

## **Inquiry into the implications of the COVID-19 pandemic for Australia's foreign affairs, defence and trade**

As CEO of The Cognoscenti Group, a geopolitical risk consultancy, I welcome the opportunity to appear before the Joint Standing Committee on Defence, Foreign Affairs and Trade to address the issues identified in the terms of reference. This submission confines itself to a discussion of threats to the global rules-based order; their implications for foreign affairs, defence and trade; and an effective national framework to ensure the resilience of Australia's economic and strategic objectives. However, time permitting, I would be happy to comment on some of the other terms of reference.

### **Threats to the global rules-based order**

The COVID-19 pandemic threatens to exacerbate US-China tensions, destabilise global supply chains, increase protectionist sentiment and jeopardise the relatively free and open international trade and communications systems underpinning the rules-based order. If these trends continue, they will be detrimental to all countries but particularly trade dependent nations like Australia.

#### **US-China rivalry**

The US is moving aggressively to decouple from China-controlled supply chains for trade, security and existential reasons. No area of the relationship will be immune. Other countries are set to follow because business as usual is no longer an option in a post COVID-19 world. The coronavirus crisis has exposed the fragility of just-in-time supply chains and the folly of relying upon a single country for critical goods and infrastructure.

The coronavirus has shifted sentiment in Washington in favour of a more severe decoupling of the US and Chinese economies than previously contemplated. This follows the dawning realisation that US dependence on China extends to pharmaceuticals and medical equipment critical to combating the spread of the virus and maintaining public health.

The shift is also being driven by an increasingly vitriolic blame game about responsibility for the pandemic. President Trump has unapologetically labelled COVID-19 as "the Chinese virus" and criticised Beijing for allowing it to get out of control. There have also been calls for China to pay reparations for the damage inflicted by the coronavirus. Chinese officials have struck back by suggesting that American soldiers visiting China were the initial source of the virus. And China's state media has drawn comparisons to the eight-nation alliance that put down the Boxer Rebellion and carved up the powers and territories of the Qing government while extracting reparations.

Some US hardliners view COVID-19 coordination with China as a "self-harming exercise in zero-sum competition for global leadership", while their Chinese counterparts see opportunities to advance the country's economic and geopolitical influence as foreigners look to invest in early recovered economies. They argue that China's ability to weather the pandemic's storm on its own proves that the country has nothing to fear from a decoupled world which may well occur on Beijing's terms.

## **Risks of a hard decoupling**

Such views are dangerously optimistic, ignoring the established benefits of international cooperation and the reality that all countries are adversely affected by the pandemic. Bringing manufacturing back to the US is easier said than done. Most big US firms in China are still reluctant to incur the costs of moving, although some reshoring will inevitably take place. The Chinese economy can't spring back without strong demand from Western markets and a sustained, wider recovery will be more difficult to achieve without US-China cooperation.

A narrative war over the origin of the coronavirus and responsibility for its destructive effects will only serve to fuel tensions, weaken the nascent global recovery and intensify the decoupling momentum in both the trade and tech arenas.

The push to disengage, or decouple, had traction in both Washington and Beijing before the coronavirus emerged. Administration hawks consider that the best way of preserving America's dwindling economic and technological lead and protecting against avaricious Chinese practices is to reduce trade exposure to China and restrict the country's access to American technology and education. The aim is to reduce US dependence on China for technology, trade and resources seen as an unwelcome source of vulnerability. The debate within the administration is over the extent of that decoupling. Chinese hawks want China to wean itself off technological and financial dependence on the US for similar reasons.

The key question is how much separation and over what time frame? Will the US and China live together under the one roof, separate apartments or in different neighbourhoods? While moves towards disengagement or decoupling of their economies could be reversed (reconciliation) it is more likely that the US and China will move towards a significant degree of disentanglement (separation) especially in the tech sector.

In a worse-case scenario, caused by rising tensions over separation, an external geopolitical crisis over Taiwan, North Korea, the South China Sea or some combination of the two, disengagement could accelerate and become more complete, resulting in a high degree of separation between the two economies (divorce).

However, global supply chains and the broader world economy are unlikely to completely decouple even in a divorce scenario given today's much higher levels of economic, financial and trade interdependence. The stronger the separation impulse, the greater the political and strategic implications, as other countries come under pressure to choose between competing US and Chinese systems of governance and technology.

