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Geopolitical Consequences of the Global Financial and Economic Crisis: A Re-assessment After One Year

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Admiral (Retd.) Arun Prakash, thank you for honouring me by agreeing to chair this session. I must thank the National Maritime Foundation (NMF), New Delhi, the prestigious organisation which you head and Commodore (Retd.) C. Uday Bhaskar, its driving force, for providing me with a platform for sharing my perspective on what I consider a fascinating subject, with this very distinguished audience. This is the subject I spoke at length about a little over a year ago at this same venue. I thank the India Habitat Centre for once again extending their gracious hospitality to me this evening.

When I went to Beijing for the first time as a young diplomat in the summer of 1974, one of the impressive slogans of Chairman Mao emblazoned on hoardings at several venues in the city proclaimed:

“There is great disorder under heaven; the situation is excellent”.

The first part of the phrase is an apt description of what the world looks like today. The second part is somewhat more problematical, but there are some positive

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possibilities lurking behind the scenes of chaos. Chairman Mao's less revolutionary successors, too, may still find some contemporary merit in it from China's perspective.

In February 2009, I put forward, briefly, the following broad propositions:

- (a) The global financial and economic crisis, which hit the world at the end of 2008, was in the words of Robert Altman, "a global seismic event", whose impact would be transformational, altering, irreversibly the geopolitical landscape. However, it was too early then to discern with any degree of clarity, the contours of the emerging terrain.
- (b) The drastic and, admittedly, necessary measures adopted by major economies to avert a full-blown economic collapse would exacerbate the very imbalances that had led to the crisis in the first place. The monetary easing and the fiscal stimuli, running into trillions of dollars, would, in the short- and medium-term, create a new set of downside risks that may lead to crises further down the road, if not dealt with in a reasonable time frame.
- (c) At the heart of the imbalance, was the "joining at the hip" of the United States (US), as the world's largest fiscal and trade deficit economy and China, its symmetrical counterpart fiscal and trade surplus country. I had suggested that it would take an extraordinary and unprecedented degree of coordination and mutual understanding between the two countries to wind down the imbalance and attempt a soft landing. I had also drawn attention to the then apparent US strategy to try and co-opt China in achieving this benign denouement by offering the latter an influential role in shaping the emerging global architecture, both economic and political, and in writing the rules of a new chapter of the global game. I had hinted at the potentially adverse consequences for India of this emerging 'diarchy' or G-2.
- (d) Finally, I had explored the coping strategies India needed to deal with an uncertain and rapidly changing geopolitical landscape. I had suggested a hedging strategy, which I now describe as "engaging with all major powers, but aligning with none". It was also my contention that India would be unable to play a role in its larger region of Asia and the world, unless it did a better job of managing its own sub-continental neighbourhood. Since I have often spoken at length on this subject, I will refrain from delving into it today. This should not create the impression that it is less worthy of deliberation. It is not.

In the concluding part of my presentation last year, I had tried to identify some of the potential advantages, which the changing international landscape offered India, particularly if we were able to maintain our own rapid growth as a continental size economy. In essence, India's enduring search for expanded strategic space and autonomy could be significantly enhanced, if we looked upon the ongoing crisis as a historic opening as well.

So, where does the world and India find themselves a little over a year since then? Have the uncertainties become less? Are the contours of the new global landscape any more visible than they were then? How has India been coping with the dynamic unfolding of events these past months? What does the future look like?

It is now evident that the massive stimuli injected into major economies, to avert a more damaging and pervasive collapse, have been successful in meeting the immediate, more limited objective. The latest *World Economic Outlook* claims that the global economy is recovering at a rate stronger than had been anticipated earlier, though the nature and extent of revival is uneven across regions and countries. This may be welcome news, but it points to potential risks inherent in the very nature of the revival. Firstly, in major economies, such as the US and the United Kingdom and in several important Eurozone countries such as Greece, Spain, Portugal and Italy, which were already suffering from large fiscal and trade deficits, massive fiscal stimuli and monetary easing have averted immediate collapse only by deferring an even more painful and drastic rebalancing in the months and years ahead. Governments have borrowed heavily to replace private demand and spending.

In the US, for example, federal debt, as a proportion of GDP will rise from 41 per cent in 2008 to over 90 per cent in 2020. Interest payments on this debt will reach US\$ 900 billion per annum. The figures are even more alarming in the case of several other industrialised economies. As has been pointed out by the economists Rogoff and Reinhart:

"Government deficits cannot be increased in unlimited fashion. At some point, and generally rather dramatically, markets lose confidence in Governments' ability to pay and the game stops".

This tipping point may soon be reached in the case of Greece and the contagion may spread to Spain, Portugal, Italy and Ireland. In a densely interconnected global

economy, there may be no national or regional boundaries to provide the comfort of insulation. Therefore, it would be fair to say that the crisis has by no means played itself out. The nature of the dangers are even more serious precisely because there is no longer the fiscal and monetary slack available left to affected governments to deal with another severe crisis. For India, this points to the need for some serious contingency planning to deal with such an eventuality.

