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# ***The structure of global power and Australia's role***

an address to the Institute on 31 March 2011 by

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*Professor Garrett reviews the current structure of global power and concludes that the world is not in the grip of another 'cold war'; the demise of the United States has been exaggerated; and the United States and China are joined at the economic hip. Australia is a key partner in the United States – China relationship, as much economically as geopolitically.*

**Key words:** global power; United States-China relationship; Australia

Australia's 2009 Defence White Paper<sup>2</sup> in effect stated that Australia can no longer rely on the United States as our defence guarantor as it seems increasingly unable or unwilling to play a lead role in Asia; yet we cannot trust the Chinese because, while they seem to believe in 'make money, not war', their behaviour in East Asia seems increasingly aggressive. Accordingly, Australia must build up our own defence capabilities.

I am not convinced that this is an accurate assessment and in this paper wish to examine the current place of the United States in the global power structure, the nature of the United States-China relationship, and the implications of both for Australia.

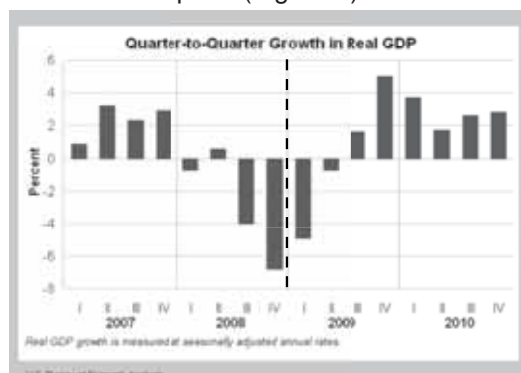
## **My Big Picture**

Contrary to the picture painted in the 2009 White Paper, as I see it, talk of the demise of the United States has been exaggerated, although its relative decline is inevitable. The United States and China are joined at the economic hip in ways that are not well understood but that promote geopolitical stability. China and the United States are not engaged in another cold war, because China is not the Union of Soviet Socialist Republics particularly because of its integration into the global economy. Finally, the Australia-China-United States triangle is as much concerned with economics as it is with geopolitics. I will explain these views further below.

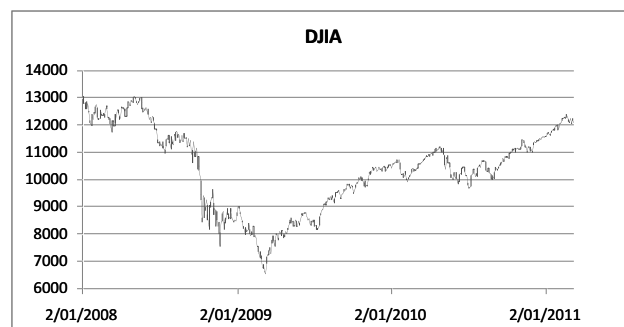
## **Economic Recovery in the United States**

The United States is recovering from the global financial crisis, but not uniformly. Business is doing relatively well, but voters are not benefiting, in part

because business is not investing in American jobs. From a low of -6 per cent in the 4<sup>th</sup> quarter of 2008, gross domestic product in the United States has returned to positive territory and was averaging around 2-3 per cent in the second half of 2010 (Figure 1). Similarly, the share market has recovered most of the value it lost during the crisis (Figure 2). Unemployment, however, which was at less than 5 per cent before the crisis, reached 10 per cent during the crisis and has remained close to that level since (Figure 3). Also, housing prices, which doubled from 2000 to 2006, commenced a steady decline during the crisis and appear to have stabilised around 2003 levels, about 60 per cent below their peak (Figure 4).



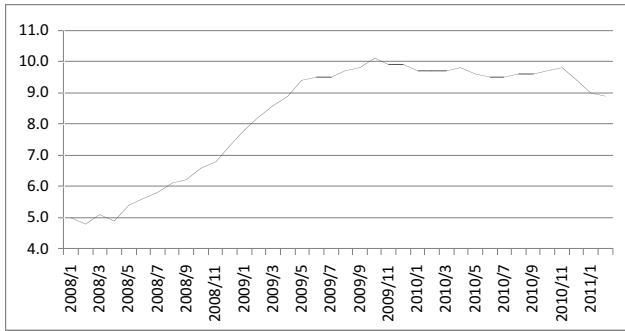
**Figure 1:** Quarterly economic growth in the United States, 2007 - 2010 [Source: United States Bureau of Economic Analysis]



