

# **The role of economic statecraft in securing Australia's future**

**ANU College of Asia and the Pacific Professorial Lecture, 24 July 2024**

**Shiro Armstrong**

Every day we are reminded that we are living in a more uncertain world, one that threatens both our economic and political security.

Australia's prosperity and security depends on getting domestic policy frameworks and strategies right — but only getting domestic settings right is not enough in our more uncertain world. Crucially, we also need to understand our external environment and craft the most effective international economic diplomacy strategies towards it.

This is the subject I want to talk about tonight.

Australia's prosperity and economic security depend first and foremost on ideas about the most effective strategies to achieve them and the capability of our national institutions to deliver them. The ANU, where I have studied and to which I have dedicated my career, has been the source of many of those ideas and my predecessors here have worked closely with our national government to realise them.

Chief among our government institutions in this context is a strong Treasury Department with its input into economic policymaking that anchors rigorous calculation of Australia's national interests. Australia's institutions of macroeconomic management and economic strategies have helped the Australian economy outperform most of the advanced economies around the world for decades and that has been a crucial source of Australian national security.

A strong Treasury with clear and robust frameworks for assessing the national interest is crucial to holding the line on bad policies in national government.

It is welcome, therefore, that Australia's Treasurer, Dr Jim Chalmers, and Treasury Secretary, Dr Steven Kennedy, have articulated a new National Interest Framework in the context of major changes to Australia's external circumstances. Their recent speeches highlight the elevation of economic security considerations in national policy and emphasise the need to respond to what is going on in the changing world in which we live.

The Treasurer, [points to changes in policies](#) in other countries and international uncertainty to justify increased government participation in the market for a Future Made in Australia strategy and a new economic security policy posture (Chalmers, 2024). [Dr Kennedy threads the needle](#) in integrating security considerations into economic policy and draws a line that urges a limit to security interest mission creep, something that has been missing in Australian policy discussion to date (Kennedy, 2024).

In his speech, Dr Kennedy discusses three aspects of what might be a 'sound and proportionate' response to global developments:

- a '*small yard, high fence*' approach for genuinely critical infrastructure and technology
- delivering more resilient domestic supply chains through highly tailored responses; and
- playing our role in strengthening global supply chains.

These are indeed important aspects of economic security strategy. But no role is assigned in his discussion to international economic diplomacy when it has been the changes to Australia's external circumstances that are driving these national policy responses.

The national argument is therefore incomplete.

My primary purpose is to consider this incompleteness in the argument and to set out the tools and arrangements that we have at our command to respond most effectively to the problems that we as a nation now confront.

On the three aspects of Australia's response to changed economic circumstances that Dr Kennedy mentions, I would simply note two points.

The first is that I too would underline his important warning about 'mission creep'.

The second is that the National Interest Framework includes an Economic Resilience and Security Stream and a Net Zero Transformation Stream. The latter is aimed at making Australia a Renewable Energy Superpower by focusing on supporting and realising Australia's comparative advantage and internalising externalities in renewable energy. That is sound policy, especially when Australia does not have a price on carbon.

There are other issues in the new Economic Resilience and Security Stream of the National Interest Framework that are essential to consider if we as a nation are to develop sound policy responses to the problems that they intend to address.

In this lecture I shall review the issues more fully, drawing on the intellectual arguments that are important to getting policy strategies right for Australia's national circumstances.

First, it is important to make clear what has changed in the world and identify Australia's priorities in responding to these changes. What are the new geopolitical risks that have raised global uncertainty and how specifically do they affect Australia? And importantly, what has *not* changed?

In doing so I identify the international economic tools that can be deployed to achieve security objectives. This element in the armoury of instruments to achieve national security has been neglected, but for a middle power, like Australia, it is crucial to security priorities.

There's a need to fill this gap and spell out the international instruments, arrangements and agency that Australia can deploy to reduce political risk and enhance its economic

security. Addressing this omission will begin to define a more complete and credible approach to Australia's national economic and security strategy — one that once more puts robust strategic economic diplomacy at its forefront.

