

CHAPTER 1

Emerging Regional Threats & Outlooks: The Australian Perspective

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Introduction

Current Australian defence and strategic planning is based on achieving four main objectives. According to the *2009 Defence White Paper*, these in descending order of importance (and in terms of Australia's ability to directly influence) are:

1. The capacity to deter and/or protect Australia from any attacks against its sovereign territory.
2. Securing Australian interests in our immediate neighbourhood (i.e., the South Pacific) through ensuring stability and cohesion in surrounding countries.
3. Strategic stability in the general Asia-Pacific region.
4. Promoting a stable, rules-based global security order.

The first two are explicit determinants of force structure and posture, while the third is highly relevant to structure and posture. The fourth is highly desirable but Australia can play only a small role (largely through contributions to and support for American efforts) in helping to achieve that end.

Although these priorities are enduring, the emerging and contemporary Australian debate is shifting to how Australian should achieve these objectives vis-à-vis a changing regional strategic and economic environment.

There is also broad agreement that the first objective—to deter or protect Australia from direct attack on its sovereignty territory—does not adequately cover the sum of Australian national security or strategic interests. As a trading nation rather than an autarkic one, a narrow 'Defence of Australia'

doctrine ignores the reality that developments in East and Southeast Asia (and increasingly the Indian Ocean) will significantly enhance or impinge on Canberra's ability to advance its national and security interests. A hostile or chaotic strategic regional environment would place intolerable strains on our capacity to achieve our security and economic interests.

Therefore, strategic debate (and future defence planning) is largely on the causes and sources of strategic instability in the Asia-Pacific region, and not just on deterring potential hostile powers to attack Australian sovereign territory.

Historical basis for regional stability

The historical basis for regional stability since after World War Two is founded on two related pillars.

The first pillar is uncontested American naval power and maritime access. Even during the height of the Cold War, the Soviet Union lacked the capacity to deny the US unfettered access to the maritime commons in the region since Soviet military power was a continental-dominated force and largely focused westward. The Soviet Union was also geographically better positioned as a Eurasian rather than Asian great power, meaning that Moscow found it particularly challenging to project power into the Far East for any sustained period of time. Importantly, American naval pre-eminence meant that no Asian power (or group of powers) could seek regional dominance, and any attempts to do so would lead to those countries suffering enormously prohibitive costs.

American naval power was sustained through its base in Guam, but also through allied Asian states hosting and maintaining American military assets in Japan, South Korea, the Philippines, Thailand, Australia, and to a lesser extent in Singapore and Malaysia. In return, American provided public security goods to the region in terms of a strategically stable regional environment, and safe and unfettered maritime access for commercial shipping.

Importantly, America also opened its immense domestic economic market to states who willingly played by Washington's rules, leading to the emergence of an Asian export-led growth model for development. Indeed, the economies of Japan, Taiwan, South Korea, Thailand, the Philippines, Singapore, Malaysia and China owe a debt of gratitude to the American consumer, just as the latter owes a debt of gratitude to the former countries for providing them with cheap consumer goods over many decades.

In addition to the increased foreign-direct-investment (FDI) inflows and outflows between the US and Asia, the economic integration between American and the region created a virtuous spiral in which American interests became increasingly tied to Asia—thereby increasing the incentives for Washington to devote significant military assets to the Asia-Pacific for the long term. This meant that American strategic and military engagement in the region survived periods when Washington increasingly doubted its own lasting power in the region (i.e., the Nixon Doctrine). On the other side of the coin, the continued prosperity of Asian states was increasingly linked to the permanence and pre-eminence of the American strategic role.

The second and related historical pillar for stability is that American strategic and military pre-eminence dampened competition between still rivalrous Asian states. This occurred for a number of reasons.

For example, it was impossible for any Asian state to match or exceed American military capabilities in the region, making it pointless (and dangerous) for larger states such as Japan to attempt to do so. Given that much of the region's security was outsourced to a much more powerful and generally reliable superpower, the pro-growth states in the region focused on achieving rapid economic development rather than engaging in an escalating and costly military competition.

Indeed, the balancing and band-wagoning activity of many large and small pro-growth Asian states over the past few decades is largely designed to perpetuate

a US-led hierarchical strategic order within which no Asian state can dominate the region or sub-region—much to the dismay of many contemporary Chinese strategists who preferred a multipolar order within which China can exercise increasing influence. It also explains why America’s geographical distance from Asia makes it the preferred security partner of all major Asian countries (excluding China). Furthermore, American alliances with Japan, Australia, South Korea, Thailand and the Philippines, de facto alliances with Taiwan and Singapore, and the security partnership with Malaysia were seen as stabilising influences in the region, rather than divisive arrangements.

