

## **GEOPOLITICAL IMPLICATIONS OF THE GLOBAL FINANCIAL CRISIS**

Australian politicians, driven by populist imperatives, are defining the global financial crisis mostly in terms of jobs, executive pay bonuses and government stimulus packages. This approach doubtless reflects short-term political necessities and pressures. But it is a mistake to believe this is merely an economic crisis—as serious as it may well turn out to be.

No less fundamentally the crisis also poses potentially serious geopolitical risks to Australians. The seriousness of these security risks will depend on the depth and duration of the downturn. But they could persist long after economic recovery takes place.

Prime Minister Rudd has noted that "accounts are already beginning to emerge of the long-term geopolitical implications of the implosion on Wall Street -- its impact on the future strategic leverage of the West in general and the United States in particular."

It is not in Australia's security interests to see a discredited, weakened, protectionist and possibly isolationist US retreat, wounded, from the world. But that is now a possible scenario that cannot be ignored.

It is within this context that the forthcoming Defence White Paper and its associated policy reviews, and Australia's \$100 billion rearmament program over the next decade, now have to be understood. Although initiated before the crisis emerged, the Rudd government's plans to acquire new jet fighters, warships and

submarines and a bigger army are assuming greater political urgency in an increasingly uncertain global and regional environment.

For Australians there are now credible empirical reasons for considering the geopolitical implications of this crisis as at least as potentially alarming as the economic consequences. This crisis has weakened Australia's ally the US while, as a recent US national intelligence assessment argues, it is speeding the movement of global wealth from west to east.

The almost plaintive US appeals for China to lead the world away from this crisis reflect something of this reality---as does President Barack Obama's move to reassure China that its investments of \$1.5 trillion in US Government bonds are safe.

As Richard Haas, the president of the US Council on Foreign Relations, has said "The world does not consist of stove pipes, and what happens in the economic realm affects political and strategic policies and realities alike." The managing director of the IMF now talks about political upheavals and the possibility of war. And the Prime Minister of Hungary warns that the failure of the EU to bail out the many eastern European countries that face severe economic privation could result in a "new Iron Curtain" stretching across Europe.

We forget at our peril that it was the Great Depression of the early 1930s that led to the rise of Hitler's Germany and a militarist Japan, resulting in the Second World War. Now, we are nowhere near in such dire straits at present. Even so, political upheaval and violent demonstrations are spreading throughout many countries across the world. And it is only too easy to come up with scenarios, which are not

fanciful, that could lead to extreme nationalist backlash in countries such as China and Russia.

The new US director of National Intelligence, Admiral Dennis Blair, has told the Congress that the economic crisis is now a bigger threat to America's national security than the Al Qaeda terrorist network or the proliferation of weapons of mass destruction.

"The primary near-term security concern of the United States is the global economic crisis and its geopolitical implications", he said. He noted that roughly a quarter of the countries in the world have already experienced low-level instabilities such as government changes because of the current slowdown.

For Australians, much depends upon how deep and for how long this crisis runs. However, we face the prospect of our traditional allies and friends in the US, Japan and the UK and Western Europe being seriously weakened and preoccupied. While this is happening, the rise of China and India as the two new great powers in our region will quicken and we will also witness a more belligerent Russia.

China, Russia and the US might not want their differences to spin out of control, but powerful fissiparous forces could be unleashed in the event of mass unrest as a result of the downturn. It remains to be seen how Washington, Beijing and Moscow would respond.

And there is the ideological issue that widely held perceptions that excesses in US financial markets were responsible for this crisis has increased criticism about free-market policies. The nature of capitalism and whether it needs to be changed has

even become something of a contested issue (raised by one of America's leading Nobel prize-winners in economics).

China is sure to try and capitalise on this crisis by demonstrating that its more responsible and regulated economy is a victory for the so-called model of Chinese communism with market tendencies. The Washington consensus of unbridled free-market capitalism is now under challenge from the Beijing consensus of heavy-handed state intervention capitalism.