My main message in this lecture has two simple and complementary parts:

1. Australia is obviously not alone in this circumstance and all our partners in East Asia — both in Northeast and Southeast Asia — with whom our national economy and its future are so deeply intertwined, are locked into a similar destiny; and
2. In this company, although sharing a now much-vaunted vulnerability, we have agency and a leverage regionally that deserves proper exploration in our national interest and in the interests of regional stability and prosperity.

The Treasurer and the Treasury Secretary's speeches are a particularly welcome foray into territory that has been for too long uncharted by economic policymakers.

Australian policy has appeared to be adrift, with national security considerations increasingly affecting economic policies without constraint or clear logic. Without articulation of a framework to guide policy development, policies from successive governments that restrict foreign investment, that call for diversification of trade partners, favour 'trusted' economic partners and push increased government involvement in supply chains and the market, are among the reactive policy impulses that have recently gained favour.

These policy measures are now fashionable in other countries, driven by the trend in major advanced economies in a more uncertain global environment and amid the return of geopolitics. How much they are driven by such concerns — and indeed help to address them — or driven by more deep-seated problems related to parochialism and protectionism, remains an open question.

## **What has changed in Australia's new economic and security circumstance**

Both the Treasurer and the Treasury Secretary point to a changing world. What is important to framing the correct policy responses to these changes, of course, is being absolutely clear about exactly what has changed, and what has not changed, and calibrating national policy changes to the new global realities, not to some chimera that does not reflect the priorities with which we actually have to deal.

A big global change is that China is larger. That was always likely to happen, and, bluntly, we have to get used to it. It is also likely that Indonesia and India and other populous countries will become significantly economically, and therefore politically, much larger relative to us and the United States. In the next twenty five years, India is likely to have an economy bigger than that of the United States, if it too does moderately well. There are some implications that we have to think through; but having to do that was always going to be part of our future.

The change in the structure of global power and wealth is already so profound that hankering for a unipolar world is no longer credible.

Managing the risks of rivalry in the new multipolar world is now a primary object of policy choice.

For Australia, the rise of China is related to these new geopolitical circumstances that include five broadly adverse developments: Australia's largest economic partner now being in strategic competition with its most important security ally; a more assertive China with a trend towards political centralisation; an increasingly inward-looking United States that has gone from enforcer to spoiler of the open multilateral trading system; an uncertain global response to accelerating climate change; and paralysis in global forums that contributes to the oft-cited polycrisis in international affairs that includes dangerous wars in Gaza and Ukraine.

In such a world the security imperative has begun to dominate the economic imperative in many countries, though the two are intertwined. Australia has also strengthened its national security response to this more uncertain world. Nobody doubts the crucial role national security agencies play in keeping Australia safe and in upholding the security of the nation. It is the job of security agencies to identify security risks, including whatever existential risks there may be. Existential tail-risks may have low probability but they have an infinite price: no amount of prosperity is worth the risk of catastrophic security outcomes.

As economists, we are used to probability estimates that emerge from well understood statistical theory. The probability estimates of war that come from the national security community, however, are not of this nature, and there is a major danger in taking the idea of a confidently asserted estimate of the probability of war as a serious quantitative estimate, and applying it to our cost-benefit analyses on that basis.

It is notable that it is the West, not the emerging markets, who are trying to dismantle the global trade regime and globalisation — because, the thinking appears to be, that will help slow or reverse the shift in wealth and power away from us to them. This strategy will certainly fail, not only because the shift in power is already so big as to make the old post-Cold War order unsustainable but also because the perennial domestic allure of protectionism that will make us poorer and weaker has now been turbocharged by xenophobic 'national security' narratives.

So it's important to be clear on an integrated response that does not move us towards corner solutions that risk prosperity. A former official or unnamed source from the security community should not automatically be taken as an accepted authority on these security risks. Why and under what circumstances is a calculation of the risk of conflict relevant to Australian policy responses? What would cause war?

Australia really is a lucky country in terms of proximity and distance. We benefit from relative proximity to East Asia, which has for decades been the fastest growing

component of global trade and incomes, and the policies that have helped unleash the forces of economic gravity to fuel our own prosperity and security. Only absolute distance matters so much for military security. And Australia is blessed by distance from flashpoints of such military risks in Asia. Australia, like any other country, however, is within missile range and a potential target for large scale cyber attack and it pays its dues to its alliance relationships. For the most part, though, the hard-headed reality is that distance means entering war is more within Australia's choice, and it would depend on the particular circumstances, as to whether Australia would choose to join a war, for example, against China.