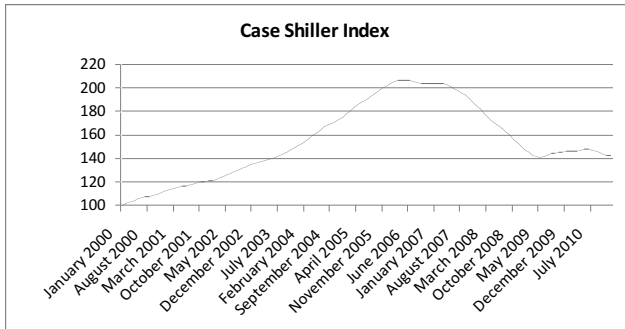
**Figure 2:** The trend in the Dow-Jones Industrial Average of leading United States Stock Market securities from 2008 to January 2011 [Source: Dow Jones]

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<sup>2</sup>Australian Government, Department of Defence (2009). *Defending Australia in the Asia Pacific century: Force 2030 – Defence White Paper 2009* (Commonwealth of Australia: Canberra) 140 pp.



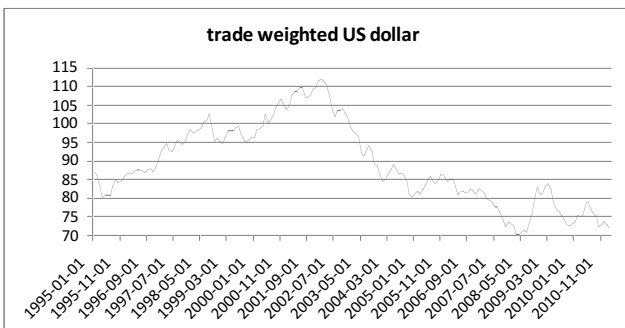
**Figure 3:** The unemployment rate in the United States from January 2008 to January 2011 [Source: United States Bureau of Labor Statistics]



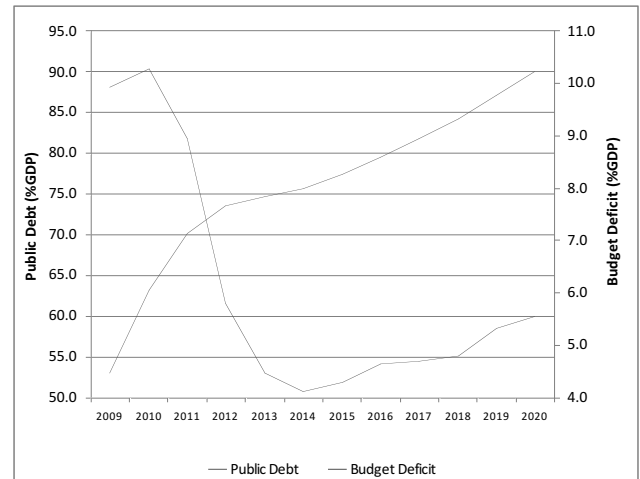
**Figure 4:** Case Schiller Index of house prices in the United States from 2000 to mid-2010 [Source: Case Schiller Housing Index]

### Is the United States in Long-term Decline?

Is the United States in long-term decline as many commentators assert? In relative terms the answer is certainly yes – driven fundamentally by catch up in emerging Asia, led by the two giants of China and India. There are many reflections of this relative decline, but the greenback is perhaps the clearest. From a peak in mid-2002, the value of the United States dollar has declined by some 40 per cent on the international market and is now trading below levels not seen in the last 15 years (Figure 5). Further, President Obama’s 2011 financial year budget projected that the United States public debt, which was around 50 per cent of gross domestic product (GDP) in 2009, will rise to 90 per cent by 2020 (Figure 6). Much of the projected increase will be caused by a blow-out in health costs. Clearly, the United States can no longer easily afford to become involved in new foreign military adventures, such as in Libya – as President Obama himself has emphasized.



**Figure 5:** The trend in the value of the trade-weighted United States dollar from 1995 to 2010 [Source: St Louis Federal Reserve]



**Figure 6:** Estimated trends in public debt and the budget deficit from 2009 to 2020 [Source: United States 2011 financial year budget]

### Will China Dominate the World?

The Goldman Sachs Asset Management assessment of the four major expanding economies (Brazil, Russia, India and China – the so-called BRICs) is that the future belongs to China, then to India (Table 1). The Chinese economy has already passed in overall size those of Italy, France, the United Kingdom, Germany and Japan and is projected to surpass that of the United States in 2027. The Indian economy is also on the ascendant, but is lagging some 15-20 years behind that of China.

