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The Strategic Risks of Systemic Instability

By Joel Ng

SYNOPSIS

The quest for strategic autonomy as a response to risk and uncertainty in international relations is understandable, but its limitations should be recognised and factored in to reduce potentially destabilising actions.

COMMENTARY

The world, we are increasingly being told, is getting less safe and more uncertain. Events such as the fresh outbreak of conflict around the Gaza Strip or the sudden game-changing developments over Nagorno-Karabakh give credence to this depiction. It has become common to develop “resilience” or to seek “strategic autonomy” under these conditions. The post-Cold War order, everyone seems to acknowledge, is unfit for purpose – challenged by people from the states who were its very architects and by rising powers who decry its inequities and outdated structures.

The Return of Cold War Jargon

As discontent with the current order prevails, scenario planners and policymakers have increasingly been pulling out old Cold War jargon. Vladimir Putin appealed to “indivisible security” as a reference to justify his invasion of Ukraine. It was not lost on observers that its original elaboration in the Helsinki Process was as a concept to craft a *peaceful* resolution to the Cold War. “Strategic stability”, a concept that historically referred to rational deterrence against nuclear first strikes and which was relegated to obscurity following the end of the Cold War, has subsequently come back on the table.

While most would say we are not in a new Cold War, observers searching for anticipatory reference points are increasingly looking back into the past and refreshing old terminology because of their revived salience. Yet, it should be obvious to us that

their falling into disuse was due to a process that had successfully neutered their threat: The systemic stability of the post-Cold War order.

The Contradictory Nature of Strategic Autonomy

How then is the post-Cold War order unravelling today? The critical part is rooted in the search for strategic autonomy. States increasingly seek the maximal latitude to respond to the prospect of continued uncertainty. As such, they are less inclined to rules-based frameworks.

Increasingly, agreements ranging from nuclear non-proliferation treaties to free trade agreements have become unfashionable. And as states prioritise autonomy over rules-based frameworks, they ironically create a system that is unable to generate the certainty of a predictability of action by its members.

But one may argue, surely states are rational and disinclined to travel down paths of lose-lose conflict? Should that not, as rational deterrence once did, be enough to provide guardrails against the outbreak of conflict?

The problem is that only nuclear weapons ever had enough force to provide deterrence through the prospect of mutually assured destruction. Conventional arms, on the other hand, have had the greater tendency to generate arms races, power struggles, and inevitably, a requisite number of conflicts to physically resolve who is mightier than whom.

Rational Destabilisation

More worryingly, institutionalists have demonstrated how individually rational actions can lead to systemically destabilising consequences. Douglas Diamond and Philip Dybvig, two of 2022's Economics Nobel Prize winners, illustrated this with their work on bank runs.

How do bank runs work? When individual depositors suspect that a bank does not have enough capital to cover the deposits of all its clients, it is rationally in their self-interest to withdraw their savings before the bank runs out of cash.

Furthermore, the fractional reserve lending system of modern banking assumes that banks only retain limited short-run liquidity. Indeed, as possibility turns to probability, it increases the urgency for depositors to withdraw their deposits, and it soon becomes a self-fulfilling prophecy. From a systemic perspective, it looks like panic.

If done quickly enough, the bank *must* collapse because its capital is invested in loans that it cannot recall quickly enough, or else in recalling loans, it might even trigger recessions as short-term interest rates skyrocket in response to the pressure. Not only do bank failures create disasters for their depositors, but their collapse creates further contagion and knock-on effects in the wider financial system.

How does this relate to the kind of instability we see today? States have largely been reliant on interdependence and found the global trading system adequate for their resource needs. But under conditions of strategic competition, states are increasingly

defining certain kinds of resources and components as “strategic” and then limiting their global availability through export controls, protectionism, or “reshoring” and “friendshoring”.

At an individual level, this is a rational response to uncertainty caused by increasing global competition and rivalry. But as states limit or protect their strategic resources, they increase the scarcity of these resources and trigger other states to take protectionist measures in a vicious circle. Like bank runs, this individual state-level logic is rational, but it generates systemic instability. As these actions escalate or intensify competition, the likelihood increases that such acts will be determined to be hostile, requiring more forceful retaliations.

Dampening Tensions

While Diamond and Dybvig’s brilliant solution to bank runs was the implementation of deposit insurance, such a policy does not quite translate to strategic resources and components. However, their dual-use nature, increasing importance in digital economies, and the destabilising effects of monopolistic practices in controlling them, suggest that they have the characteristics of public goods. Discussion must be initiated on maintaining inclusive, open access, rules-based orders for their allocation against mercantilist tendencies that historically led to conflict.

Moreover, as institutionalists have demonstrated time and again, just because an action is rational does not mean that it cannot have systemically destabilising effects. Confidence-building measures are in urgent need of rethinking, and part of this conversation might include the way states may actively try to dampen tensions, rather than focus solely on inward resilience. This onus should be greater on states aspiring to global leadership.

It should not be lost on us that the previous rules-based order was itself a solution (however imperfectly implemented) to problems that we are now seeing resurface as the present order is challenged. As Nobel Prize laureate, Amartya Sen, argued in *Development as Freedom*, the creation of institutions (including rules-based ones, when they were conducive to growth) allows for the expansion of choice, and sometimes self-restraint in some areas pays much greater dividends elsewhere.

The desire for strategic autonomy should not come at the cost of destabilising the larger time-tested system.

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