The frontline in Australia's response to China has been responding to China's economic coercion. That was the diplomatic priority for the previous Australian government and a rallying call in its dealings with G7 and other advanced industrial democracies. It was identified as the major threat to Australia's economic security that is now driving the departure from many decades of economic policy consensus that delivered prosperity and security.

The Treasury Secretary points out that China is the top trading partner for over 140 countries, including being by far Australia's largest trading partner. Last financial year, at A\$317 billion, China accounted for 30 per cent of Australia's two-way trade while all G7 industrial countries (including the United States) accounted for 26 per cent.

In 2020 that interdependence was weaponised by China via the economic coercion it sought to exert over political differences with Australia. Learning the right lessons from that experience is important in formulating the policy response.

China's attempt at economic coercion against Australia in 2020 failed both economically and politically. Whatever Beijing's intentions were, the episode created substantial political blowback for China and repairing trust will take time. The economic weapons that China deployed against Australia were blunted by the multilateral trading system, which, whatever its weaknesses, allowed Australian exporters to, first, find alternative

markets and, second, ultimately seek redress through threat of international legal processes against China.

Trade coercive measures would have inflicted significant economic damage in a world of closing markets with fewer alternative buyers or sellers. That was the world of the beggar-thy-neighbour protectionism of the 1930s where trade restrictions fed aggression, insecurity and ultimately war. We cannot take what we have now with open global markets for granted and it should be a primary policy objective to preserve openness. Contestable markets raise the costs of intervening in them, dilute economic leverage and thwart the exercise of market power. [Contestable markets reduce our vulnerability to other powers](#) (Armstrong, et al., 2021).

The multilateral trading system, with the WTO at its core, remains fundamental to Australia's prosperity and economic and political security. This is not simply because it can limit the exercise of power against Australia itself via trade coercion but also because it is fundamental to all of Australia's major trading partners' economic and political security in the region. A breakdown in confidence in the multilateral trading system would unravel economic and political ties globally — but especially in East Asia where political cooperation is still underdone and economic cooperation has been shaped significantly by the ambition for development and its corollary, a necessary international economic interdependence.

A major and immediate problem with the WTO, however, is that its dispute settlement system has been rendered ineffective by the United States' exercise of veto power over the appointment of judges to its Appellate Body. The United States has neutered the WTO's dispute settlement system to avoid being held to account by world trade rules.

A workaround measure that kept the dispute settlement process working has seen 53 other WTO members — almost a third of WTO membership — join a Multi-Party Interim Appeal Arbitration Arrangement (MPIA), a plurilateral framework which duplicates the Appellate Body, enabling members to resolve WTO disputes among themselves. MPIA



was initiated by the European Union and Canada, but Australia and China were both founding members, four months after the Appellate Body ceased functioning in December 2019.

China has a substantial stake in the established system of trade rules and, despite its trade sanctions against Australia and some other countries, has a demonstrated preference for enforceable rules including through its membership of MPIA. China's track record in the WTO in the number of cases against it and its acceptance of rulings — in black and white on the WTO website — is better than that of either the US or Europe. China is getting better at navigating and gaming the system, just like the other members, and many of the problems originate in domains where WTO rules are outdated and China's actions create large spillovers to the rest of the world.

China's circumstance, as the world's largest trading nation and a nation without any major formal allies, means that it is deeply dependent on the system that helps to manage its trade exposure for its economic and political security. Australia and the region's economic and security interests lie in sustaining Chinese dependence on that system and the maintenance of its multilateralist posture.

What has *not* changed, then, although to some it may appear to have, is the value, relevance and importance of the rules-based multilateral trading system to the global community and to Australia, and the security that it still provides.

This is the crux of what has recently served to defend Australia's economic security; it is not some faint-hearted hope.