**Table 1:** Economic projection by Goldman Sachs Global Investment Research [Source: BRICs and Beyond, 2007]

Year when China/India economies will pass:	Italy	France	United Kingdom	Germany	Japan	United States
China	2004	2006	2006	2008	2010	2027
India	2017	2021	2023	2024	2027	---

Some assert that China is spending too much on its military. Certainly, while United States military expenditure increased by two-thirds in the decade from 1998 to 2007, China’s grew by some 200 per cent, although in absolute terms the United States was still spending overwhelmingly more than any other country (Figure 7), but it was also fighting two wars. China’s military spending is projected to increase by 10 per cent per year for the next 30 years. China says that this is necessary for self-defence in a neighbourhood packed with countries, although many external critics do not believe this. Nevertheless, China appeared to receive a salutary lesson in 2010 when it overstepped the mark in aggressively enforcing its territorial claims in the East and South China Seas. Its neighbours reacted adversely and the United States was welcomed back into the region.

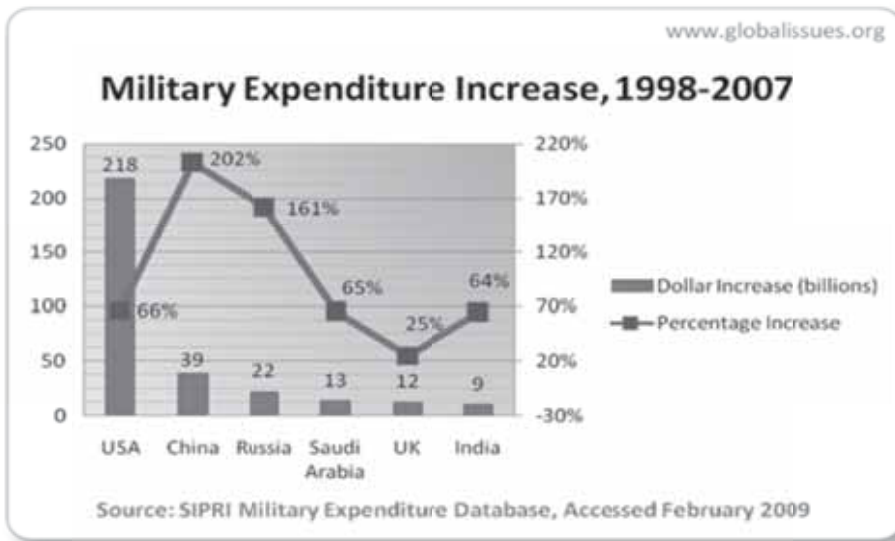


Figure 7: Increase in military expenditure by leading powers between 1998 and 2007 [Source: Stockholm International Peace Research Institute (SIPRI) Military Expenditure Database, accessed February 2009 at www.globalissues.org]

### United States and China in the Global Economy

China, in effect, 'owns' much of the United States; but American demand 'drives' the Chinese economy. China lends money to the United States so the United States can buy Chinese goods. For example, United States Treasury bills purchased by China between 2001 and 2010 increased astronomically, while the United States trade deficit with China almost trebled over the same period (Figure 8), notwithstanding the global financial crisis that was supposed to reduce these imbalances significantly. Both sides are heavily dependent on each other.

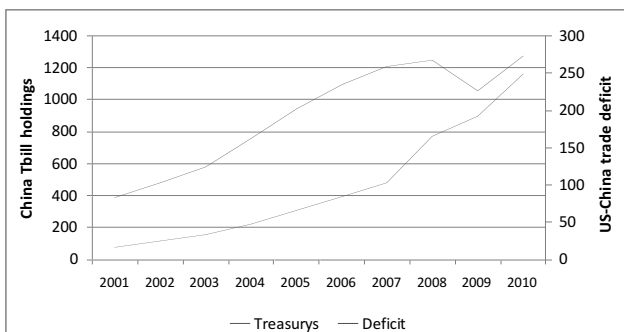


Figure 8: Trends in China's holdings of United States Treasury bills and the United States trade deficit with China from 2001 to 2010 [Sources: United States Treasury – Major Foreign Holders of Treasury Securities; United States Census Bureau – Foreign Trade]

