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Perspectives



The Hostile World: Part 1 - Coping With Geopolitical And Economic Uncertainties

Some days, it looks like the situation in Iraq is getting better. And that's when a chorus of voices tells us that the oil price will soon drop, the stock market will rally and prosperity will be restored. Indeed, during my 35 years in the financial industry, I've noticed that analysts are almost always too optimistic. Some of you will attribute it to human nature; others will take a more cynical view and conclude that analysts have a vested interest in making the world look better than it is.

Decades of Dislocation

"This is not the end. It is not even the beginning of the end..." said Winston Churchill during the darkest hours of World War II. When I look at the discontent of the Muslim world and the growing threat radical Islam poses to all centers of political and economic power, I'm reminded of Churchill's words. Geopolitical dislocation will be with us for some time to come and, most likely, dominate not only our lifetime but also our children's.

The sources for today's massive unrest are manifold. Among other factors, economic opportunity is not a universal phenomenon, socio-political systems vary dramatically and educational standards are seriously lacking in many developing nations. Add to that an explosive demographic profile, in which most first world Western countries have a distressingly low birth rate, while populations in many third world nations are exploding. The most massive population increases are in the Muslim world, which adds to the volatile mix.

But let me deal concentrate on geopolitics; in the next issue I'll deal with demographics and what it'll all mean for your portfolio. As I said at the beginning—I believe tensions in various theaters will remain extremely high. One reason is that the US is extremely preoccupied in Iraq; another, that the US and its former allies remain divided on key issues. Given these circumstances, "rogue nations" like North Korea, Iran or Syria feel emboldened to push far harder than if Washington were less occupied or could draw on help from its former allies.

The current showdown over Iran's nuclear ambitions is a case in point. Despite the fact that the US has risked a further escalation in Iraq's Shiite centers (over which Tehran's ayatollahs have enormous influence), and despite the fact that the European Union is taking a harder line, Iran continues to push ahead. And why not? With economic sanctions already in place, the worst thing that can happen is a pre-emptive strike against the country's Bushehr nuclear reactor. A strike executed by the US or Israel (the two nations capable and willing to go that far) would probably translate into minimal collateral damage, but would fuel anti-American sentiment throughout the Islamic world even further.

Much is being written about past mistakes, especially as the US presidential election is entering the home stretch. I think it's important to appreciate the causes of what we're now witnessing, but I think it's even more vital to understand that the only long-term solution is education. That, however, is easier said than done. Think of how agonizingly slow Westerners are to recognize the need to reduce dependence on fossil fuels (in spite of a plethora of educational tools and the broadest imaginable access to them); then try to time how long it will take for the impoverished masses coming from Islam's *madrasa* schools not to hate what is Western. Given their scant access to comparative sources of knowledge, I would think several decades.

Not All Muslims Are Terrorists

"Not all Muslims are terrorists," concluded a prominent Arab journalist in the wake of the wholesale slaughter of Russian school children, "but at this time all terrorists happen to be Muslims." For nearly three years now, I've said that the War On Terrorism will gradually morph into the War On Islam. Governments will never call it that, but that is irrelevant—signs of that transition are now abundant. The reality is that people in the nations of the West, Russia, China and South East Asia are coming to view the Muslim educational system as the cause, and radical organizations like Al Qaida as the instrument, of destruction. Islamic fundamentalism has become the enemy of the world. As this process gains momentum, Muslims around the world will feel even more disenfranchised and isolated, which will help terrorism gain even more supporters.

But a world united in the view that radical Islam is the central threat to stability does not make for a world that agrees on how the problem should be tackled. On the contrary, tensions between those who oppose the terrorist agenda are likely to rise. Russia recently announced that, like the US, it will prosecute terrorists anywhere in the world. Reading the Russian communiqué between the lines is easy—Moscow's viewpoint is that attacks on its territory have frequently been staged from the Republic of Georgia, a US client state. If Washington can't compel its Georgian allies to keep Chechen rebels under control, Mr. Putin hinted, Russia will do the job.

Tensions between Would-Be Allies

Some say that such tensions between would-be allies would never have occurred if President Bush had not acted unilaterally. I agree that responding with a "committee" of allies might have given Washington greater moral authority, but there is little doubt that it would also have badly impaired efficiency of execution. Critics of the unilateral approach forget how rocky US-European cooperation was during the various military campaigns against Milosevic's regime, when France consistently tipped off Belgrade as to the exact bombing sites targeted by the allies.