The global trade regime is still a reference point against protectionism, and the open global system with its substitute markets and alternative suppliers is what protects against market shocks, politically motivated or otherwise, including in Europe from the big political shock of severing of energy trade with Russia. The WTO's dispute

settlement system, with all its problems, provided the exit-ramp for both Australia and China from that episode of economic coercion.

Realistically it needs to be acknowledged that the United States is in retreat as a leader on rules-based trade, and is becoming a disrupter of that system. Gone are the days when the United States gained influence in our region by offering the 'promise of prosperity' to those willing to follow the rules of an open global trading system. A major pillar of its liberal internationalism has crumbled. Worse, the United States is now undermining that system for those who still depend upon it. However, those countries that remain within its compass comprise most of the rest of the world and their share of the world economy is growing.

Middle powers are increasingly shaping the global economic order and this provides Australia with an important opportunity.

Under the first Trump administration, the United States invoked the WTO security exception to justify higher tariffs on imported steel and aluminium. As a WTO panel ruled in December 2022, there was no 'emergency in international relations' to justify the national security exception for Trump's steel tariffs. Having lost the case, the United States appealed 'into the void' of the non-functioning WTO Appellate Body. The Biden administration doubled down on Trump's national security tariffs with US Trade Representative Katherine Tai trashing the WTO ruling. We should not underestimate the hardening bipartisan consensus in Washington on this.

Increasing use of the Article XXI(b) security exception of the General Agreement on Tariffs and Trade (GATT) has the potential to rip a hole in the centre of the global trade order. For the increasing list of goods and services that are designated as having 'dual use', or having both civilian and military applications, the rules will offer very little defence against protectionism.

The policy priority for Australia that is crucial to add to the new National Interest Framework is trade regime defence and multilateral trading system reform. This policy priority is not merely multilateral: it is also at the core of regional economic diplomatic initiative. The list of countries joining MPIA is slowly growing (with Japan joining in 2023 and the Philippines this year) and the security exception hole needs to be plugged.

The WTO, which underpins the multilateral trading system, is not working perfectly but remains crucial to Australian and global economic security. Great power rivalry does not mean the end of a level playing field and equal treatment in international affairs — it means that the most-favoured-nation (MFN) principle is more important than ever to provide economic security. These are the principles that are to be sought and sustained wherever it is practical. ‘Friendshoring’ and measures that favour trade with trusted partners contradict the MFN principle.

The alternative is a world ruled by political might and competing blocs, one that would be considerably less prosperous and more threatening and insecure, with consequences in terms of political instability and human displacement detrimental to Australia’s security interests.

This assessment is no starry-eyed nostalgia for the past. For a small open economy like Australia, a multipolar world means finding domains — on issues such as investment, technology, climate, migration or in geographic spheres — where large powers have an interest in developing and enforcing rules. These interests are shared by middle powers and open economies, both of which are heavily concentrated in East Asia. Australia is not alone in its region, or globally in this multilateral mission. ASEAN, Japan and South Korea are all aligned to the same objective.

The United States is likely to be a major source of trade policy uncertainty for the foreseeable future, but the rest of the world relies on a rules-based global economic order that tilts toward a level-playing field and equal treatment. Keeping the rest of the world open and committed to the rules-based trading system is a very high priority.

For no region is this more true than the highly trade-exposed East Asian region that has most to lose from a breakdown in the established international trading system.

Many countries have come to see high trade shares as a vulnerability and are trying to diversify away from their fundamental comparative advantage and economies of scale in international markets. That makes countries poorer, and likely less secure, and fails to recognise what has *not* changed in the global economy. Choosing such a path leads to reinforcing a downward spiral where countries increasingly turn inwards because of the actions of each other. The collective bargain of mutually enforcing prosperity through open trade reverses with escalating protectionist interests.

Policies that diversify away from interdependence and high trade share because of the threat of weaponisation will not only make Australia poorer, they are likely to make Australia less safer and less secure.

Economic analysis is important to identify that the risk of war and benefits of peace are not independent, and when economic strategies might be exploited to reduce security risk.