The upshot is that there was a general balance of capabilities and influence between states in East Asia, and between states in Southeast Asia which provided a strong foundation for strategic stability in the region—despite the prevalence of historical rivalries and unresolved territorial disagreements.

Contemporary sources of systemic instability—China’s rise

There are developments within individual countries and events that could negatively impact Australian interests in the region. The future political and strategic trajectory of a rising Indonesia is one that will always preoccupy the attentions of Australian strategists and strategic planners. Another is developments in the Korean Peninsula which could trigger serious strategic and economic instability, and even lead to the threat of a nuclear arms race or exchange in East Asia. A third is the prospect of failing states in Australia’s immediate environs, dramatically increasing the problem of criminal activities such as drug trafficking, people smuggling and money laundering into Australia.

However, it is China’s rise which has the potential to systematically and seriously undermine every element of the aforementioned historical pillars of regional security and stability; and which commands the most attention and dominates long term strategic thinking. China is the first major power in the post-World War Two period to emerge as a strategic competitor to America

in East and Southeast Asia. Its emergence is of unparalleled significance and creating unique disruption for several reasons.

The first factor is China's absolute size and resulting potential capabilities. Although the Soviet Union was a more formidable military competitor to the US at the peak of its powers, the Soviet economy was barely one third the size of America's. In contrast, although its GDP per capita is still about 1/8 that of the US, the size of the Chinese economy is already half that of America's. Even though it is likely that the Chinese economy will grow at more modest pace over the next few decades, it is almost certain to match or exceed the size of the America economy in absolute terms over the next ten years.

Already, the Chinese defence budget is almost three times larger than Japan's, even if it is less than one quarter of America's overall defence budget. But America has global interests and responsibilities while China can focus primarily on its immediate environs. In other words, China's re-emergence signals the rise of an Asian power that could dominate Asia, but for the American presence.

The second factor is China's geography and historical place and role in the region. Unlike the Soviet Union, China is geographically at the centre of Asia. It shares an extended maritime border with almost every major trading country in Asia. Whereas the Soviet Union's interest in maritime Asia was an ideological-driven matter of extending its influence into the region, China's interest in maritime Asia is permanent and unavoidable—deepened by its reliance on seaborne trade of especially energy resources and commodities. It also means that the growth in Chinese strategic, military and economic power directly affects the interests of every major Asian state. In particular, the contemporary Chinese shift from being a predominantly land power (as it has been throughout most of its history) to a maritime power is disconcerting for other maritime Asian states; especially given China's more assertive recent behaviour in asserting its maritime claims in the East China and South China Seas.

Moreover, unlike the Soviet Union, China has crafted (and also somewhat exaggerated) an image of itself as the enduring and natural hegemon in Asia. China has propounded and domestically nurtured an interpretation of history which sees itself as the victim of foreign powers jockeying to remove China from this historical and natural position, and that Beijing is simply reclaiming its natural preeminent status. In other words, the roots of Chinese ambition in Asia are far deeper, and are more extensive, than that of the Soviet Union's.

Third, China is the first major Asian country in the post-World War Two period to emerge as a formidable military competitor vis-à-vis the US—at least as far as capabilities in the region are concerned. Furthermore, the greatest advances in Chinese military capabilities are maritime-relevant capabilities along its east and southeast borders—impacting the interests of both American and all maritime Asian powers.

Significantly, Chinese military advances from the mid-1990s onwards are explicitly designed as a counter against both American military capabilities in the region and against the effectiveness of conventional American extended deterrence on behalf of East and Southeast Asian allies. The fact that these capabilities were initially designed to primarily counter America's capacity to defend Taiwan is increasingly irrelevant since these Chinese capabilities can be redeveloped and deployed in theatres of conflict beyond the Taiwan Straits.

In particular, Chinese investment in anti-access/area-denial (A2/AD) capabilities threatens to upset the long-standing regional strategic and military balance, if it has not done so already. The A2/AD strategy is part of what the People's Liberation Army (PLA) term 'counter-intervention operations' which is a stratagem designed to slow, limit or prevent a militarily superior enemy from conducting successful military operations in China's core theatres of conflict. Part of an awkward sounding capability to 'wage and win local (or regional) wars under conditions of informatization,' cyber-warfare capabilities and anti-satellite weapons will be used to disable or else inflict severe damage on the 'eyes and ears' of America's heavily networked offensive military assets (such

as aircraft carrier battle groups). Diesel and nuclear submarines, mines and missiles will be used to inflict heavy losses on supporting vessels within the carrier group, and possibly on an aircraft carrier itself.