## **A 'Balkanised' internet?**

Could decoupling lead to a 'Balkanised' internet? Even before the coronavirus pandemic, this was a real possibility as the US and China battled for control over next generation information and communications technology systems. But COVID-19 is accelerating the momentum towards separate tech standards and systems - in the name of national resilience and independence - widening differences between democracies and authoritarian states over

privacy, freedoms, regulation and government control of the internet's architecture and content.

China has suggested a radical change to the way the internet functions to the International Telecommunications Union, a UN body whose primary role is to standardise global telecommunications technologies, services and operations. The Chinese proposal envisages a different standard for core network technology called New IP (internet protocol) that would make the internet more efficient and better structured for the digital age. But New IP could bake authoritarianism into the architecture underpinning the web and give state-run internet service providers granular control over citizens' use. For Australia, this raises the troubling question of what an internet dominated by China might look like as Beijing pulls out all stops to shape fifth generation mobile network technology.

Acceptance of the proposal by the ITU would realise a long-term Chinese digital foreign policy goal — to entrench Chinese standards and technology as the foundation stones of the future internet, since the new global network would be designed and built by Chinese engineers, led by telecommunications giant Huawei. The US is highly unlikely to accept this outcome because internet power is mostly held by four large American corporations: Apple, Google, Amazon and Facebook. New IP would end this virtual oligopoly, turbocharge China's march to technology leadership and facilitate the export of its authoritarian model globally. If no consensus emerges, which seems probable, the world could split into two separate information worlds, one led by the US and the other by China.

A Balkanised internet is not in Australia's interest. A fractured digital world would vastly complicate e-commerce and trade, restrict the free flow of information, reduce international collaboration and human interaction and leave us vulnerable to the exploitation of our relatively open system by authoritarian states secure behind their digital firewalls.

### **Impact on trade**

Already under duress from China's mercantilism and the Trump administration's tariff wars, the international system is likely to be further weakened by rising protectionism and a renewed emphasis on self-reliance as pandemic afflicted countries re-shore, and ring-fence, the production of goods deemed vital for national security and economic resilience.

If Trump is successful in pinning the blame on China for causing the pandemic and forcing the world into a deep recession, electoral politics may cause him to erect trade barriers and initiate a new round of the tariff wars, playing to his populist base. A Biden administration could be even tougher on trade policy if China becomes a defining election issue as seems likely.

The American political class is becoming increasingly disillusioned with the World Trade Organisation. Many believe that it has been a disaster for US interests. COVID-19's exposure of the vulnerability of global supply chains has fed into American frustration with hyperglobalisation, China's perceived "economic imperialism" and a broken world trading system fuelling demands for a withdrawal from the WTO.

If this were to occur, trade dependent countries like Australia would be exposed. For all its flaws, the WTO and its predecessors have presided over an unparalleled era of growth and prosperity. Global value chains accounted for 73 percent of the rapid growth in global trade between 1993 and 2013. The organisation still enjoys the support of most member states and is the only institution capable of protecting the trading interests of smaller states and adjudicating trade disputes, despite its waning authority.

The alternative is trade-inhibiting autarky, or a power-based trading system where the strongest states use their superior economic and political leverage to achieve gains at everyone else's expense. Such a system would not only be less fair and free. It could usher in a new era of trade protectionism that would encourage imitative behaviour and roll back the gains of the last 70 years.

### **Geopolitical bifurcation**

There is a real possibility that the world would divide into two competing trading and geopolitical blocs, much as occurred during the Cold War, except that the bifurcation would be more fluid and diverse. The US bloc would build outward from North America, and include some Latin American and African countries, parts of Asia and most European states. China's bloc would extend across most of Eurasia, including Russia, the Central Asian republics and much of Southeast Asia. It could also capture a significant number of countries in Africa, the Middle East and Latin America although these regions would be contested by the US.

Where we would fit into this recast world would depend on the rigidity of the blocs. If they were mutually exclusive – the nightmare scenario for Australia - we would almost certainly side with the US. If the geopolitical fallout of the COVID-19 virus continues to aggravate their relationship, the trade and tech wars may turn out to be only a skirmish in a bigger fight with much higher stakes and costs to both countries and the rest of the world.