Diplomacy can reduce the risk of war, particularly by facilitating deeper economic and social interests and understanding across borders. War or peace is not a gamble where the odds are fixed or risks of war only increase as there is a shift in the relative economic or political power of potential protagonists. While some may believe the risk of war grows inexorably with the Chinese economy and power, there are other factors which will reduce that risk. For example, the more China trades with the world the more it would lose from disruptions that war would cause (see Angell, 1909, for the argument prior to World War I that the economic cost of war was so great that war was economically and socially irrational). That constraint does not eliminate the prospect of war, but it makes it more costly, particularly in the case of an economy like that of China.

The most enlightened states throughout history have understood this. Economics and security have always been entwined in the service of each other. The main elements of the global economic order today were forged in the middle of the Second World War at Bretton Woods. Economic and security challenges were tightly enmeshed in the thinking that led to its creation (Hirschman, 1945; Armstrong, et al, 2021). The United States imposed commitment to this postwar multilateral system under the Wartime Pact with Australia in 1942, in the middle of the Pacific War (Armstrong et al, 2021).

Trade strategies in particular have historically been directed to securing peace — sometimes called the commercial peace — as in the European Project or the political rapprochement forged by economic interdependence in Northeast Asia. That equilibrium among Northeast Asian countries was generated by their all eventually signing onto the postwar rules-based trade regime that binds the major powers together despite their long-standing political disagreements and rivalry (Armstrong, 2012). By contrast there has been no similar economic engagement or political rapprochement between India and Pakistan in South Asia, and in some other parts of the world.

The great debates about trade and peace date back to at least the 18th century. In 1748 Montesquieu famously argued that peace is the natural effect of trade, an argument extended by John Stuart Mill a century later (1848) with evidence from throughout history. Adam Smith argued in the *Wealth of Nations* (1776) that commerce between nations ought to be a source of peace but that it can in fact be ‘the most fertile source of discord and animosity’. Again, there is evidence of this throughout history and in contemporary US-China relations. What determines the relationship between trade and security is the nature of the regime within which countries engage economically.

The postwar trade and economic order with its organising principle of most-favoured-nation treatment and disciplines on discrimination was indeed framed to constrain the exercise of raw political power in the conduct of international commerce (Cooper, 1972). It is consistent with the overarching principles of the postwar political order embedded in the United Nations Charter. Over the almost 80 years since its

foundation it has built global prosperity and a significant measure of peace among the nations that signed on to its rules through deepening international integration. The perception that those who support a rules-based economic order are beholden to commercial interests and neglect security risks is naive.

Trade and economic interdependence have been a cause of peace in East Asia, Australia included. This was by design.

### **An external strategy for Australia's economic security and prosperity**

The assumption underlying Australia's new economic security policies is that we are operating in a world in which international trade rules and arrangements have *no* role to play. This is what is missing in the new National Interest Framework.

An unspecified country — China — is playing totally unfairly in the global economic system to grow its global trade share, risking Australia's and global economic security. The message is that the abuse of market power should be viewed through a security lens. A favoured strategy is to de-risk critical minerals trade with China and to de-risk from Chinese supply chains, leading to reduced trade shares, and with government help to develop 'trusted markets and suppliers'. The costs are not assessed, but that strategy on the evidence we have available would be very costly (see, for example, Aiyar et al, 2023 and IMF, 2022, for assessments of the costs of where that strategy might lead). It is noteworthy that this strategy is very much in keeping with the stated national policy interests of the United States, despite the US and Australian economies and their trade structures being very different.

The question here is: does this strategy make Australia safer or reduce risks from China?

One of the most important security objectives served by an open and rules-based trading order is to reassure rising economic powers that they will have access to the

basic raw materials they need. Policies that divert trade, on the other hand, serve to increase paranoia and to strengthen the conviction that political pressure or military force alone can secure access to necessary markets. Australia's trade war against Japan in the 1930s helped to heighten Japanese economic insecurity instead of, as Sir John Crawford argued at the time, trading Japanese economic security objectives for Australian political security (Crawford, 1938). Instead, we bolstered Japanese nationalists.

Australia's relationship with China is one of high-level interdependence, not just asymmetric dependence by a smaller country on a superpower that has shown itself willing to abuse perceived economic leverage. Australia is indispensable to China's economic security: China has no substitute for Australian iron ore in quality or quantity that must supply over half its entire steel industry for more than a decade at least. Australia is heavily dependent on its large resource trade with China, not just to sustain its international spending power, but also for its substantial contribution to national revenues. To disengage from this huge trade relationship would be very costly to both Australia and to China.