For strategic instability to emerge, China only needs to create a credible fear for Washington that the PLA is able to inflict prohibitive losses on US aircraft carrier groups, making the prospect of US intervention in any Chinese conflict less likely or far more difficult. The point is that China's military modernisation and doctrine could mean that uncontested and unfettered access for American naval vessels in East and Southeast Asia is at an end for the first time since after World War Two.

Fourth, China's emergence as an economic power is a unique challenge to the post-World War Two order. Unlike the Soviet Union, sectors of the Chinese economy are heavily integrated with the rest of Asia and America. China has emerged as the largest trading partner of Japan, South Korea, Vietnam, Indonesia and Australia. China is the largest trading partner of India and America in Asia. The dilemma for many of these countries including Australia is that their largest trading partner is now engaged in a deepening strategic competition with their American security guarantor.

Unlike relations with the Soviet Union, there are potential economic costs for all major regional states should relations with China dramatically worsen. More than that, many states (including Australia) are increasingly dependent on a growing Chinese economy for their own continued growth—meaning that security and economic interests are not necessarily aligned. Importantly, China's importance to the regional and global economy means that it is not possible for America to lead an overt security coalition against China in the absence of immense and sustained provocation by Beijing. At best, American-led security coalitions and relationships can at most serve to 'shape' Chinese strategic actions without at the same time inhibiting China's economic rise.

It is obvious from the above observations that China's rise presents a systemic

or structural threat to the existing regional order since American strategic influence and military power is increasingly contested.

Moreover, the prospect of other Asian states bulking up their defence spending and capabilities could lead to unpredictable and destabilising ramifications. (Note that China's rise is not the only factor behind increased defence spending. Economic growth and arms competition between regional states besides China are also important drivers.)

For example, the military 'normalisation' of Japan would create apprehensions in South Korea. Significantly increased defence spending in Indonesia or Malaysia would create consternation in Singapore and perhaps Australia. Defence spending in Southeast Asia in 2010 was 60% higher than it was in 2001. If America was the cork in the bottle that kept the champagne from spilling over in the region, then China's rise could well release the proverbial cork.

The Australian and Regional Response¹

Given the difficulty of engaging in any strategic initiatives that are overtly and assertively aimed at China, regional states are engaging in a variety of balancing activities.

Traditional American allies such as Australia and the Philippines have pursued an external balancing strategy, strengthening their military relationship with the US. Thailand is allowing the US military greater access to its facilities, even though Bangkok remains extremely fearful of displeasing Beijing. Singapore has agreed to host two US Navy littoral combat ships, and are discussing the possibility of hosting four in the near future.

Maritime countries are also improving political and operational links with each

¹ This section will only deal with Australian and Southeast Asian responses since the other papers will look at East Asian, and especially Japanese, responses.

other. Naval exercises between India-Indonesia-Singapore, India-Vietnam, Indonesia-Japan are examples. All major countries have also made significant efforts to improve and/or deepen their political and military relationship with the US.

Almost all major countries—Indonesia, Malaysia, the Philippines, Singapore and Vietnam - are committed to internal balancing approaches by rethinking their force posture in response to Chinese capabilities and bulking up their capabilities more generally. Australia is committed to a similar internal balancing approach although recent defence budget cuts is creating concern that there is a gap emerging between Canberra's future capabilities and strategic doctrine. Its *2013 Defence White Paper*, and any subsequent defence policy documents released the conservative Coalition should it win power against the incumbent Labor government will be carefully monitored in the region.

Additionally, all major countries are engaging in non-military 'soft balancing' through greater support for multilateral institutions in which the US is a member, the most notable of which is the East Asia Summit. Although there are no illusions equating regional institutions with collective security agreements, the value of these institutions is to raise the political and diplomatic costs of deviant or bullying behaviour by China. Such institutions are also used by countries such as Vietnam and the Philippines to 'internationalise' maritime disputes, an approach at odds with China's desire to treat them as a bilateral issue between itself and smaller countries.

Indeed, whereas China used multilateral institutions as a way of extended its influence during the 'smile diplomacy' first decade of this century, America now seeks active membership of institutions to extend its leadership role and presence in the region as an essential part of the 'pivot' back to Asia.

Summary of regional responses

There is no formal coordinated response to regional uncertainty and instability caused by China's rise. Countries such as Vietnam with a recent history of conflict with China are much more explicit about their desire to restrain the actions of a rising China through hard, internal and soft balancing approaches. Traditional allies such as Australia, Japan are far more vocal about welcoming renewed American engagement, including offering their sovereign territory as hosting or training assets for American use. Other allies and partners such as the Philippines and Singapore are also enthusiastic about offering sovereign territory for use by American military assets but are more discrete about their desire to do so. Officially unaligned countries such as Malaysia and Indonesia remain publicly insistent that China's rise presents few threats, but nevertheless welcome an increased American presence behind the scenes.