### **Implications for Australia's Foreign Affairs, Defence and Trade Policy**

#### **Managed decoupling is necessary**

For Australia, a key take-away is that although we may hope for reconciliation the odds favour a partial separation. This could threaten our future prosperity because of our trade dependence on China and susceptibility to US pressure to support a China push-back that could aggravate already strained relations with Beijing. Divorce, of course, would be even more problematic, so we must think creatively about managing the consequences of heightened Sino-US rivalry.

Some degree of economic separation is unavoidable and, indeed, necessary to preserve the integrity of a robust, open trading system and democratic values, freedoms and institutions. This is not a rejection of trade, but a rethinking of its architecture and norms as well as interdependence. Decoupling is not an attempt to isolate China or deny it a position of influence in the world, but rather to establish a sustainable relationship between competitor states with different political systems.

Every effort must be made to keep decoupling within manageable limits to contain the damage to US-China relations, value chains and the world economy. It must be done with a surgeon's scalpel not a blacksmith's hammer. A hard decoupling would not only delay and complicate global economic recovery. It could also sow the seeds for a second global recession, or even depression, as the US-China trade and tech wars would likely intensify, further fracturing global supply chains, reducing international cooperation and opening up new arenas of conflict and contestation.

Our dependence on China for a range of critical technologies and goods has become a major security liability and must be reversed because Beijing has shown a willingness to exploit trade and investment for geopolitical purposes. And we are not alone. Many other countries have become overly dependent on China for pharmaceuticals, medical equipment, automotive parts, computers and smart phones making them more vulnerable than the US because they don't have its countervailing power.

China has practised a form of decoupling for many years, by carefully avoiding dependencies, creating protective trade barriers and positioning itself to control strategic areas of the economy - from rare earths and pharmaceuticals to advanced manufacturing. Its success has been due, in no small part, to our neglect of national capabilities and a reluctance to confront China's dirigiste impulses.

But a more astute approach to decoupling is required. Democracies need to embrace common approaches to managed decoupling that still permit global engagement and open trade with one another and China, while building a new consensus for reform of trade and technology governance. Finding the right balance between risk reduction and cost reduction is a conundrum facing every policy maker in the world requiring thought, and refinement, before a new equilibrium is reached. There is no one size fits all formula for managed decoupling. Each nation will have to assess its own needs and capabilities, but the trend is unmistakable.

There will be a much higher priority on self-reliance and national resilience. These will be the guiding principles in a product and industry-wide reassessment of the capabilities required for security, development and critical public goods. A renewed focus on strategic industries and national champions is likely along with pressure to deliver new social contracts in democracies. But global supply chains will continue to underpin international trade, albeit with higher levels of redundancy.

### **Strengthen international cooperation and middle power diplomacy**

The US and China's determination to resolve their trade and tech disputes bilaterally reflects not just their leaders' preferences, but a global swing in sentiment away from multilateral cooperation as disillusionment with globalisation fuels the rise of nationalism and nativism. However, making the US and China great again can't be at the world's expense. Neither unilateralism, nor bilateralism, are panaceas for globalisation's shortcomings. International cooperation is essential to achieving equitable and enduring solutions to complex global problems.

Should US and Chinese leaders be unwilling to embrace change, the aftermath of the coronavirus pandemic will present new opportunities for meaningful and effective middle-power diplomacy. Even as we look for ways to minimise exposure to China risk, we should consider constructive measures to persuade Beijing to change course or moderate its mercantilist practices. Australia can make its voice heard by ensuring that decoupling is a priority agenda item in influential economic and trade meetings such as the G7, G20 and East Asia Summit.

Following Trump's decision to withdraw the US from the Trans Pacific Partnership (TPP), Australia worked with the other 10 members to rescue the deal and keep it open to future US membership in the hope that Trump might change his mind or a new administration would decide to re-join. Although China is not a member because it cannot yet meet the TPP's high standards on IP and investment, the willingness to keep the TPP alive with inducements for China and the US to join at a later stage shows that international cooperation on trade is not dead. The rest of the world should not be cowed into inaction if the US and China are unwilling, or unable, to bridge their differences.

In partnership with other middle powers, Australia should use its influence and diplomacy to warn the US and China that they need to reverse their escalating rivalry, tone down their inflammatory language, re-engage and use the existing multilateral architecture to find constructive solutions to their disputes.

