed to think more in terms of the metaphors of adaptation and movement: flexibility, versatility, agility, resistance and pressure, pushes and drives.

The reason for the sense of permanent instability that has set in over the past two decades is that the dominant ideology of the new international system became liberal capitalism, the victor of the cold war competition with communism, celebrating individual freedom, cultural as well as political, and open markets. Because it is the ideology of the dominant powers its radicalism is not always appreciated. Yet it is naturally subversive of authoritarian regimes and undermines attempts to establish ordered societies. In its post cold war confidence, and in the name of globalisation, it threatened collectivist governments, protected economies and social conservatives. It has challenged the Westphalian rules of international order, based on non-interference in the internal affairs of other states, however obnoxious those affairs might be. Closed economies have been encouraged to open up, repressive regimes have been pressed to allow basic political freedoms, and democracy has been urged on one and all as the best guarantor of peace and stability. The great liberal push of the 1990s was often resisted and derided yet it chalked up some remarkable successes, helped by the fact that it was the governing ideology of the only superpower left standing, and inspired the world's most successful economies. Under the heading of globalisation, there was rush of economic deregulation which led to a period of rapid, and widely spread, economic growth. Under the heading of humanitarian intervention, there was a readiness to act to alleviate economic distress and stop major crimes against humanity.

Over the course of this decade there have been indications that the optimistic model of the 1990s was starting to produce perverse results. Contrary to hopes, embracing free markets did not lead inexorably to free politics, as China demonstrated. Globalisation revealed its unpleasant underside, as organized criminals took advantage of the new openness to traffic on a greater scale and with greater efficiency, in everything from drugs, to arms, to humans. Radical Islamist groups showed how they could use the new information technologies as well as anybody else and move their people and weapons around the world to devastating effect. The benign nature of US global leadership came to be

questioned as it fought back against Islamism but with methods which lacked both subtlety and focus. It was one thing to promote the virtues of democracy, but quite another to insist upon it and seek to impose it on sceptical societies. Then there was the excitement of a global economic boom, with the normal accompaniment of unwarranted confidence that this time there will be no day of reckoning. Stein's Law states that 'If something cannot go on forever, it will stop'. And that is what happened last autumn.

Economic crises of this magnitude aggravate and accelerate existing fractures and tendencies at all levels, from the parochial to the global. They stress societies and test their coherence and self-confidence. At some point the result may be quite new political constellations that may even become transformational. My aim in this lecture is to explore the extent to which this may be so in this case, and just how disorderly the world might become. As Mark Twain remarked, prediction is easy so long as one stays clear of the future, and so my talk will be stronger on generalities than specifics – but what else would you expect from an academic!

In the second half of 2008 there was an abrupt financial crisis of extraordinary severity, which soon became an abrupt economic crisis of equivalent severity. Both are now on a global scale. Neither is yet close to being resolved to that level of comfort that produces the magic ingredient – confidence – that leads to a revival in investment and trade and a return to employment and growth. I assume for the purposes of this lecture that we are facing an extreme version of the business cycle, with a mutually reinforcing downturn to be followed eventually by a mutually reinforcing upturn, though one not necessarily as steep as the downturn or likely to take us back quickly to the positions of the first half of 2008. The impact will vary across countries and regions, and questions of phasing and pace at local as well as global levels will help determine the specific political effects of the crisis.

Even during the relatively short period since the start of this crisis, assessments both of its severity and its political consequences have had to be regularly revised. So long as this was taken to be a largely financial crisis it was widely assumed that the United States and the United Kingdom would suffer most, and that this might accelerate a perceived shift to the rising economic stars of China and India. Continental Europe could look on smugly and the oil producers would continue to benefit from high prices. The collapse of world trade, and subsequently the oil price, soon made these judgements look premature. Indeed the shock may be greater for countries with no relevant experience of the business cycle or else, as with the oil producers, burdened with ambitious plans based on the always dangerous assumption that the recent past described an indefinite future. Over time, the shocks to some parts of the system will turn out to be more traumatic for some than for others. We have all entered this crisis together: we will not all exit in the same way and at the same time, and some may not exit at all.

This crisis is described as ‘unprecedented’, though often in combination with a reference to the great depression of the 1930s. This decade is associated not only with high unemployment and poverty, but also with political trends culminating in the Second World War. So to the extent we have a precedent it is a disturbing one. Economics and politics combined in great upheavals to throw some countries into civil war, take others into the grip of dictatorship while millions became mesmerized by totalitarian ideologies, creating unexpected alliances which then broke asunder with extraordinary violence. Raising the comparison between now and then is to ask just how bad our situation really is.

