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SPEAKER: IAN BREMMER

Ian Bremmer is the president of Eurasia Group, the leading global political risk research and consulting firm.

Ian Bremmer created Wall Street's first global political risk index, and has authored several books, including the national bestseller, *The End of the Free Market: Who Wins the War Between States and Corporations?*, which details the new global phenomenon of state capitalism and its geopolitical implications. He also wrote *The J Curve: A New Way to Understand Why Nations Rise and Fall*, which was selected by *The Economist* as one of the best books of 2006, and *The Fat Tail: The Power of Political Knowledge for Strategic Investing*.

I'm going to talk about China tonight, as well as state capitalism, and I suspect people here will want me to address the Middle East. I will do so. And I'll take questions on whatever you like, frankly, as long as it's within my general purview.

Let me start globally. I always like to give people a little taste of what my world view is. It's not a pro-U.S. world view and it's not an anti-U.S. world view. It's not Democrat or Republican. I'm not Jim Carville. I'm not Karl Rove. I'm just a political scientist.

At Davos a few weeks ago I was talking about the fact that the

G20 is effectively for global economics what the U.N. Security Council is for global politics; it doesn't do very much. And the South Koreans and the French ministers and so forth were on the stage and they were giving me a hard time. They said, "What do you want? Do you want a G192? Do you want everyone in? What do you want? You want a G7? You want to go back to what it was? Is that what you want?" And I said, "I'm not a politician. It's not about what I want. It's about what you have."

This is analytic. It's not an aspiration. So I want to start you with my world view as a political scientist. It starts a little bit like this: in the last forty years, if there was one thing that you did not want to get wrong as an investor, as an executive, as someone with a pension, as someone with kids, it was globalization. And when I say globalization, I don't mean the world getting closer.

I mean multinational corporations based in Western advanced industrial democracies taking advantage of increasingly global economies, global consumer markets, global labour markets and global capital markets. I am talking about multinational corporations in the West with a set of rules that were established by developed states reaching out to emerging markets and bringing their goods, their manufactured goods, their labour, to markets closer to us. That was what globalization was for the last forty years. Globalization is not over. But the specific globalization I just described is. And we have not yet come to terms with that. We are in a new world order.

I wrote a book called "The End of the Free Market." Do I really believe that the free market is over and if I do, do you want to listen

to me? I do believe the free market is over: not in Canada, not in the U.S., not in Europe, but globally. Globally we had a free market for a long time; sometimes well-regulated, sometimes very badly-regulated.

In the post-financial crisis world you have two economic systems competing; a free market system and a state capitalism system where the state is the principle actor in the economy and uses markets for political purposes. When I started this book I had this very interesting phone call from the Chinese Embassy. It was He Yafei, China's Vice-Minister of Foreign Affairs. He's not very well known but just to give you a little colour on him, do you remember the failed Copenhagen Summit on climate change, when Obama did not meet with Hu Jintao at the last minute because Hu Jintao didn't want to show up? The guy that ended up showing up and meeting with Obama was He Yafei. So he gets around.

We met, and the first question he asked me was, "Now that the free market has failed, what do you believe the appropriate role of the state in the economy should be?" And this has been one general response that you hear post-financial crisis -- the Western model and most particularly the American variance of the Western model, has failed. As a consequence these other states that are now part of the G20 feel they should really go ahead with their own models: the Brazil model, the Beijing model, the Jakarta model, the Argentina model -- God bless 'em -- which is basically default whenever you can and repeatedly. I think that's their model. It seems to work for them. That is one response.

There is a second response, equally ideological and that is yes, the free market has failed because Obama is a crazy socialist and he's

going to drive the U.S. into looking like France. I hear this one a lot. Again, I'm a political scientist. I'm not particularly ideological. I don't think Obama is a socialist. He is certainly not a state capitalist, nor do I believe that the free market has failed. I believe two different things go on that are problems in our two different systems.

In state capitalist societies you do not want volatility. You don't want eight percent growth one year and two percent the next, or 15 and two. What you want is to make sure that you manage inflation, manage the currency and you manage state investment so that you can smooth it out so that you don't have the kind of social instability that could upset your political survival. And by doing that you create structural inhibitions that don't get rid of the bubble, but that make sure the bubble you eventually get will be further in the future and much bigger. In other words, state capitalism works really well until it doesn't.

At the beginning of the 20th century, if you were in Europe looking at the Western Hemisphere, you could not have been sure whether Argentina or the United States was going to be the big success story. You had these gauchos from Buenos Aires who were very, very cultured and charismatic and they seemed quite cosmopolitan and it looked like they were going to do very, very well until their state capitalist system ran out of land. And then they had problems.