Australian should work with Asia's middle powers to prioritise the development of Confidence Building Measures to reduce tensions in the Western Pacific and reverse the dangerous militarisation of disputed islands in the South and East China Seas which could easily trigger a serious confrontation between the US and China to the detriment of the region. An initial step would be to proscribe the deployment of major weapons systems, military aircraft, ships (including coast guard vessels) and submarines to these islands. Follow up CBMs would build trust by developing verification measures and setting out a pathway for the joint development of disputed maritime resources and the shelving of territorial claims.

### **Develop new cyber and tech rules, protocols and agreements**

A core lesson from the coronavirus pandemic is that improved national resilience and sovereign capabilities are essential to future proof Australia from external shocks. Strengthening our telecommunication infrastructure should be a strategic priority because the risks are mounting. Australia couldn't have managed the pandemic nearly as well as it has without a reliable, functioning internet and a robust telecommunications sector. If we couldn't communicate and transact in real time economic activity would grind to a halt and social contact would be even more difficult. But if these networks were to become untrustworthy or disrupted for any length of time it would be hard for the country to function effectively.

The government would be well advised to take a more holistic approach to telecommunications policy that transcends narrow commercial considerations and places a premium on risk reduction rather than cost reduction, a lesson driven home by the pandemic. Narrow, market-based calculations should be replaced by a more strategic approach that

takes better account of the need for sovereign capabilities to improve national resilience, and factors in the cost of relying on systems that don't pass the democratic values test.

Australia should work towards cyber and technology standards that preserve an open, free, safe and secure internet. Digital infrastructure is an essential enabler of freedoms and innovation. Its openness and accessibility must be proactively maintained whilst also adequately regulated. In the meantime, the government needs to have a strategy in place to ensure that China's New Internet Protocol does not win the day at the ITU's November meeting.

Beyond the internet, there is a pressing need to develop a comprehensive set of global rules, standards and norms in cyber-space and associated areas of technology and industry. Unlike trade and geopolitics, which have established rules and processes for managing differences, cyber and technology governance is fragmented. In some areas it barely exists.

### **An effective national framework for ensuring resilience and national security**

Our dependence on global supply chains for critical commodities and manufactured goods pre-dates, and is more serious, than the shortages of medical equipment and pharmaceuticals illuminated by the pandemic. Liquid fuel is a prime example. COVID-19 has driven home Australia's dependence on overseas supplies of crude oil and a range of critical, refined products. Although the government has taken steps to reduce that dependence by establishing a sovereign petroleum reserve in the US, we are a long way from where we should be.

The coronavirus pandemic provides a once in a generation opportunity to unite the country around a new, fit-for-purpose defence, foreign policy, trade and national security agenda that will reshape how we live and what we do in a post COVID-19 world. The structures and working arrangements developed for COVID-19 should be embedded in a new, whole of society approach to crisis management that increases community buy-in to national preparedness by including business, trade unions and non-government organisations as legitimate stakeholders.

Over the past three decades, the national security machinery of government has been improved beyond recognition. But the Government's decision to establish a national cabinet to coordinate the response to the coronavirus suggests it's not optimally configured for the new challenges ahead. Policy should be more holistic, integrated and focused on making Australia resilient to pandemic like shocks.

Some obvious fixes are to re-empower the position of National Security Advisor, enhance the role of the intelligence agencies in assessing and collecting data on non-military threats and establish new mechanisms for inter-agency and cross-jurisdictional cooperation beyond the traditional national security community.

Conventional analytical lenses were developed for the analogue world of the 20<sup>th</sup> century. They need to be recalibrated for the digital world of the 21<sup>st</sup> century in which trade, technology and geopolitics are treated as intertwined elements of a fluid, coupled global

ecosystem. Economists, technologists and strategists must learn to work more closely with each other and bring their skills, disciplinary knowledge and perspectives together in a shared approach to problem solving.

Government could improve national resilience by:

- Putting economics and trade at the heart of national security policy by creating economic security branches, or groups, in key departments and agencies.
- Establishing new epistemic networks of think tanks, foundations and university centres to deepen and cross-fertilise ideas for reducing trade, technology and geopolitical frictions.
- Creating a powerful business-security partnership to create a wider constituency for change by building awareness of each other's concerns, interests and thinking.
- Establishing innovative university and higher education curricula that offer a blend of business, economic, technology and international relations courses designed to train and nurture a new generation of analysts and policymakers who can think across disciplinary boundaries.

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