Australia's economic interests in China are thus quite different from those of other developed countries. While the United States and Europe may feel threatened by China pushing out the technological frontier, Australia and the world more generally benefits from it. Cheaper, higher quality electric vehicles are unequivocally good for Australian consumers since we make none of them, even as the European Union and United States impose tariffs (in the US case already at 100 per cent) upon imports of Chinese EVs.

For very sound economic reasons, Australia provides significant inputs for industrial production in China rather than competes with industrial outputs from it. China's strong comparative advantage in green machines (solar panels, wind turbines and electric vehicles) is mirrored by increasing comparative *dis*advantage in sectors where we happen to benefit (exports of green goods that embody green inputs and use green

machines). From a security perspective, it also makes little sense for a small open economy to distance itself from a larger one likely to be a leader across many future technologies. This is especially so in technologies that help with the energy transition. Countries ranging from Japan to China itself deliberately and successfully sought engagement with whichever country was ahead of them technologically so they could develop economically and become more secure — whether they were rivals or not.

Similarly, a strategy that builds interdependence with China in critical minerals and close cooperation with China in the massive transformation that will need to take place in its steelmaking technology over the coming decades to achieve decarbonisation goals via the input of green energy is likely to contribute to Australian prosperity and security, not detract from it. More iron and steel trade interdependence and more production of critical minerals in Australia makes us more secure while serving our economic interests. Australia's resource trade continues to contribute to regional security, not detract from it.

Chinese investment is important for making lithium hydroxide in Australia, for example, and we need to regain our confidence in regulating foreign investment, especially from China, to ensure such ventures succeed. There are economic and security benefits that derive from welcoming Chinese investment if properly regulated like any other investment, domestic or foreign, instead of turning it away, which is what Australia has done in the past decade.

The risks of economic coercion or misuse of assets and profits can be managed within the framework of Australian domestic laws, bilaterally with China and, most importantly and concurrently, multilaterally, through regional and global arrangements. That interdependence could once again cushion Australia's economic performance in the next global economic downturn.

The 'small yard high fence' contention is that there are a small number of goods that warrant protection even at a high cost, and that this will somehow free us up to be more



liberal in other domains. There are ways to achieve that security objective, including ways that do not involve trade or investment discrimination.

China's integration into complex global supply chains that reach deep into the Chinese domestic market is a constraint on China's economic and political action. A Chinese economy and society that is less integrated into the global economy is one that brings more international political risks, not less.

An economic question of political consequence is whether the global economy is on a trajectory towards a 1930s-style [epic fail equilibrium](#) (Armstrong and Quah, 2023) — a generalised prisoner's dilemma where everyone is made worse off by narrowly self-interested national decisions even if better outcomes are possible from cooperative international decisions — driven by US-China strategic competition and beggar-thy-neighbour policies brought on by uncertainty-induced policy short-sightedness in major economies.

Dr Kennedy argues that, 'we are facing a more contested, more fragmented and more challenging global environment'. The situation appears to be deteriorating. The world he describes is a world made by policy choice, not one exogenous to policy influence, and Australia is not, nor should it be, a passive bystander in that world. It is a world on that trajectory because of decisions in Washington, Beijing and other capitals that of their nature are not all-embracing, and purposeful actors in the global community can alter that trajectory by deliberate policy choice.

Even in such a world, the choice of openness is a viable option. International markets can be a source of resilience, if shocks are managed with a robust and flexible domestic macroeconomic framework. International economic diplomacy aimed at keeping markets open and contestable in East Asia helps build foundational resilience for Australia. It's the flexible exchange rate and dynamic markets at home, with macroeconomic policies that target full employment, which help manage risks and shocks.

Australia, as a small or middle power, clearly cannot single-handedly alter the trajectory of a great deal in world affairs. So what influence can Australia realistically bring to bear on its external environment to make it more congenial to its critical economic security interests?