I referred to the centrality of the US-China equation in dealing with the structural imbalance, which lies at the heart of the crisis. Have the two countries demonstrated a willingness to acknowledge their almost symbiotic interdependence and an ability to work together to reduce the imbalance which engenders instability and risks a mutually destructive action and reaction process?

In my view, the US effort to co-opt China in its recovery strategy, by offering the latter the prospect of global co-leadership has failed. The Chinese perceived the US invitation as evidence of US infirmity and, therefore, an opportunity for strategic assertiveness by China. Despite its inferiority in various other components of national power and global reach, China saw its trillion dollar surplus as a potent weapon to change the geopolitical pecking order permanently in its favour. Such perceptions also led China to adopt a more muscular and sometimes overbearing, posture vis-à-vis other major powers such as Japan, the European Union and India. Consider what happened on the Dalai Lama issue. While commenting on President Barack Obama's decision not to receive the Dalai Lama at the White House, before his own visit to Beijing, an Indian political leader observed to a visiting dignitary:

"The Chinese frowned and Obama ducked".

But the fallout of this Presidential deference to Chinese sensitivity was that the Chinese, in their posture towards India, became increasingly vocal in their opposition to His Holiness' proposed visit to Arunachal Pradesh and even our own Prime Minister's visit to the state provoked strong criticism. Fortunately, we refused to succumb to such pressures.

The US expectations of any *quid pro quo* from China were, of course, thoroughly belied during President Obama's visit to China in October 2009. On none of the issues that the US anticipated Chinese cooperation, be it the revaluation of the Chinese Yuan, the sanctioning of Iran or leaning on North Korea to give up its nuclear

ambitions, were expectations met. Rightly or wrongly, there was a sense in the US, that its President had been treated as a supplicant. The US frustration led to a targeting of China – as an adversary rather than as a strategic partner, with common interests and responsibilities. The US had sought “strategic reassurance” from China. Instead it received a lecture on how it must respect China’s core concerns. US resentment resurfaced as sharp criticism of China at the Copenhagen Climate Change conference, and the prospects of diarchy receded. Both sides miscalculated. Both sides were victims of misperceptions. The point, however, is that the extraordinary and unprecedented level of mutual understanding and coordinated action required to enable the two countries to seek a “soft landing” was not forthcoming. This raises the risk to the global economy and may trigger a new and even dangerous polarisation in international affairs.

For India, the receding prospect of a Sino-US condominium is, of course, welcome since that would have restricted our own room for manoeuvre. The reference to India-Pakistan relations and the regional situation in South Asia in the Sino-US Joint Communiqué, points to the risks we confront in this regard. But Copenhagen created, unexpectedly, an opening for India, to leverage its position as a significant swing state. Faced with an unexpectedly negative and increasingly high decibel campaign by the West to paint China as the “Climate Villain”, thereby temporarily displacing India as the recalcitrant and obdurate naysayer, the Chinese leadership turned to India for support and relief. It goes to Prime Minister Dr. Manmohan Singh’s credit that he displayed no hesitation in agreeing to work together with China, to confront and eventually forestall the Western offensive at Copenhagen. Then, as if someone had flicked a switch, the negative projection of India in the Chinese media came to a virtual halt. This may not mean a fundamental change in India-China relations, but certainly, it restores a degree of diplomatic space to India and increases its regional and global leverage. How we utilise this unexpected advantage is a challenge which I hope our policy makers will rise up to.

The past year has thrown up some tangible features of the emerging geopolitical landscape:

- (a) Even though there is continuing uncertainty over likely developments in the global economy, there is no doubt that the large, emerging developing economies, in particular China, India, Brazil, South Africa and now Indonesia, are managing the revival of their economies better and displaying greater

resilience and dynamism. On the one hand, this is accelerating the overall diffusion of power and, therefore, promoting multi-polarity. On the other, it is reinforcing the shift in the centre of gravity of geopolitics towards Asia. Increasingly, it is Asia which will provide the engine for growth of the global economy. However, within Asia itself, the significant accretion of economic assets and need for accessing resources globally is already leading to a steady increase in regional security assets.

The rapid growth of People's Liberation Army Navy is a case in point. This issue is of special relevance to the NMF and its extended fraternity. Other countries in the region are also acquiring substantial military capabilities and there is a risk that the security environment in the region may deteriorate in the absence of a region wide institutional framework to manage and reconcile inter-state differences and potential conflicts. A unilateral assertion of its security interest by any country, such as China reportedly claiming that the South China Seas are its "core concern", on par with Tibet and Taiwan, would be difficult to accept by littoral countries, including India. For India, this points to the need for a significant upgrading of its naval assets and a much closer security relationship with Southeast Asia, Japan and Australia. While the US and India have been having more frequent naval exercises in this region – and the latest edition of the *Malabar* exercises is currently in progress – it is not clear to us how the US itself perceives the changing security environment in the region and in what manner it hopes to cope with its own diminishing pre-eminence and reach in the Asian theatre. In our interactions in Japan and Southeast Asian countries, we have come across a pervasive perception that the US preoccupation with the wars in Iraq and Afghanistan has relegated Asia-Pacific to a lower priority in its calculations. Even if these wars were to end soon, the US may return to Asia to find a vastly altered and probably irreversible landscape. This points to India developing its own perspective for the region, drawing upon US strengths wherever possible and feasible, but aiming to develop its own network of security linkages with the countries of the region. As I have had occasion to argue elsewhere, the Indian preference should be for a multi-polar Asia, no different from our preference for a multi-polar global order. We should aim at an open, inclusive and a loosely structured economic and security architecture in the region. We have the

