

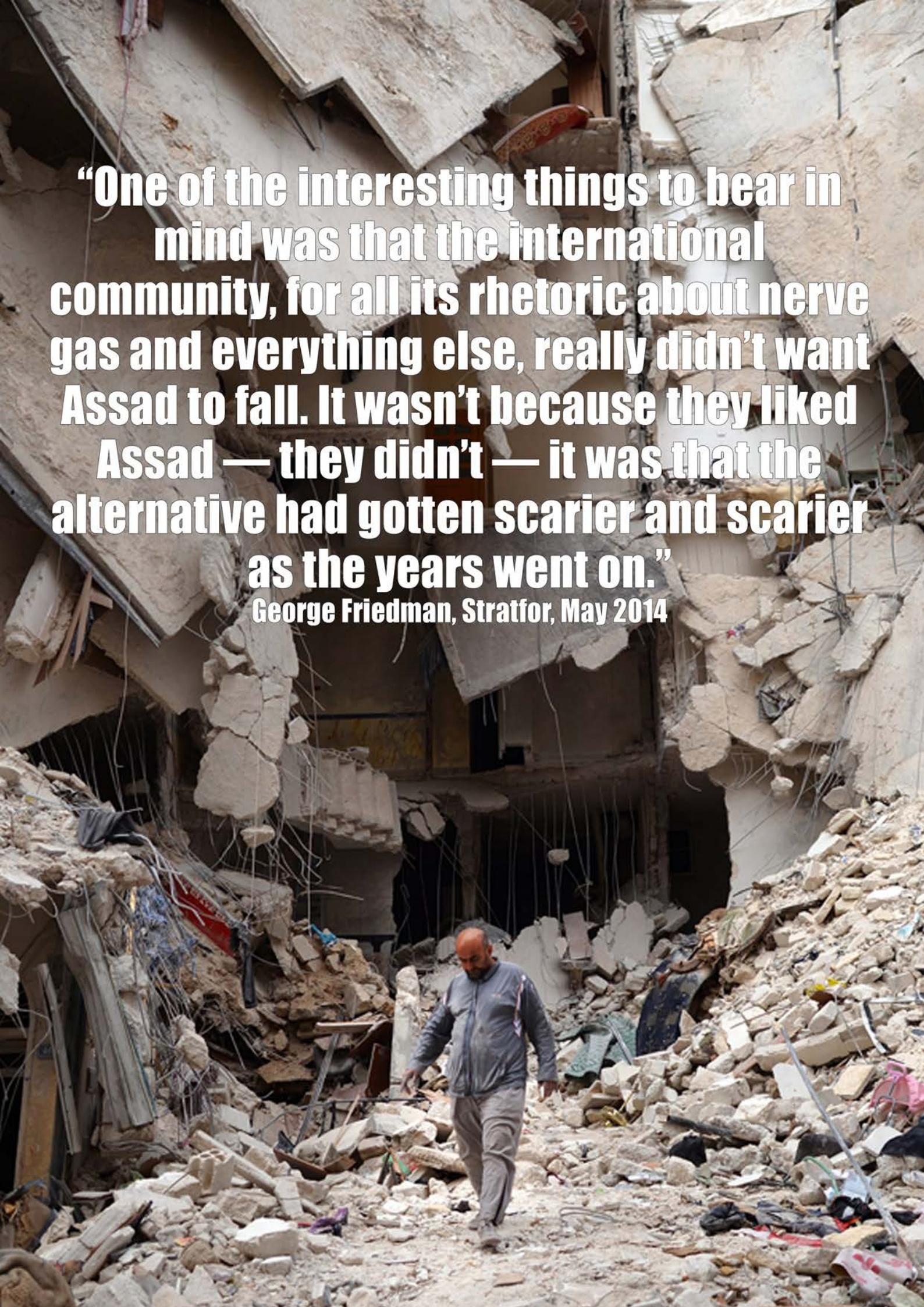
# STRATEGIC ESTIMATE 2015



**Adnan Khan**  
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**“One of the interesting things to bear in mind was that the international community, for all its rhetoric about nerve gas and everything else, really didn’t want Assad to fall. It wasn’t because they liked Assad — they didn’t — it was that the alternative had gotten scarier and scarier as the years went on.”**

**George Friedman, Stratfor, May 2014**



# Introduction

*Strategic Estimate 2015* is Khilafah.com's fifth annual assessment of the global balance of power. We concluded our 2014 assessment with the US remaining the world's superpower as it began rapprochement with Iran and through ensuring real change did not take place in both Egypt and Syria. In 2014 developments in the Middle East saw US military action in both Iraq and Syria and this has dominated the attention of US policy makers in 2014.