When you've got cheap stuff, you can do really well. You run out of cheap stuff and it's a problem. Saudi Arabia does really well with cheap oil. If they run out of cheap oil they'll have a problem. Venezuela did very well until they destroyed their economy and today

if oil goes under 85 -- which won't happen tomorrow -- they will run a deficit. That's astonishing. If you go to Calgary you actually see Venezuelan engineers there because they can't get jobs in Venezuela. They hate it there. It's cold. But they're there.

If China runs out of cheap labour it's in trouble. But there's the rub. China's not running out of cheap labour. They are in Shanghai, where per capita income is \$14,000. But they're not in the interior of the country where over the next ten years 300 million additional Chinese are going to be moving into urban centres. The average hourly wage for manufacturing in China is \$1.25, give or take a couple of cents. They're immensely productive and so the ability of the state capitalist system to continue to pose a serious challenge internationally for the purposes of the near-to-medium-term future, which is all we really care about, is very, very high. That is the problem with the state capitalist system.

The free market system has a problem as well. But it's a completely different problem. In the state capitalist system the state captures corporations and in free market systems you have to guard against corporations capturing the state, which is what happened in the U.S. in the financial sector, in the oil drilling sector and perhaps in the automotive sector. Not in the technology sector; it didn't happen in places where you have lots of competition with folks who have a lot of different interests.

But when you have regulatory policy that is made by a very strong lobby that is focused on allowing short-term maximization of profitability and compensation which supports CEOs and shareholders

at the expense of long-term sustainability, you have a problem that creates massive bubbles in volatility in the short term. It's a very different kind of problem.

I think the big secret about the free market is that CEOs don't want free markets. They want monopolies. They want subsidies. Bob Zoellick, when he was U.S. Trade Representative, said he was so frustrated because 98.5 percent of the people that came to him -- and Zoellick is a free market guy -- were looking for handouts and an unfair advantage. They had political connections. Now, to be fair to the corporate CEOs, if they can't get monopolies and subsidies, they damn well want to be sure that their competitors can't get subsidies and monopolies either, which means that the second best outcome is a well-regulated free market, which is why we have government regulations. This is obvious to Canadians but to Americans we have a problem.

That is where we are on the free market versus state capitalist spectrum. Thinking about that globally, we want to talk about Europe for a second. Europe over the last decades has been a story of convergence. No matter whether you were fiscally responsible or irresponsible, you basically had the same credit rating, you had the same ability to arm, you had the same ability to provide quality of life and spend what you wanted because you were part of Europe. That is, until the crisis became severe, until the bond vigilantes in the market said this is ridiculous, we're not going to support this anymore.

And so we saw divergence. We saw massive divergence. We saw that what was happening in Greece and Portugal and Spain was no

longer sustainable. Now, I do think the Spaniards are doing a surprisingly good job of engaging in real reform, much more than Angela Merkel would have expected. I do think that helps because if the other countries are irresponsible, well, they are comparatively small, and I think the Germans are taking a leadership role. All of those things will facilitate a messy at times and ugly at times eventual resolution. We can talk about that.

But the reason I bring it up is because the divergence has become sufficiently grave that the Europeans in the core states and the peripheral states are actually taking the conversation seriously. They recognize that bills have to be paid. They recognize what those bills are going to cost and that it is fundamentally zero sum. German taxpayers can pick up more and Greek taxpayers can pick up less and vice versa. There's a rebalancing happening in Europe which is huge. They've gone from East-West, New Europe-Old Europe, North-South, Rich Europe-Poor Europe, in a matter of just a few decades. But they recognize the problem and they're addressing it.

My argument is that globally the same thing is happening. Over the next 20 years, depending on who you talk to, 60 to 75% of the world's economic growth will come from emerging markets. The fiscal dynamics of the United States, Europe and Japan are not sustainable. We know that the consumption patterns in the U.S., the world's largest economy, are not sustainable; the U.S. dollar as the reserve currency is not sustainable over the long term. We know all of this. We know that consumer growth will increasingly come from countries like China, India, Indonesia and Brazil. We know this.

And yet we are still acting as if there were convergence. We are talking about a G20. We are talking in terms of win-win. We are talking in terms of a level playing field. Yet we are entering an environment where the world's two largest economies increasingly have fundamentally different views about the future. In other words we're entering an environment where we're going to see much more zero sum behaviour economically at the global level. That, in my view, is not compatible with the kind of global growth projections that we keep seeing from the major banks, however excited we are about the U.S. upturn right now.

That's what I wanted to talk about in terms of the global view. I'm happy to talk about what the Chinese are doing and where U.S.-Chinese relations are going, but let me spend a few minutes on the Middle East because it's in the news, it's real.