Most broadly, all major countries remain committed to a 'strategic holding pattern' for the foreseeable future, even if there is no explicit coordinated strategy as such between major capitals. For those countries without formal alliance arrangements with America, the broad approach is also accurately characterised as a 'hedging' strategy, designed to welcome an enhanced American regional role without decisively throwing one's lot in with Washington for the long term. Thus, while no major country is band-wagoning with China in strategic terms, few are willing to permanently risk Beijing's opprobrium. The official Australian position that Canberra does not have to 'choose' between its most powerful security guarantor and its largest trading partner is genuine and represents the viewpoint of other major capitals. But the suspicion is that we are also waiting out a period of interregnum—where linear narratives about China's rise and America's decline are still being watched and assessed.

Future-focused strategies

There is unanimous regional agreement that future peace and stability depends on a powerful and engaged America in the region. Every potential

source of instability—China’s rise, North Korea’s nuclear ambitions, maritime disputes—is much more likely to be successfully managed with American involvement and influence. This explains why the strategic holding pattern has so far held firm. It does not appear to be in the interest of any major country to plan for a post-American Asian Century ahead of time or evidence.

Even so, there are questions as to the extent to which the current strategic holding pattern can (or should) persist, or whether there ought to be a fundamental reorganisation of strategic relations throughout the region.

One of the more prominent suggestions has come from Australian academic and former defence official Hugh White. The essence of his thesis is that as America’s closest ally in the region, Australia has unique influence over Washington’s course. A growing China will expect much more ‘strategic space’; which Australia, America and the region could benefit from advocating. But White goes further, arguing that America treating China as a strategic equal is the first and most important step towards establish a stable ‘concert of great powers’ in Asia, which is the best hope for a peaceful future.

White’s thesis is elegantly and eloquently presented. But it offers few policy details, and where it does, its suggestions suffer from some serious defects.

For example, there is little evidence that ‘sacrificing’ Taiwan would permanently satisfy Chinese ambitions, and recent events in the South China Sea suggest otherwise. Such a surrender will more likely give Beijing a larger strategic gateway into the Western Pacific and seriously undermine the credibility of America as an alliance partner, thereby diluting America’s strategic role by a greater margin than was ever intended. Recognising Indochina as a Chinese sphere of influence, another of White’s criteria, makes little moral or strategic sense. Vietnam would never agree to it; trying to negotiate Chinese suzerainty over the Vietnamese will engender rather than subdue conflict in that part of the region.

More broadly, there is little guarantee that artificially or prematurely elevating China as an American equal in Asia would lead to greater Chinese contentment. After all, China sees itself as a permanent ‘Middle Kingdom’ in Asia, and America as a foreign interloper. Over time, rising powers tend to always want just a little more.

White’s thesis also makes the mistake of assuming that the current strategic architecture is completely inflexible when it comes to giving China greater strategic space. In fact, China is indisputably viewed as a legitimate great power in the region, and is offered a seat at every significant multilateral negotiating table in Asia. Under the current strategic environment, very few countries are decisively and irreversibly balancing against China. Beijing’s continued strategic isolation is more a result of negative reactions to its recent assertive behaviour than the result of an obsolete American hub-and-spokes system. Stated differently, it is China’s inability to generate trust that is driving its neighbours to embrace the renewal and expansion of the America-led hub-and-spokes model in Asia.

White’s thesis is emblematic of two broader problems in many contemporary strategic debates.

The first is an assumption that the current strategic holding pattern is a temporary and static arrangement, and therefore a dangerously short-sighted approach in need of creative revision.

Officials would persuasively reply that current approaches constitute a prudent wait-and-see approach as to whether the US can get its fiscal house in order, and whether China can resolve its structural economic problems and still grow as rapidly as it has. Moreover, the region is still in flux. Will Indonesia continue its reforms, or will it retreat into a militaristic past? Will Japan emerge from decades of stagnation or is it in terminal decline? It would be foolish to embark on an irreversible strategic course without knowing the answers to these questions.

Moreover, the current strategic holding pattern is not static but evolving and adaptive. Most attention is placed on America's role as the 'hub.' But less attention is focused on the spokes, many of which are deepening relations between themselves. To be sure, the current strategic holding pattern cannot hold without a powerful America at its centre. But the more entrenched and multi-layered these hub-and-spokes relationships are the more difficult, complex and costly it becomes for an emerging power like China to fundamentally reorganise the strategic environment. Such an evolving complex of relationships also makes it difficult for any regional power to 'jump ship' and abandon the balancing/hedging strategy against China's rise. This means that while we cannot hope to shape Chinese ambitions, there is the prospect of shaping its tactics and actions.