In 2014, a nation on the edge of Europe drew the attention and intervention of the world's powers. On its anniversary, Ukraine is still being fought for by the EU and the US on one side and Russia on the other side who annexed Ukrainian territory in 2014. In *Strategic Estimate 2015* we assess the position of the world's powers and their attempts to steer Ukraine away from Russia's clutches.

Russia in 2014 saw the overthrow of the Viktor Yanukovych, someone the Kremlin brought to power in 2010 in order to reverse the 2005 Orange Revolution in Ukraine. A stand-off ensued for all of 2014 with Russia making various moves to counter western attempts to bring Ukraine under Western control. Russia's 'Asian' strategy of reducing both energy and trade dependency upon Europe continued in earnest with the historic deal with China for the export of \$400 billion worth of gas from the Russian Far East to China over the next 30 years. The impact of this on Russia's position in the world and the ramifications of what is taking place Ukraine will be assessed.

The Middle East once again attracted the attention of the world with the crumbling of Iraq, the continuation of the struggle in Syria and the emergence of ISIS in the region. In 2014 the post-Arab spring architecture was laid by the countries that experienced uprisings. With the declaration of Khilafah by ISIS the regions importance once again attracted the attention of the world's powers. In *Strategic Estimate 2014* we asses all these developments.

In *Strategic Estimate 2014* the sustainability of China's rapid economic growth based upon low wages and aggressive exports showed the unmistakable signs that as a model it had run its course. Throughout 2014 China's leadership initiated the first of many new programs aimed at economic transformation, including an unprecedented anti-corruption drive in the political realm. In *Strategic Estimate 2015*, we assess the challenges that lay ahead in this colossal restructuring and what the current economic slowdown means for China's attempt to become a regional power.

As the global economic crisis shows little signs of ending soon this has continued to strain relations between the European Union's member states as well as relations within a number of states. Both Scotland and Catalonia had referendums in 2014; showing separatist tensions remain a major issue in Europe. Tensions escalated between Germany and France in 2014 as France challenged German leadership in Europe and questioned the German deficit and debt targets. Over the past five years, Germany has used the European crisis to carefully introduce controls on the fiscal systems of EU members but as the economic situation struggles to improve friction between Europe's powers is growing. *Strategic Estimate 2015* will assess the economic situation in Europe and how the policies to overcome these are faring.

The global economic crisis reached its seventh anniversary in 2014 and the performance of the world's premier economies during the year highlighted the underlying factors that led to the global economic crisis still persist.

In 2014 'MINT' entered the global political lexicon, alongside the BRIC nations. Mexico, Indonesia, Nigeria and Turkey (MINT) became countries considered most likely to assume a place at the high table of economic success and political power. Tipped to follow Brazil, Russia, India and China (BRIC) they are considered to teeter on the cusp of potential greatness. In *Strategic Estimate 2015* we assess their political and economic prospects.

What follows *inshallah* is the author's opinion and assessment of 2014 and the trends for 2015 and beyond. Like any assessment, they are estimates and forecasts.

**Adnan Khan**

9 Rabi' al-Awwal 1436 AH

31<sup>st</sup> December 2014 CE

# Ukraine

Ever since the collapse of the Soviet Union, Ukraine has been a political football with both Russia and the EU fighting to bring the nation into its orbit. Ukraine has always been on the edge of empires, the name 'Ukraine' literally translates as 'on the edge.' Throughout history it has been part of Tsarist Russia, the Ottoman Caliphate, Poland and the Soviet Union in its most recent history.



With its economic situation dire in late 2013, the Ukrainian Prime Minister at the time Mykola Azarov confirmed he requested €20 billion from the EU for financial assistance to shore up the nation's finances due to its economy being in recession.<sup>1</sup> This request was turned down by EU officials. Ukraine spent years trying to negotiate with Europe over closer integration with the bloc. The association agreement which was to be signed in November 2013 would have tilted its foreign and security policies, justice and home affairs, and most important, its trade agreements toward Europe. Scheduled to sign the agreement at the Eastern Partnership Summit on the 21<sup>st</sup> November 2013 in Vilnius, Lithuania, the Ukrainian government refused to sign the deal and instead proposed the creation of a three-way trade commission between Ukraine, the European Union and Russia that would resolve trade issues between the sides. This rejection is what triggered large protests on the streets of Kiev.

