Geoeconomic competition in the Indo-Pacific

It is widely recognised that economic relationships are fundamental for international politics. Domestically, a country's economy is a principal source of national power: it provides the material and knowledge resources on which both civilian and military capabilities are based. Changes in economic relativities between states are a leading indicator of power balances in the international system. Internationally, the presence of cross-border economic connections – for goods, capital and knowledge – also create interdependence between states. Economic interdependence is unquestionably beneficial, as it allows a country to access resources and opportunities not available within its own borders. But it can also be a source of strategic risk, if it leads to external dependence, undermines sovereignty, or poses security externalities.

Analysts have coined the term 'geoeconomics' to understand the strategic effects of economic interdependence[1]. In broad terms, it can be defined as *"the application of economic instruments to advance geopolitical ends"*[2]. The concept argues that economic interdependence builds various forms of linkage between countries, and that these linkages have strategic implications – both positive and negative – that go beyond their purely economic effects. Moreover, these linkages can be deliberately manipulated by governments to project power and shape the international order in favourable ways.

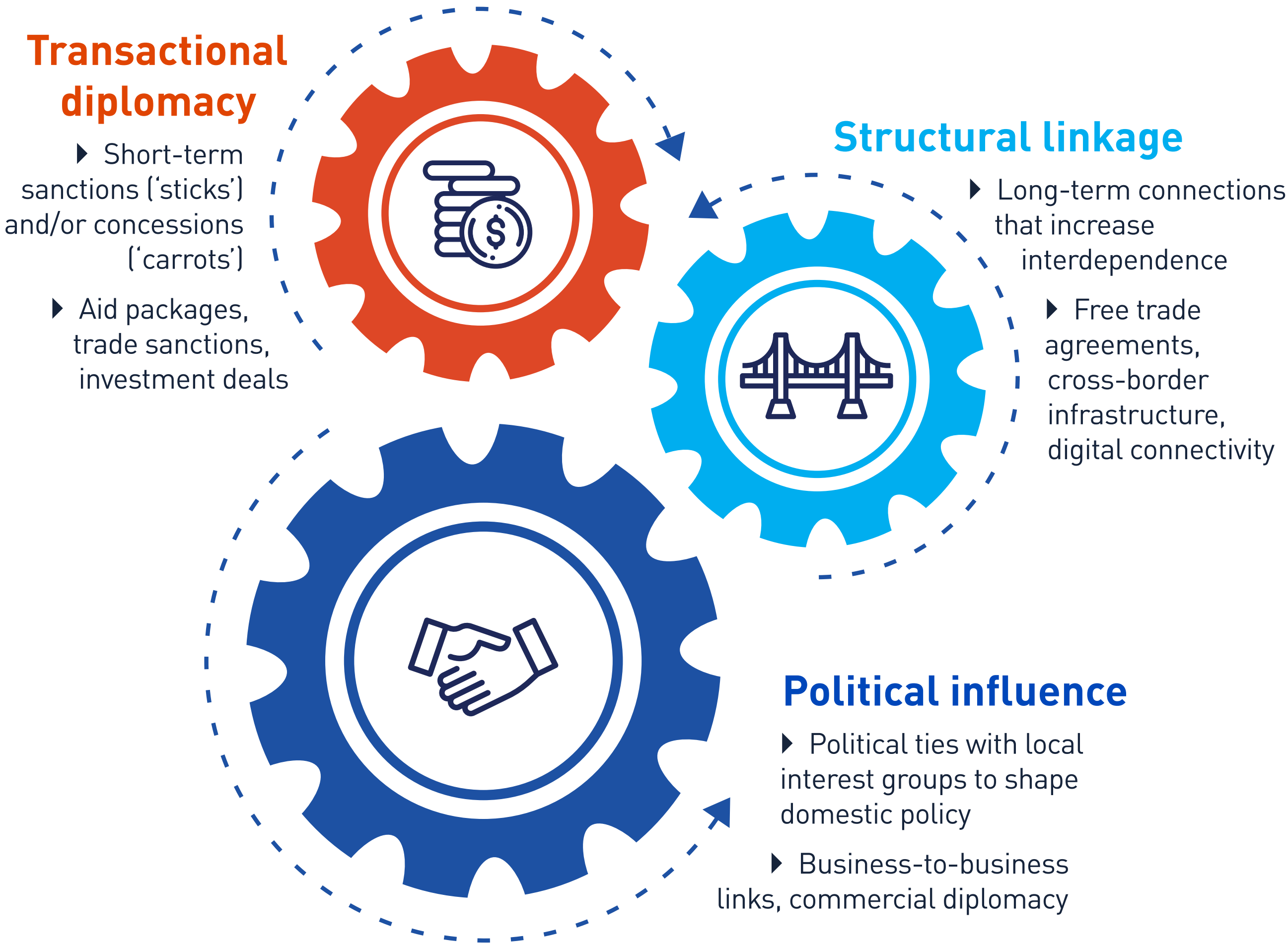
Put simply, geoeconomics captures how economic policies can be used as a form of statecraft.