The second problem is that although we cannot know the future trajectory of Chinese and American material power, many Australian (and regional) debates about future strategic options tend to overestimate contemporary Chinese leverage, and underestimate Chinese vulnerabilities—leading to the advocacy of flawed forward-focused policy.

China's economic success and a state-dominated political-economic structure give Beijing a disproportionate amount of resources with which to extend its military and technological capabilities. But many analyses are based on its emergence as the major trading partner of every major Asian power, leading to assumptions about Beijing's capacity to use economics to enhance its strategic leverage.

Beijing certainly tries to do this on occasions, with its halting of exports of rare earth materials to Japan in 2010, and the curbing of banana imports from the Philippines in June 2012 following another spat over claims in the South China Sea. Yet, Beijing's record of extracting meaningful and enduring strategic concessions from major powers has been weak. That it remains so should not be surprising for a number of reasons.

The first point to note is that the majority of Chinese two-way trade with major economies in Asia is processing trade—up to 70% by some estimates. Some 75% of processing imports into China come from Asia, and about 60% of the processed exports go to non-Asian OECD countries. The raft of regional Free-Trade-Agreements with China are mostly about streamlining processing trade.

The export manufacturing sector in China employs about 50 million people directly, and another 100 million people indirectly. Beijing could ill-afford any major disruption to this sector. Moreover, even though China is the more exciting growth market, the reality is that the American and European consumer remains far more important to Asian manufacturers than the Chinese consumer and will be so for a considerable period of time. The EU and the US has a domestic consumption market of around US\$10-11 trillion, while China's is about US\$2.3 trillion. The bottom line is that access to Western markets is still far more important to Asian manufacturers than the Chinese market.

The second point to note is that market access in addition to the absolute size of the economy itself is the factor that gives countries leverage. As a matter of national policy, foreign firms are still heavily restricted from accessing most important and lucrative sectors in the Chinese economy, while Chinese state-owned-enterprises are not just given privileged access but considerable subsidy and other tax advantages. As one revealing statistic, the diversified American corporate giant, GE, makes more profits in the Australian market than it does in China.

In contrast, America's larger and open domestic and capital market means it remains a far more important and attractive investment economy than China's. Foreign Direct Investment (FDI) figures, which are arguably a better indication of economic intimacy and opportunity than trade figures, are telling. From 2000-2010, FDI inflows into the US averaged US\$173 billion annually, with a 2010 figure of US\$228.2. US FDI outflows averaged US\$199.2 billion during the same decade, with a figure of US\$328.9 billion in 2010.

For China, FDI inflows over the same decade averaged US\$72 billion annually, with a figure of US\$105.7 billion in 2010. But bear in mind that an estimated 80% of FDI inflows into China are destined exclusively for the export manufacturing sector (in which the end consumer is predominantly in the West.) For the decade, FDI out of China averaged US\$22.3 billion, with a figure of US\$68 billion for 2010.

The more general point is that American consumers, domestic and capital markets will be more important to Asian economies and firms than China's into the foreseeable future. This partly explains China's lack of strategic leverage, despite its economic size and importance. China's difficulty in using economics to acquire strategic leverage will also remain until China reforms its political-economy and liberalises its capital markets. But that will mean the rise of a very different China to the one we are seeing today.

Finally, the Chinese Communist Party (CCP) is one major recession away from possible political disaster. Major foreign policy errors, leading to severe disruption of seaborne supply lines, are an immense vulnerability for the Chinese economy, and for the CCP.

Conclusion

In a messy and uncertainty strategic environment, neat and elegant strategic solutions will almost certainly fail and lead to adverse unintended consequences. Formidable as it is, China cannot comprehensively impose its will on the region whilst the US remains engaged and active. Instead, Beijing will continue its search for 'windows of opportunity' and take an opportunistic approach to furthering its strategic and other interests.

Likewise, the strategies for managing the sources of instability in the region—particularly China's rise—will be necessarily ad hoc and reactive for much of the time. Adapting the current strategic holding pattern, deepening the hub-and-spokes model, and enhancing the model's resilience as the region evolves,

is an imperfect and imprecise but superior approach to wiping the slate clean and redesigning the strategic environment. Indeed, expert execution of this strategy is the best Australian (and regional) defence and strategic planners can hope to achieve in the current and foreseeable environment.