I want to highlight three significant differences between then and now. The first is that we know what happened in the 1930s. The economic calamity and the associated human misery, along with the decade’s terrible conclusion, have been studied intensively by economists and political scientists. There is no excuse for history repeating itself, either as tragedy or farce. Indeed, for the moment one can see a keen appreciation of the lessons learned, as shown by the adoption of counter-intuitive fiscal policies, the embrace of contemporary equivalents to the old public works programmes and the regular strictures against protectionism. Moreover globalisation describes a real development. However much politicians may demand forms of economic self-reliance or energy independence autarchic options are barely credible and are apt to backfire quickly if attempted. Whether the right economic lessons have been learned from 80 years ago and whether they are being properly applied I am in no position to say. All I can say is that this generation of policy-makers will make their very own mistakes rather than copy those of their predecessors.

This leads on to the second difference. In the 1930s liberal capitalism was widely seen to be decadent, regressive and doomed. It was challenged by the totalitarianisms of the left and the right. Yet it survived, having first seen off Fascism and Nazism, and then Communism. Now, once again we have a crisis of capitalism. There is nothing else to blame for the current travails. Having enjoyed capitalism’s capacity to unleash creative forces during the good years we must now cope with its destructive force. This has already led to a rebalancing of the relationship between the market and the state. This arguably began with laws to cope with terrorism and crime, which have reduced civil liberties, and it is now moving into financial services, with the right to have a mortgage without any actual income now being taken away. Governments are adopting measures in nationalising banks that are frankly socialistic, but without any confidence in a socialist ideology as they do so, and a determination to get the banks back into private hands as soon as possible. What is striking about this crisis is that thus far it lacks any ideological struggle along the lines of the 1930s. The crisis of capitalism will open up space for alternatives, but the obvious one – state socialism – has been discredited. Nothing else can claim a universal application.

The most likely ideological responses will therefore be populist and nationalist. Nationalism is always a potent force because it is the most vivid identity on offer. In its most virulent form nationalism may feed on emotions and xenophobia, but because these forms also lack an underlying theory they are apt to disappoint, or at least feed upon themselves as all problems are blamed on foreigners or fat cats. Fortunately nationalism can take much milder forms, in ways that do not preclude capitalism, or even aspects of pluralism and liberalism.

The most mooted alternative to a clash of ideologies is a clash of civilizations, along the lines suggested by the late Sam Huntington. But again these religion-based civilizations are compatible with a variety of economic and political forms. Potentially the most severe challenge is posed by radical Islamism, though this has many different, and often contradictory, strands. In some states Islam provides the language of the privileged elite; in others it speaks for the disenfranchised and the marginalised. Islamism does pose a challenge of sorts to the western world but it is of a quite different nature to that posed by Nazism and Communism. It is not an ideology that has become harnessed to advanced industrial or technological strength, and it is unlikely to be so. Within the major powers, it is always going to be a minority identity, even if in many cases this is a growing minority. Its most extreme adherents seek to hurt those of whom they disapprove, which can be a very broad category, but they have no economic programme to speak of, and where Islamists have had a chance to run countries they have not done very well.

The lack of sharp ideological confrontations within western states is part of the third difference between now and the 1930s, and reflects broader changes in international relations. One of these changes was the progressive simplification of the great power system. The 20th Century began with shifting relations between the US, Russia, Britain, France, Italy, Austro-Hungary, Turkey, China and Japan, but by its conclusion, after a prolonged period of two superpowers competing for global dominance, it concluded with the United States clearly on top, enjoying close, if not always warm, relations with the other erstwhile great powers. Another change, and arguably even more important, was the great decolonization drive, to which the Second World War gave such an impetus. The colonised wanted their countries back and the colonisers lacked compelling arguments as to why they should be denied. When people talk of a continuity in the international system, as if structurally barely anything has changed over the past couple of centuries, so that we can analyse current conflicts with the categories and expectations of the past two centuries, they miss more than anything else the impact of decolonisation. The collapse of the Soviet Union was perhaps the last great act of the struggle for supremacy between the traditional great powers but it was also the last great act of decolonization. At the same time the fragile bands which held together Czechoslovakia and Yugoslavia also broke, in the first case peacefully and the second with extreme violence.

The politics of the last two decades, the post cold war era, has been dominated one way or another by the end of empires and the fragility of multinational states. It is of course the case that western powers, and in particular the United States, are regularly accused of imperialism, but this is a straightforward category mistake or else involves such a redefinition as to miss the difference between being in control of another state and merely exercising considerable influence over its affairs. If we allow imperialism to refer to assertions of hegemony and domination without true transfers of sovereignty then we miss the vital difference between current relations between strong and weak states on the one hand and the territorial grabs that marked the age of imperial rivalry on the other, when there was assumed to be a direct relationship between number of colonies and claims of greatness, and also when mercantilist assumptions ruled about the value of controlling resources, markets and trade routes. That era has gone forever. Mercantilism is both discredited and now impractical except with regard to some raw materials, and one wonders if at the moment the Chinese are feeling quite so clever as they thought they were in over-paying to gain privileged access to resources which they now do not need.