It remains to be seen whether those countries in Asia that, through no fault of their own, have seen decades of economic advancement wiped out overnight will now be drawn more to the Beijing model with its authoritarian political control.

These trends portend crucial geopolitical shifts for us, resulting in Australia being more isolated as a member of the Western strategic community and distant from our main associates, and increasingly flanked by countries which have values different from ours. This will only exacerbate those tendencies in Australian political culture to fear our geopolitical vulnerability as a sparsely populated, resource-rich continent in a world about to face severe climate change and food and water shortages.

It is not yet clear what the impact will be of this economic crisis on the stability of our neighbourhood, which will always be of crucial strategic importance to Australia. However, it is a fair bet that the potential for failed states in places such as East Timor, Papua New Guinea and the Solomon Islands will be worsened.

It remains to be seen whether Indonesia can weather this storm and avoid political upheaval in a country of over 240 million people near Australia. The global financial crisis is starting to create economic conditions that could lead to the sort of human suffering and political instability that could, with little encouragement, trigger security crises in potentially volatile places such as Jakarta. We need to recall that it was the Asian economic crisis in 1998 that resulted in the overthrow of the Soeharto regime.

At a time when China is already cutting out a sphere of influence for itself in Southeast Asia, Beijing could well take advantage of its relatively superior economic strength in a part of the world of key strategic importance to Australia.

The plain fact is that this crisis will strengthen some nations relatively and it will weaken others. The most serious strategic concern for Australia is that this crisis has already damaged America's reputation for world leadership. As Admiral Blair has remarked, "It already has worsened questioning of US stewardship of the global economy and international financial structure."

Our view is that the damage to America's leadership goes further than this because it comes on top of the damage to its moral authority over such issues as Guantanamo Bay and torture, as well as to its indifferent military performance in Iraq and Afghanistan.

We think that the global financial crisis will hasten the relative decline of America and improve China's status. That simple statement in itself reflects the crucial geopolitical nature of this global financial crisis for Australia.

In an important article in the current edition of *Foreign Affairs*, Roger Altman -- a former US Deputy Treasury Secretary -- argues that the current crisis is a major geopolitical setback for the US and Europe and it has stripped Washington and European governments of the resources and credibility they need to maintain their role in global affairs.

He acknowledges these weaknesses will eventually be repaired, but in the meantime they will accelerate trends that are shifting the world centre of gravity away from the US.

Let us stress, none of this is to predict the end of US power any time soon. Americans are a dynamic and innovative people. A recent report by the Boston Consulting Group concludes that the most likely scenario we are facing is a long and deep recession, but with a 1929 style Great Depression averted as a result of stimulus packages by governments and central banks around the world. But it also acknowledges there is an increased risk of protectionism and trade wars and, we would add, the rise of nationalisms.

If the ugly head of protectionism and rising nationalism results from over 50 million people in the world being made unemployed as a result of this crisis, then we should be on the lookout for isolationist tendencies and even acts of aggression. Beware the re-emergence of a protectionist spectre from the darkest period of modern history, argues the *Economist*.

The sheer size and fury of this crisis, and the crucial lack of warning, suggests that it will not be business as usual for Australia in the global geopolitical order. We would be foolish to think so.

At the very least, much of the world may be turning an historic corner and heading into a period in which the role of the state will be larger and that of the private sector will be smaller. The fact that this is occurring at the same time as major new historic forces herald the rise of China and the resurgence of Russian nationalism may come to be seen as a serious setback for the US and European model of modern capitalism.

For Australia we must be alert to China taking advantage to increase its leadership role in our part of the world, including by making strategic investments from its sovereign wealth funds. We do not want to see a free market West that turns inward and focuses solely on the home front and so giving the advantage to autocratic powers such as China and Russia.

These are potentially dangerous times for the liberal international order that is so central to Australia's basic values and alliances. Of course jobs matter; so does government action to stop outrageous bonuses and pay-outs to failed executives. But we should also be aware that our national security future could be increasingly at stake as this crisis unfolds.