Let me again start with the big picture. Revolutions can go in many directions. There was a revolution in Georgia many years back, the Rose Revolution. President Eduard Shevardnadze, former Foreign Minister of the Soviet Union, was a died-in-the-wool Communist and a famous, famous Georgian. The great thing was if you went to the Caucasus they'd say the Armenians have the Diaspora, the Azores have oil but the Georgians? We have Shevardnadze. That was then. The revolution came and Shevardnadze was gone, his cronies in government were gone, his cronies among local business were gone, oligarchs were gone, his cronies in the military were gone.

Georgia's economic orientation changed 180 degrees and their political orientation was a new and complete democracy where the

average age of civil servants was in their late 20s. And their security orientation went against Russia, so much so that the Russians eventually invaded. Now that is a successful revolution. In the broad scheme of revolutions, in the artificial intellectual hay that political scientists would make it is on one side.

On the other side is the Green Revolution in Iran. They tried, they gave it a shot. The others shot back heavily and at the end of it the opposition parties were shot down and smashed. Opposition newspapers were closed; opposition academics and deans with tenure were stripped of their posts. And if you look today at Iran you see a government that is more hard-line on balance than it was five years ago and that has less of a threat from organized opposition than it did. Now that, my friends, is an unsuccessful revolution.

I say this because we are now in the midst of a series of what the media have told us are revolutions that are going to cause a domino effect, contagion and tipping points absolutely everywhere in the Middle East. I am skeptical. Tunisia as a revolution was closer to the Georgia end of the scale, Egypt was not. They got rid of Mubarak, but the military didn't go anywhere. By the way, the military was supporting Mubarak right up until the moment they realized they might as well let him go because it was going to be more problematic for them to keep him. He's still in the country and they'll probably fight for him to have immunity should that come up.

What you are going to have in Egypt is very similar to what you had in Turkey in the early 1990s, which was a strong military, very weak political parties that formed very weak coalitions that lasted on

average 18 months and that were incapable of bringing about major political and economic reform. A big difference is that in Turkey they were part of the European Union process which meant that there was a strong institutional guiding principle that allowed them to eventually undermine the position of the military. The E.U., however, does not extend across the Mediterranean to Egypt. So that process will not be in place. The revolution was somewhat successful in Egypt. You would never know that from reading Time Magazine's cover story this week where they found a couple of very charismatic Egyptians who speak English that they were able to interview.

We're getting it wrong. So which countries going forward are going to be destabilized? Not the ones in the Persian Gulf. The Bahrainis decided that when things got unstable they were going to provide \$3700 to each of their 37,000 citizens. The point is that the Bahrainis have an average per capita income of \$25,000 and I know that throwing cash at people that are demonstrating sounds crass, here in Toronto. It even sounds a little crass as an American. But in Bahrain it's actually really effective because that is what the basic social contract of legitimacy in the government is all about. And so you're not going to see instability in the Emirates or in Oman or in Saudi Arabia. In the energy producing states most of their unemployment is exportable. It's Bangladeshi, it is Pakistani.

Two days ago I got an email from someone in the region showing me the first demonstrations they had in Saudi Arabia, and it was clearly Pakistanis and Bangladeshis in hardhats that wanted more money. It was a real demonstration but if they push too hard they will be sent back. The Saudis will just hire different workers. That's what

they do. These guys are on six-month visas. It's not romantic.

So Bahrain is very interesting and I just want to share an anecdote about it. After the demonstrations started in Bahrain the Saudis held an emergency meeting of the Gulf Co-operation Council where they told the Bahrainis they were going to provide security support. But they also pressured the Qataris to stop covering Bahrain on Al Jazeera. I have not seen this reported, but the next day Al Jazeera coverage of events in Bahrain dropped to five percent of what it had been. One of the reasons that this isn't going to expand to say, Venezuela, is because Al Jazeera matters.

Where do I think there is potential for broader instability? Yemen. I'm not sure we'd notice though, because it's already close to a failed state, not because it doesn't matter. Algeria might have a little instability but they'll repress it strongly; Morocco absolutely not, in fact they'll probably get rid of the prime minister because he's very popular.

Libya of course, is the big problem. There are three things in the Middle East to which we need to pay attention. The first is Libya. Libya is like the North Korea of Africa. You've got a charismatic crazy guy that's running the country with really no grounded and stable institutions. The military is very weak though well paid. The tribal structure such as it is, is very strong but doesn't actually create strong institutions; it is a little closer to Afghanistan than it is to Iraq. And so I look at the potential outcome and I have no idea how long Gaddafi is staying. I have no idea if at some point he will say, this is just too hard and I'm leaving the country, I'm killing myself, or whether someone

close to him will take him out. I have no idea.