An important fact to which I referred earlier, of course, is that the heavy concentration of Australia's trade and economic interests in its region (its putative source of economic vulnerability) also defines its primary theatre of policy initiative and action. The East Asian region accounts for 67 per cent of all Australia's foreign trade compared with 17 per cent with the trusted Five Eyes allies and North Atlantic English-speaking friends or 26 per cent with the G7 industrial economies (Armstrong, et al. 2021). Australian exports to ASEAN were A\$86.2 billion in 2023, Australia's third largest market behind only China and Japan, and much larger than the A\$33.6 billion Australia exports to the United States or exports to the European Union. Total trade with ASEAN was A\$143.8 billion, making it Australia's second most important trading partner after China. While the United States has many other theatres of interest, East Asia is Australia's primary theatre of leverage and action.

Australia has agency in the international economic order through its global initiatives (at the WTO, in the G20, and as a first-mover with the MPIA) but it has particular leverage because of its prominent role and diplomatic standing in its region. Australia, as a small open economy and a middle power politically, has helped, with the input of ideas and the persuasion of our neighbours to engage with them, to influence its external circumstances in ways that have been rather more congenial to the prosecution of our national interests internationally than might otherwise have been so. Australia has a track record in the region with intellectual leadership and deft economic diplomacy in the establishment of the Asia Pacific Economic Cooperation (APEC) forum (which includes China and the United States) and more recently the negotiation of the Regional Comprehensive Economic Partnership arrangement (which includes China) and the Comprehensive and Progressive Agreement for Trans-Pacific Partnership (CPTPP,

which as yet includes neither of the Great Powers). Australia has more agency than its economic weight would imply because through these arrangements and independently, the structure and strategic importance of its trade yields close alignments of interest and diplomatic opportunity with a highly interdependent set of regional economies that account for around 30 per cent of global output and trade.

Obviously, were Australia to mismanage this diplomacy and retreat from free and open trade it would also risk accelerating the fragmentation of the global economic order, a culpability that it can be said to have shared in its treatment of Japan at the League of Nations settlement in 1919 and in its trade policies later during the interwar period.

A priority for Australia is to work to defend and strengthen the rules to avoid abuse of international market power, especially in the primary theatre of its economic interest.

This is the vital second front of diplomacy for Australia's national security strategy. Our alliance relationships are the first front in national security strategy. Without initiative on this second front, the risk of military conflict that ends in tears and ashes will be higher.

The global regime that helped Australia build its prosperity with high trade shares with its neighbours in Northeast Asia has been weakened and is under threat but it is far from dead. Australia does not have to reconstruct the whole castle of international trade law and norms to protect the moat around it. The primary line of defence is in Asia where Australia has agency. Contributing to regional rules that enmesh China in ASEAN-centred arrangements and taking seriously and probing thoroughly Chinese intentions to sign up to existing arrangements can help.

The alternative is not a safer world.

Loss of confidence in the multilateral trading system is leading to countries and companies to self-insure with diversification, stockpiling, friendshoring, onshoring and other policy measures in the name of economic security. These are third-best policy

responses in a second best world that reduce our chances of reaching the first-best solution.

The idea of ‘trusted partners’ is a misunderstanding of the role of trust in economic interactions. The great benefit of markets is that they reduce the need for interpersonal trust. Before we had widespread markets, a blacksmith in a rural village had to trust the farmers for whom he repaired ploughs and hoes on credit, that they would repay him in grain when the harvest came in. Communist countries who conducted international trade on barter terms had to do something similar, one of the reasons they traded so little, and, especially for the smaller countries, on such bad terms. When markets are thick, on the other hand, we trust in the rules of the game and the power of markets, rather than the participants. Competition crowds out strategic behaviour with alternative buyers and suppliers. When you have a good tennis umpire, you don’t need to trust the person on the other side of the net when they tell you they think your volley was out.

In the aftermath of the Second World War, Australia also found itself asking whether it could trade with countries it did not trust. Chief among them was Japan, then still a recent enemy. Rather than give in to the temptation to trade only with trusted partners, Australia signed the 1957 treaty with Japan that normalised trade relations and helped drive Australia’s postwar economic expansion. Trust was a consequence of trade, not its cause.