These demonstrations throughout the freezing temperatures in December 2013 grew from initially small protests, but swelled when security forces cracked down upon protesters. Protesters occupied the Kiev city-hall and the Independence Square (Maidan), turning the Square into a tent city, which then became a rallying symbol for the protest movement. A worried president, Viktor Yanukovych consequently responded with new anti-protest laws which restricted the right to protest. This however only made matters worse and emboldened the protesters who took over a number of government buildings. President Yanukovych emboldened the protesters with knee jerk reactions, and as a result, he was constantly backtracking on his decisions.

It was these knee jerk reactions that allowed the West to play a direct role in directing the protest leaders, just as they did in the Orange Revolution in 2005. Many foreign powers weighed in on the escalating situation in Ukraine. The European Union and the United States condemned the Ukrainian government for the violence, while Russia urged the West not to "meddle" in the crisis and blamed the violence on the radical protesters. The West used the protests to pressurise President Yanukovych and weaken him in order to remove him as was the case in the Orange Revolution. The

West provided financial support, organisational and political support, as well as training for the civil and political leaders.

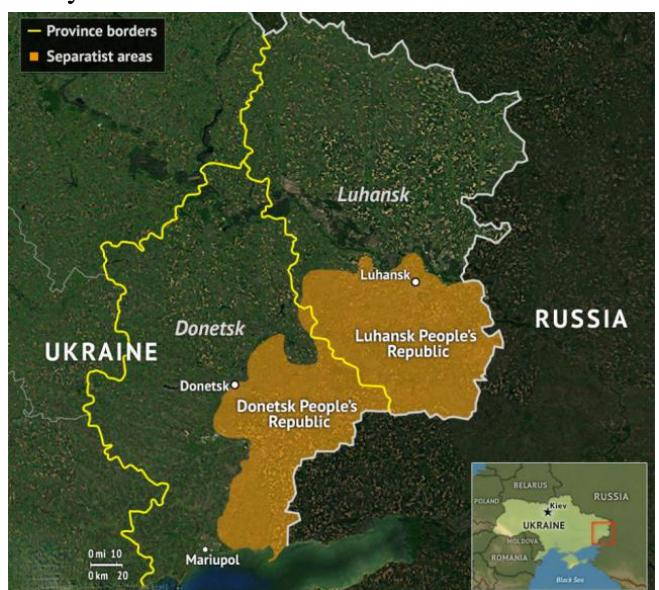
Sensing the end was near for its man in Kiev, Russian Prime Minister Dmitri Medvedev sealed the fate of Yanukovych on February 20<sup>th</sup> 2014, when he announced: “*Moscow would not be beholden to a delegitimised leader like Yanukovych,*”<sup>2</sup> and that Russia will only deal with “*legitimate and effective authorities — a leadership which people aren’t wiping their feet on like a doormat.*”<sup>3</sup> Yanukovych frantically tried to reshuffle his security and intelligence chiefs as defections increased. Virtually all state institutions across Ukraine remained loyal to Yanukovych only a week prior to his ouster, which eventually came on February 22<sup>nd</sup> 2014 after the Ukrainian Parliament voted to remove him from power.<sup>4</sup>



Immediately after the ousting of Yanukovych the EU and the US openly supported the pro-Western government that emerged in Ukraine. This validated the Kremlin’s position that the West was behind the unrest. Given the existential importance to Russia and that a pro-Western government in Kiev poses a direct risk to Moscow, the Kremlin did not take these events lightly. Russia hit back immediately by using a so-called snap military exercise to distract attention and hide preparations

for an invasion of Crimea, it annexed Crimea in early March 2014 by bringing the strategic peninsula under its control. By the end of March 2014, a referendum transferred the Crimea politically to the Kremlin. As a result of this, numerous other pro-Russian regions throughout eastern Ukraine began demonstrating in support of Russia's moves and many of these protests eventually turned into armed pro-Russian separatist movements supported by the Kremlin.

With Crimea firmly under Russian military control, the centre of gravity of the Ukrainian crisis shifted to the pro-Russian eastern part of the country - the industrial and economic heartland of Ukraine. By May 2014, armed men reportedly carrying AK-74s who appeared to have training and experience in handling such weapons became a regular feature. Unidentified protesters stormed and occupied government buildings and police stations across eastern Ukraine. They were, by this point firmly in control of buildings in at least six towns, including Donetsk, Kharkiv and the port city of Mariupol. By May 2014 the easternmost provinces of Donetsk and Luhansk, held referendums on formally separating from the Ukrainian state and establishing self-rule, something the Kiev government did not



recognise. By June 2014 Kiev launched military operations against these separatist republics. After more than five months of conflict between Ukrainian security forces and Russian-backed separatists was still taking place. The Ukrainian government failed to subdue large parts of Donetsk and Luhansk, because of weapons and personnel flows from Russia. This failure compelled Ukraine to sign a cease-fire with the separatists and agree to certain ‘special status’ measures for the territories outside its control.