Furthermore the natural focus on the intensively exploitative aspects of imperialism misses out on the sense of obligation that could be an accompaniment, if only to look after a useful asset. The imperial powers varied considerably in their treatment of their colonies, but they had an interest in maintaining order and defending territories from local predators. Even with the bits and pieces of colonial residue with which they have been left we can see how this still creates expensive obligations, whether the British flotilla sent in 1982 to liberate 1,800 Falkland islanders from Argentine occupation or the recent despatch of a small force by France to quell unrest in Guadeloupe. The end of empire means not only independence for the former colonies but also no reasonable expectation of automatic support if they get into trouble.

This does not mean that they never get help. Indeed there is a whole new philosophy of foreign policy, which some have even labelled as neo-imperialist, which attempts to create a sense of international responsibility for the misfortunes of those struggling to cope with complex economic, social and political challenges. This responsibility can be realised through programmes of sustainable development or occasional humanitarian interventions. But for the major powers these are largely matters of choice, in which the risks of action can often outweigh the risks of inaction. During the course of the cold war the newly independent states could promise or threaten to embrace the competing ideologies of liberal capitalism or state socialism, or at least offer bases and diplomatic support in return for subsidies and protection. To some extent the threat of radical Islamism can be used now in the same way, although this can backfire on both the government seeking support and the external power(s) providing it. Interestingly the main link that still seems to count is alliance. Once alliances were seen as expedient and temporary, designed to prepare for war or deter war. But in both

Asia and Europe the cold war alliances remain, and in Europe have been expanded as a means of confirming the new ideological identity of former communist countries.

On the basis of this analysis I would suggest that the least interesting question connected to the current crisis is whether it will lead to a shift in the balance of power away from the United States. We are too fixated by the notion of the decline and fall of great powers, for which I suppose we should blame Mr Gibbon. The end of the US era has been regularly called, but each time the claim has turned out to be premature. There were always good reasons for the call: the demoralizing impact of Vietnam, the impact of OPEC and the sharp rise in oil prices, and then claims about overstretch. Unfavourable comparisons were drawn with the dynamism of Asian economies, first with regard to Japan at the end of the 1980s and more recently with China, and perhaps in both cases just as their fantastic growth rates were grinding to a halt.

Why am I convinced that this is the wrong answer to the wrong question? It is precisely because the United States is NOT an empire that it can survive setbacks and reassert its power. It does not have to worry about independence movements. In particular conflicts there is often a worry about credibility and commitment, and that can lead it to fight for lost causes. In the end, however, if the going gets tough in a particular place where it has asserted an interest it can accept the hit to its reputation and move on, as it did in Vietnam, Beirut, and Somalia. There is an elasticity to America's global reach – it can contract and expand according to circumstances and political preferences. Moreover, one should never underestimate America's economic and political vitality. Because it is a democracy it has the capacity, as we saw last year, to reinvent itself during the course of its presidential election.

Most importantly, because it is still at the centre of a network of cold war alliances, and has been the predominant power for as long as anyone can remember, it has a sense of global role and the institutional structures and habits of mind associated with such a role. These can also be found in countries such as Britain and France if not always the capacity to play the role as was once the case. Once lost, as in Germany and Japan, they are difficult to recreate, especially when there is so little appetite to do so.

There are no alternatives. The EU is too cumbersome and divided to offer a decisive approach, even to the problems of its own region. Russia desperately wants to be a great power, and it has some cards to play, but it is difficult for it to have an impact much beyond its own periphery or as a spoiler at the UN. Its long-term economic and demographic profile counts against it. China has been rising, but with a regional rather than a global focus, and it could struggle more than most in the current crisis, because of the deep inequalities and political dysfunctions being thrown into sharp relief.

Neither Asia nor Europe expects to be of much help in each others' regional crises; but they all look to Washington.

There is no basis to the easy assumption that international relations are animated by the competitions to achieve world domination. This is not a world that is easy to dominate. There is no land left to grab. Hegemony is soon contested. Mercantilism no longer offers a route to national wealth. Security calculations have become complex and diffuse. In a post-imperial, post-mercantilist and, in a very particular sense, post-ideological age, the downside risks associated with great power status outweigh the upside. Being a great power may lift national self-esteem but it also invites trouble. It is hard to keep your hands down when volunteers are needed to sort out a particular crisis even though no direct interests are at stake. Those unburdened with this aspiration can be free riders. Rather than get excited by world domination, which is the supposed aspiration of every up and coming new power, life is much easier if you keep your aspirations in check.