Day to day decisions by the government require a nuanced risk-based approach to balancing prosperity and security, and in some instances a difficult trade-off between security and prosperity, but without a clear priority on the longer term strategy of preserving strategic policy space in a multilateral rules-based economic system, Australia will be a price taker in a smaller world heading towards a corner solution of stagnating growth and the incapacity to provide hard security (Armstrong, et al., 2023).

Benign globalisation and a ‘benign international environment’ was not a lucky accident — it was created by the rules and a regime forged, with a proactive diplomacy and

Australia at the table, at the dying stages of the Second World War and then for decades through patient diplomacy designed to deepen and entrench it. The multilateral system created then, and subsequently extended, still diffuses economic and political power. But it appears now missing from the framing of Australia's economic security strategy. Regardless of the external environment, everything we want to achieve will be harder without the institutional framework that the multilateral system provides. Every time the system is weakened, our set of policy options narrows.

This system is of crucial importance to Australia and its key partners in East Asia that have successfully integrated into the global economy and are more trade exposed than countries in any other region outside a framework of economic union.

The Treasurer argued that 'a Future Made in Australia does not mean a future made alone' and Dr Kennedy acknowledged the nature of the new multipolar world where the G7 counts for a much smaller proportion of global output and power. We cannot sensibly afford reliance that depends only on the G7 plus advanced economies for partnerships in new areas like critical minerals. The BRICS grouping is now larger than the G7 in economic weight, in purchasing power parity terms, and emerging market economies are becoming more important.

There's a need for more policy attention on the emerging markets beyond China and India. Southeast Asia (where established automobile production capacity makes it a likely new EV growth hub) is a particular blind spot in Australia's **global** economic diplomacy despite its being on its strategic front line.

Putting policy effort into working with trusted suppliers and partners is a limited response to our national economic security objectives. Working with partners facing similar forces to develop rules and norms that provide collective security is more likely to deliver dividends.

The clear-eyed assessment must be that the heightened risks to the global economic order that we face have more than one origin and a one-dimensional defensive strategy not complemented by a proactive diplomatic policy strategy will lead our country in the wrong direction, weakening national economic strength and security. Australia has agency and has neighbours looking to engage with leadership in keeping the region open, stable and secure. The only way is to do so within the most pertinent coalitions, collectively and multilaterally.

The incorporation of security interests in economic policy in Australia risks making Australia poorer in the name of national security. It may also risk making Australia less safe and less secure, creating a more uncertain world, especially as the United States moves towards isolation as well as friendshoring much more rapidly now than we had hoped.

A reframing of Australia's economic strategy towards a [smaller world for Australia](#) limits strategic policy space, reduces options for traders, like barley growers suddenly cut out of the Chinese market, limits influence in Australia's own region and in global forums and is hardly likely to advance Australia's economic or political security objectives (Armstrong, 2023).

## **Conclusion**

Australia became the richest country in the world in per capita terms in the nineteenth century. It did so by specialising in areas of comparative advantage: particularly land-extensive agriculture and minerals — initially, wool and gold. Federation brought wider and deeper domestic markets but also a turn towards protectionism that stunted growth and left Australia more dependent on its traditional protector and economic partner, Great Britain, itself an economic power in decline. What made Australia rich again was the late twentieth century turn to openness and, as a consequence, finding an economic place in Asia.

Today the apparent trajectory of the global economy and increased geopolitical uncertainties are causing a retreat from the ideas and principles that have so successfully guided the pursuit of our national interests in the past half century or more — towards economic policies that encourage more self-sufficiency against external vulnerabilities, a shift away from natural comparative advantage towards trade with so called trusted partners, and implicit discrimination in trade and investment strategies that have the potential to deliver our nation a poorer, less prosperous future.

Underpinning all of these problems in one way or another is the inevitable logic that global public goods, such as maintaining peace, responding to climate change or opening international trade are much harder to deliver in our new, multipolar, world (Acharya, 2016). But retreating to focus only on national responses instead of how to deal with the realities of the world as it is, risks making Australia poorer and less secure.

I return to the important role that the ANU and Treasury need to play in today's more uncertain world. Australia may be a small open economy and middle power politically but it can be a leader in its theatre of influence and interest, in East Asia. That is where Australia will find agency to protect its national and global interests.

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