capability to actively contribute to and participate in such a framework. Enabling such an outcome should be a strategic objective for our foreign policy.

- (b) If we look at the past couple of years, India's hedging strategy has been fairly successful. We have been able to adjust to and cope with a new US administration, whose priorities and preoccupations have relegated relations with India to a somewhat lower trajectory than during the Bush administration. We have begun to define our interest in Afghanistan independently of US objectives. The recent Chechen suicide bombing in Moscow provided an opportunity for India and Russia to revive a regional partnership, including with respect to Afghanistan, which helps the two countries to go beyond their largely military hardware relationship. We were able to deflect US and European pressures on climate issues, by forging a coalition with China, Brazil and South Africa and hold our ground successfully. This led directly to US acknowledgment of the influence of this group, when Obama negotiated the final version of the Copenhagen Accord with the BASIC (Brazil, South Africa, India and China) leaders, leaving other actors including the Europeans, out in the cold. The efficacy of BASIC will go beyond Climate negotiations. India's role in BASIC as also in IBSA (India, Brazil and South Africa) and the BRIC (Brazil, Russia, India and China), offers opportunities to increase its global leverage and relevance. This has helped India to deal with an uncertain and rapidly changing global environment with a degree of confidence.

Mr. Chairman, let me conclude by summing up the main elements of my presentation.

While major economies of the world have been successful in averting a debilitating economic collapse as a consequence of the global financial and economic crisis, the revival of the global economy is uneven across countries and regions. The fundamental and structural imbalances which led to the crisis in the first place, have not even begun to be addressed. In fact, the massive fiscal stimuli and monetary easing to deal with the immediate fallout from the crisis, has even accentuated these imbalances and have made several major economies vulnerable to sovereign default and prolonged stagnation. Therefore, the forces buffeting the geopolitical order are still at work and the global economy remains at risk.

India must engage in contingency planning and work out coping strategies in an environment fraught with continuing uncertainty and the very real possibility of new crises emerging.

Over the past year and a half, the larger emerging economies have demonstrated greater resilience and dynamism, in particular, the major economies of India and China, but also including countries in Southeast Asia as well as Republic of Korea. This is reinforcing the emergence of Asia as the new geopolitical centre of gravity. Asia may eventually become the main engine of global growth, but is also likely to acquire a much higher security profile. As the countries in the region acquire larger economic assets and their security stakes increase, this region will see the deployment of much more significant military capabilities, both within the region itself and in terms of force projection capabilities to safeguard extra-regional resource assets as well as transport and communication links. This points to the need for a new regional architecture to manage and reconcile divergent concerns and requirements of countries in the region and avoid unilateralism. India's preference is for an open, inclusive and loosely structured architecture both in the economic and security fields.

The prospects for a Sino-US condominium have receded for the time being but there remains the opposite danger of growing tensions between the two countries. Neither condominium nor confrontation between the two is in India's interest. For the present, particularly since Copenhagen, India's strategic space and room for manoeuvre has increased and should be leveraged judiciously while this window remains open.

There is need to continue with hedging as long as the international situation remains uncertain and in rapid flux. Building coalitions with other major powers, wherever interests converge and whenever opportunities arise, will continue to offer the best prospects for safeguarding and promoting India's interests. The success of BASIC at Copenhagen is a case in point. India not only needs a big picture or strategic vision, it also needs institutional capacity and a certain nimble footedness in identifying and exploiting what may prove to be short-lived opportunities. Our effort should be to use such opportunities to put in place, wherever possible, long term assets. I believe India does have a certain vision of itself and a consistent world view. These are rooted in our history, our civilisational values and the nature of our society and its ideals. Harmony in an increasingly globalised world will need universal values which respect diversity, tolerate plurality of views and are imbued with a strong sense of equity and justice. The Indian spirit, in its finest expression, embodies precisely these values,

embedded as they are in our character as a crossroads culture. Again, the world of the future is going to be one in which knowledge not material, will be the most valuable resource. The society of the future will be a knowledge society and the empires of the future will be empires of the mind, not territory. I believe that India and its people are well positioned to be the builders of such an empire in the future. And this truly should be India's "unending quest which began at the dawn of history" that Jawaharlal Nehru spoke so eloquently about at India's independence.

Thank you for your attention.