But what I do know is that there aren't any actual good outcomes in Libya. There are a lot of people getting killed, but even if Gaddafi goes, well, let me put it this way: imagine what would have happened if Saddam Hussein had been taken out, the Baathists had all been taken out and then the United States had said, "Done. No military on the ground, no humanitarian aid of any significance. You guys figure it out." That's closer to what Libya will look like. In other words, we're going to see a lot of oil off the market from Libya for a long time. Now, from a market perspective the best outcome is probably Gaddafi represses everyone and stays in but I don't think he'll be able to. So that's one bad story. It won't lead to contagion in the rest of the region but it's ugly and it's going to affect oil markets.

The second bad story is that Iran is being emboldened by all of this. Demonstrations in Bahrain are cheap. The new government in Lebanon that came about before all of this is close to the Iranians and of course there has been the empowerment of Hezbollah. The Iranians feel a little bit looser as a consequence of all the current pressure on Arab states. And the Iranians have not had much to say about Bahrain because they don't want to be out front on that issue and give the Saudis any excuse to engage and blame them.

But they have been quite supportive of the revolts in the Arab world. And they've done it across the board. To everyone that's been talking about how the Iranian government is falling apart and how there are all these schisms in Iran, I would like to ask how come I haven't heard anything from those people in the last three weeks. In

fact, the Iranian government has been speaking with one voice ever since this started. That should tell us something. And the ability to move those warships through the Suez and push oil prices up – from which the Iranians benefit -- that should tell us something. So we don't yet know how provocative the Iranians will be as a consequence of these changes, though we should start to be concerned about that. We shouldn't be concerned about Israel going to war but Iran is a different story.

The third thing we don't yet know is how bad U.S. relations with Saudi Arabia have gotten. Obama clearly is much more popular internationally than was Bush. And a lot of countries that think the U.S. isn't very effective right now still think Obama's a reasonably good guy. One place where that is clearly not true is Israel, though Obama's tried to improve his relations with Israel lately – he's changed positions on missile defence and shown a willingness to back off of the settlement issue in the West Bank. Still, they would have preferred McCain.

But the one country that has really seen their relations with the U.S. go off the rails because of Obama is Saudi Arabia. Part of that is because Saudi Arabia doesn't really have a governing structure. They have a few people that are in charge and they make the big decisions. The Saudi royals' personal relationships with the Bush family were very strong and long-lasting but with Obama and Rahm Emanuel and other White House insiders, the Saudis don't have those same easy ties. On top of this, Obama's relations with oil CEOs in the U.S. -- who are the folks that the Saudis are closest to – were, at least before he became president, absolutely non-existent. So the Saudis were already

skittish about Obama.

Then when Obama came out and started hedging in terms of not fully supporting the demonstrators but also not standing behind the Egyptian regime, and the same in regards Bahrain, the Saudis started going a bit nuts. Three days ago I saw one of the Saudi princes actually contradict Petroleum Minister Nahimi on oil. That may not sound like much but the princes never talk about oil directly. That's new. The Saudis never argue like that in public. People always ask me what's going to happen after Abdullah dies. And what I know is that internally it will be a disaster, but externally it will be like the Vatican. We'll know nothing and then -- white smoke, gray smoke.

So we are in danger of seeing the Saudis, which means OPEC, start playing considerably less ball with the United States, which would have an impact on how they price oil and on how they think about countries in the region. It's important on many levels and we don't know where it's going.

If I were advising Obama, I would tell him to fix things with the Saudis right now, because strategically both countries are aligned in many ways. But there is not much trust there. And remedying the situation is something that can only be done at a high level, and frankly the Obama administration is not doing foreign policy at the high level. They're doing domestic policy at the high level. They're much faster to go on the offensive against the Republican Governor of Wisconsin for bashing the unions than they are to go on the offensive against Mubarak. That is their strategy. It's a strategy that's working for them.

When I was at Davos I met with the Jamie Dimons of the world, these CEOs who hated Obama before the mid-terms. They're fine with Obama now, because he's going to win. And in the U.S., corporations will always back a winner. Obama's figured that out and he's not going to go do Obama foreign policy. We're two years in and there is no Obama Doctrine. There was a Bush Doctrine. You may not have liked it but there was one. There was a Clinton Doctrine, a Carter Doctrine, a Reagan Doctrine. There is no Obama Doctrine because he doesn't see any advantage in sticking his neck out on foreign policy. And without the U.S. are the Europeans or the Japanese going to?

So that's where I think we are on the Middle East right now. I haven't covered as much as I would have liked to and I haven't talked about places like Russia and India. But I'd be delighted to. I'm happy to take any questions or comments.