Geoeconomics goes beyond the simple notion that economics and security are linked. That it is economies which produce the 'guns and butter' underlying national power has long been recognised. Rather, geoeconomics describes how governments can deliberately use economic policies for the achievement of strategic, rather than purely economic, objectives. Free trade agreements (FTAs) provide an illustrative example. By mutually lowering trade barriers, FTAs produce an economic gain of increased trade. But they also change the form of interdependence between the involved members, with strategic implications for their relationships. When negotiating FTAs, government must therefore balance both economic and strategic objectives, and will often undertake agreements principally for their strategic results[3].

How do these ostensibly economic initiatives produce strategic outcomes? Because they change patterns of interdependence between governments. If Country A becomes dependent on its economic relationship with Country B, then A will face incentives to grant B concessions to secure that relationship. As Hirschman has argued, this creates an 'influence effect': where B gains some form of economic leverage over A that can be used to extract concessions[4]. Geoeconomic strategies aim to exploit the influence effect by changing patterns of interdependence. Infrastructure platforms can lead to recipient countries becoming reliant on investment from the donor/s, creating an incentive for recipients to accommodate donors' political requests. Regional trade agreements increase connections between their members, deepening influence effects within the blocs.

Geoeconomic strategies can change political relations in multiple ways. Broadly speaking, three mechanisms can be identified (Figure 1):

Figure 1 Three mechanisms of geoeconomics



- **Transactional diplomacy involves short-term, one-off exchanges.** It occurs when a government uses economic tools to reward or punish another, in the hope of changing the other's behaviour. It can take negative forms, such through the application of trade sanctions; or positive forms such as offering aid packages or investment deals. Transactional diplomacy is a quid-pro-quo interaction whose influence effect lasts only as long as the transaction itself. It does not require longer-term political comity.
- **Structural linkage builds longer-term connections between economies.** It involves the development of lasting economic ties – such as free trade agreements, cross-border infrastructure or digital connectivity – to increase the density of ties between countries. In situations where there are size asymmetries, these connections give the larger partner an influence effect over the smaller. It is distinguished from transactional diplomacy by its longer-term nature, and therefore requires a degree of political alignment between governments.

- **Political influence operates indirectly at the societal level.** It results from the fact that international economic connections asymmetrically benefit certain groups within a state (typically, businesses that gain from economic opportunities). These groups develop an interest in supporting ties with a foreign country, and advocate for that country within domestic policy debates. Political influence is the deepest form of geoeconomics, and requires linkages between business and civil society groups.

Importantly, geoeconomics changes the logic of foreign economic policies. Economic objectives are no longer the sole concern of international economic relationships. Rather, they are also overlaid by a range of strategic considerations, some of which may have little to do with economics at all. These can include diplomatic concerns (such as building political ties with certain partners), or security concerns (including reducing economic exposure to partners considered hostile, and/or leveraging the exposure of partners for one's own gain). This process is described as the "securitisation" of economic policy, wherein economic objectives are mixed with – and in extreme cases, entirely subsumed by – security considerations[5]. As a consequence, geoeconomics complicates the calculation of national interests with respect to foreign economic relationships, particularly when economic and security objectives clash.

In recent years, many geoeconomic contests have emerged between the Indo-Pacific's main powers. One domain is infrastructure competition, which was catalysed by China's launching of the Belt and Road Initiative (BRI) in 2013. Fearing that the BRI would provide China economic leverage over recipients in the region, counter-balancing infrastructure initiatives were launched by the Japanese, US and Australian governments in subsequent years[6]. On the trade front, the launch of the Trans-Pacific Partnership (TPP) by the US in 2010 unleashed a similar dynamic. Concerns – especially amongst China and smaller economies – that the TPP would create a US-dominated trade bloc within the region catalysed moves to commence negotiations for the competing Regional Comprehensive Economic Partnership (RCEP) in 2011[7]. Geoeconomic factors also play a role in regional disputes over cyber-security, foreign interference, territorial disputes, and most recently the COVID-19 pandemic.

> **Economic integration has become a proxy domain for strategic competition between the Indo-Pacific's major powers.**

Geoeconomic contests have major implications for the regional order. Integration through cooperative and rules-based institutions has been a feature of the Indo-Pacific for over three decades, and proved critical for its consistent developmental successes. But economic integration is becoming politicised – and its progress arguably undermined – due to competitive dynamics introduced by geoeconomics. In strategic terms, it also means that economic relationships are getting dragged into diplomatic and security competition between the region's main powers. The political separation of economic and security relationships – which allowed strategic rivals such as the US and China to build deep trade and investment ties – is beginning to break down. As the remainder of this report illustrates, this turn towards geoeconomic competition poses significant challenges for a medium-sized and open country like Australia.