The reality is that each of the major powers has its own cultural baggage—not to speak of its particular commercial interests. President Chirac's pitiful recent entreaties that two French journalists should be freed, because France had opposed the invasion of Iraq and was a friend of the Arab world, illustrates the point. Those who suggest that the US would be in considerably less trouble if it had acted like France should take note that Chirac's plea has, so far, not yielded any results. Arab leaders marshaled the combined power of the Islamicist propaganda apparatus to broadcast that French subjects should be left alone—but to no avail. The simple fact is that the disgruntlement of radical Islam is so massive and its educational orientation so twisted, that no dose of reason can possibly prevail.

Another reality of the terrorist equation is that reason cannot, by definition, be part of it. Terrorism has only one aim: to terrorize. And in order to achieve that, terrorists always have to keep surprise on their side. While the machinery of the state is highly predictable, because it's driven by policy, terrorist acts occur randomly, both in terms of time and place. If they don't, terrorism no longer evokes terror.

Instability the Hallmark of Our Time

Where does that leave us? In my opinion, the war which started on September 11 of 2001 is only just in its first stages. The United States will remain deeply engaged in the Middle East, whether under President Bush or Mr. Kerry. Part of the reason is that Iran, Syria and others are deeply hostile towards the Western agenda, which will make for ongoing fireworks all by itself. Another part is that those Middle Eastern nations friendly to the West or dependent on it will come under increasing pressure. Saudi Arabia, Kuwait, the UAE, Oman, Jordan and Egypt are all castles with rotten foundations. My expectation is that at least half of them will fall during the first part of this century.

Major trouble can also be expected in South Asia. The Afghanistan campaign has been a success in that it ousted the Taliban, but a singular failure in creating a stable nation. Outside of Kabul, all is chaos. The idea of "nation-building" in Iraq is deeply flawed. The Iraqi state was created out of thin air at the 1919 Paris Peace Conference; coexistence between Shiites, Sunnites and Kurds has never worked and never will. Then there are Iran and Pakistan—both on the verge of revolution, civil war or complete collapse.

President Putin has spent the past couple of years consolidating his power in Russia and now finds himself threatened by Islamic fundamentalists in Chechnya and the Caucasus. I have no doubt that he'll do everything to annihilate the terrorists, even if that means invading Georgia and crossing the US.

China, deeply preoccupied with economic challenges and internal social tensions, will gladly look the other way when the US and Russian campaigns against terrorism hit the occasional pothole. The expected trade-off is that Beijing wants to be left alone to pursue its own hemispheric ambitions.

Which only leaves Japan, Europe and the UN, all three of whom are, for purposes of geopolitical analysis, irrelevant. Japan has little choice but to support the United States. Not doing so would leave it exposed to China's designs which, without any defensive capacity, is a dangerous proposition. Europe is deeply divided and cannot, by the established articles of the European Union, make any foreign policy decisions without achieving complete unanimity between its 25 member nations. And the UN, increasingly, is a toothless debating club whose main purpose is to provide a convenient cover for the world's major powers during times of moral failure.

Agenda Controlled By Terrorism

These overall circumstances embolden me to make some predictions:

-With the US, Russia and China preoccupied on far too many fronts and Europe internally divided, control of the geopolitical agenda remains firmly in the hands of Al Qaida. The idea that the capture of Osama bin Laden or any one of the other senior operatives of the terrorist cartel would fundamentally change things is utterly naïve.

-Different cultural values and varying economic interests will continue to prevent an effective alliance against radical Islam. On the contrary, the growing threat of terrorism to all major powers will continue to destabilize historical relationships.

-Extreme instability will sporadically dislocate financial markets and place enormous strains on social policy, especially at a time of explosive migration from the Muslim world to Western nations.

-The wars conducted by each of the major powers against radical Islam will increasingly curtail the civil liberties we are accustomed to. They will also cost trillions of dollars, which will impair economic growth and undermine government finances.

The bottom line is this: geopolitical developments will guarantee massive instability for some time. To expect that financial markets or the quality of our lives will not be affected would be highly imprudent. Moreover, geopolitics are only one source of uncertainty—as I'll explain in the next issue of Perspectives, explosive demographic changes will also have a deep effect on the next few decades. The dramatic changes ahead mandate major adjustment in our thinking...from how we lead our lives to how we invest. I'll present my conclusions next month. □

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