But the trade and currency stories conceal another important dimension to United States-China relations: American multinational corporations. For example, Apple iPhones embody today's complex global economy. They are designed in California (6 per cent of the value of components and labour) and are assembled in China from components that are manufactured in Japan (34 per cent of the product value), Germany (17 per cent), South Korea (13 per cent) and other countries (27 per cent). China, in fact, only contributes 3.6 per cent of the value. Because China sells the phones to the United States, traditional

accounting allocates the total cost, \$1.9 billion, to the United States trade deficit with China. Using a value-added approach, however, the picture changes. As a consequence of this global trade in iPhones, the United States actually has a \$4.8 million trade surplus with China and a trade deficit of \$563 million with Japan, \$219 million with Germany, \$138 million with South Korea and \$421 million with other countries.<sup>3</sup>

Motor vehicle manufacture highlights the dilemma for American domestic jobs. During the global financial crisis, General Motors was

saved from economic collapse by the United States taxpayer and is now recovering well, based largely on sales of vehicles to China<sup>4</sup>. In 2010, General Motors sold more cars in China than it did in the United States. Unfortunately for American autoworkers, though, the vehicles that General Motors sells in China, it builds in China.

Henry Kissinger got succinctly to the nub of the issue last January when he said: "In the American-Chinese relationship, the overriding reality is that neither country will ever be able to dominate the other and that conflict between them would exhaust their societies." So, the reality is that we are not faced with another 'cold war' and neither side could afford a hot war. For both sides, as uneasy as it may be, co-existence is essential. This may not always be evident in the public statements of the leaders, but those statements are usually directed primarily at domestic audiences, while the leaders manage the issues bilaterally out of the public glare.

### Australia

So, where does Australia fit vis-à-vis the relationship between the United States and China? Australia really is essential to the relationship. Australia can be viewed as being at the base of a three-way economic triangle:

- China is on the upper left selling its goods to the United States as well as giving her the money to buy those goods;
- the United States is on the upper right buying the Chinese goods, sending China expertise (multi-

<sup>3</sup>Xing, Y., and Detert, N. (2010). How the iPhone widens the United States trade deficit with the Peoples Republic of China. Working Paper No. 257, Asian Development Bank Institute: Tokyo.

<sup>4</sup>General Motors vehicle sales in the United States between 2003 and 2010 declined from some 4.8 to 2.2 million vehicles, whereas its sales in China increased from around 200,000 to 2.4 million.

national corporations, intellectual property) and giving China market access; and

- Australia is at the base, supplying China with raw materials for manufacture and receiving mining contracts and foreign direct investment in return, while investing superannuation funds in the United States and receiving foreign direct investment in iron ore, coal, liquefied natural gas (Chevron, for example, owns about half of Western Australia's liquefied natural gas) and food from the United States in return.

### **Conclusion**

The emerging relationship between Taiwan and the Peoples Republic is salutary. Taiwanese investment is critical to the development of Shanghai. Despite all the talk of sovereignty, independence and military tensions, Taiwan is now an economic part of China. Both Taiwan and the mainland benefit from this economic integration, so they have powerful incentives to manage down the political frictions between them. This economics-dominating geopolitics may serve as a template for similar relationships in our region. The United States and China are joined at the economic hip and Australia is enmeshed along with them. China and the United States cannot afford a hot war; coexistence is essential.

**The Author:** Geoffrey Garrett is the founding Chief Executive Officer of the United States Studies Centre and Professor of Political Science at the University of Sydney. He was previously President of the Pacific Council on International Policy in Los Angeles and before that Dean of the University of California Los Angeles International Institute. He has held academic appointments at Oxford, Stanford and Yale universities and the Wharton School of the University of Pennsylvania. He is a member of the New York-based Council on Foreign Relations as well as the Los Angeles-based Pacific Council on International Policy.

Professor Garrett is a frequent commentator on United States politics, economics and foreign policy in the Australian media. Among the most influential political scientists of his generation, Garrett is author of *Partisan Politics in the Global Economy*, editor of *The Global Diffusion of Markets and Democracy*, both published by Cambridge University Press, and over 50 articles in the world's leading social science journals.

A dual citizen of Australia and the United States, Professor Garrett was born and raised in Canberra and holds a BA (Hons) from the Australian National University. He earned his MA and PhD at Duke University in North Carolina, where he was a Fulbright Scholar.