Indeed the problem may not be a rush to gain the right to meddle in the affairs of other states, but an increasing reluctance do so. The liberal interventionism of the past couple of decades, under the heading of the 'responsibility to protect', has run out of steam. After the experiences of Iraq and Afghanistan, and in the light of pressures of all public finances, including aid and defence budgets, extra support for sustainable development or overseas military expeditions is going to be hard to find.

There have been potentially significant shifts in regional power balances. My argument is that the US lacks what the Pentagon has called a 'peer competitor'. It is not that it will not face significant challenges if it seeks to influence sets of contentious regional relations. Two of the most difficult are the Middle East, broadly defined to include Afghanistan and Pakistan, where many of the problems flow from unstable states and radical movements, and the Asia-Pacific region where the problems result from something more akin to a traditional balance of power, with China, Japan, Russia and the United States co-existing in an uneasy pattern, and vulnerable to the sudden outbreak of tensions. Recent Russian assertiveness with regard to its 'near abroad', which includes new members of NATO, creates problems of a quite different sort. In each of these cases the domestic challenges resulting from the economic crisis may lead to some reappraisals of security relations, for better and for worse. Some oil producers, Iran and Venezuela as well as Russia, have adopted assertive foreign policies which they may now regret, especially if they want to bring in new investments. As the only seriously global power the United States has an interest in all these regional balances, and it may be that the crisis has given it an unexpected opportunity to encourage a series of breakthroughs that seemed unlikely only six months ago. President Obama stated his desire to rely more on diplomacy during his election campaign. The risk, if it was only the US suffering from the crisis, is that the regional powers would be able to take advantage of perceived American weakness. When everybody

is weaker, with big domestic issues to confront, a series of calm conversations on contentious issues may make more sense than angry confrontations.

I assume that in the following months the focus will be on the inherited international agenda – Iran, Russia, Palestine and in particular Afghanistan and Pakistan. I suspect that the real test of the new foreign policy team will be somewhere else, though I don't know where. It just would be par for the course for the first major crisis of an American administration to involve a country for which options papers and proposed policies do not yet exist. And one reason why this may be even more likely over the coming year is because of the economic crisis.

So the right question to ask about the current crisis is which countries are most at risk and whether there is the will and the capacity to do much to rescue them. In many countries the impact of severe economic dislocation may mean no more than an electoral challenge to the governing party. These are the times when liberal democracy is at its most valuable, for this provides opportunities for political discontent to be expressed, channelled and absorbed, threatening governments but not the state. Even some democracies are going to feel the pressure of the unrest that will ineluctably follow abrupt declines in standards of living and the developing despair as jobs disappear and poverty takes hold of whole communities. In a number of countries, the crisis has already led to mass demonstrations, strikes and riots. In some we may see insurrections, coups and violent struggles for power. Some states are preparing for trouble, limiting the opportunities to express dissent and readying their security apparatus to crack down on that which is expressed. Countries which were already fragile risk breaking up altogether under the pressure of these events.

How will the international system cope with these upsets? There is an analogy which is probably unwise to push too far with the banking system. In September 2008 the US Treasury decided that it would not rescue all banks – so Lehman Bros was allowed to go under while AIG was rescued. This suggested that these matters were being decided on a case-by-case basis so that until the decision was made there was no guarantee of safety. It was therefore worth betting against survival, and to sell on perceived vulnerability. In retrospect at least this is now seen to be the point when the rot set in because of the degree of uncertainty that suddenly surrounded all financial institutions. Similar issues may arise if states start to get into trouble because of the combination of chronic indebtedness and popular discontent. If one or more is allowed to go under will that put the pressure on the next down the line? If some are going to be saved will this be on the basis of strategic significance, humanitarian need or just practical feasibility?

This is a crisis of liberal capitalism. Even where countries have made their own mistakes and embraced the values of the market with exaggerated exuberance, and even when they have maintained

authoritarian political forms, so denying themselves the safety valves and mechanisms for orderly change that liberalism provides, they will insist that they were led astray by the West and its bankers, and they won't always be wrong. We have celebrated globalisation and the riches it can bring and encouraged others to follow. This has shaped the expectations of key players in the international system and it is not surprising that they are disillusioned. If there was an alternative ideology that offered a compelling explanation for capitalism's failures and a new way forward the position of the United States and its allies would be even more difficult. As it is they have an opportunity to reform capitalism, reassess the relationships between markets and the state, reasserting the strength and flexibility of liberal values and institutions at home while demonstrating caution about the extent to which they can be actively promoted abroad. The result of this may be that the countries most responsible for this crisis may cope better than most, while doing little to help those left struggling. That is the main reason why I doubt that there will be major shifts in the international system as a direct result of this economic crisis, except as a result of individual countries getting into serious trouble. If you are looking for the signs of upheavals to come instead of staring up to the heavens searching for new constellations of great powers, keep your eyes firmly on the ground where the stresses and strains of the crisis will be felt and where movements for change will emerge.

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