In response to this significant Russian reversal of western gains, the US government announced sanctions against Ukrainian, Crimean and Russian officials. The US targeted a precise list of Russian officials who were important tacticians within the Kremlin. The EU also drew up its own list of sanction targets. The effect of these sanctions was zero, as none of these officials have ever traveled to the EU or the US and had no bank accounts in those regions.

By mid-June 2014 Ukraine elected a new president, Petro Poroshenko, but on July 17, 2014 at 4:21pm local time, Malaysia Airlines Flight MH17, a Boeing 777 flying from Amsterdam to Kuala Lumpur and carrying 298 people, crashed in Ukraine's Donetsk province. According to an unconfirmed audio intercept by the Security Service of Ukraine, a pro-Russian rebel group based in Chernukhino, Luhansk province, was responsible for the crash.<sup>5</sup> This came a day after two Ukrainian military Su-25 planes were shot at in Donetsk province and only a few days after a Ukrainian An-26 was shot down in Luhansk province.

Even before the end of 2014, the Ukrainian government lacked NATO support and faced growing military pressure in the east. As a result Petro Poroshenko was forced to compromise with the Kremlin. By the end of 2014 Russia is in a stronger position in relation to neutralising Ukraine. Russia has regained the upper hand on the battlefield in Ukraine and has weathered the sanctions imposed by the EU and US. During the winter season energy exports are a more powerful tool for Moscow to influence Kiev and the downstream governments that have cautiously tried to aid Kiev through reverse energy flows. Through its efforts in eastern Ukraine, Russia effectively has established another frozen conflict on its doorstep. Kiev does not have a viable military option for reversing the separatists' gains, nor is it able to restore its military capabilities.

The collapse of the Soviet Union in 1990 led to a decade of decline in the former Soviet territories. The emergence of Vladimir Putin and the security establishment in 2000 stabilised the countries situation. Despite suffering setbacks in Ukraine, neither the government in Kiev or Washington and Brussels has been able to remove Russia from Ukraine. The reality for the Kiev government is most of its allies have provided limited support and even equipment has been mostly non-lethal aid, Ukraine is unlikely to receive the significant military help that it desperately needs. Kiev continues to struggle in accessing its own airspace in the East. The crisis in Ukraine boils down to one important issue: the conflict in Ukraine simply matters much more to Russia than it does to Ukraine’s western allies.

# Middle East

*Strategic Estimate 2014* concluded its assessment of the Arab Spring with the following:

**“At the start of 2014, aside from the Syrian uprising the others that took place have all ground to a halt as those who espoused Islam are in reality maintaining the pre-revolutionary systems. They are attempting to keep the West happy with their moderation and the people that voted them in happy by making cosmetic changes, whilst all the while keeping in place the secular systems and protecting Western interests.”**

The Arab Spring reached its fourth anniversary at the end of 2014. The euphoria that captured the world in 2010 is now a thing of the past as the pre-Arab Spring systems are being maintained in many countries, the uprisings have been hijacked by the west, which themselves are facing an intense Anglo-American struggle.

## Tunisia

When Ben Ali was overthrown in January 2011 an interim government replaced him and elections took place later in the year in October 2011. The country's Islamic group Ennahda won the legislative polls, securing 89 out of 217 seats and proceeded to form a coalition government with the secular parties that won the second and third-highest number of parliamentary seats. The rivalry between all these groups created political crisis at every juncture as they all jockeyed for power. For many having elections was considered progress from an era when Ben Ali monopolised the country's rule. But the elections that took place were flawed from the outset. The elections were for parliaments which were a relic of everything that was wrong in the Muslim world. Ennahda entered the corrupt system and replaced Ben Ali.

As leaders of the constituent assembly, Ennahda was charged with the writing of a new constitution for the country. Despite running on an Islamic ticket, Ennahda immediately abandoned Islamic rule and began labelling it impractical. Ennahda declared it would not support making the shari'ah the main source of legislation in the new constitution, maintaining the secular nature of the state.<sup>6</sup> Ennahda's leader, Rachid Ghannouchi, explained with regards to establishing the Khilafah after its electoral victory: “*Definitely, we are a nation state. We desire a state for Tunisian reforms, for the Tunisian State. As for the issue of the Khilafah, this is an issue that is not one of reality. The issue of today's reality is that we are a Tunisian State that desires reform, so that it becomes a State for the Tunisian People, not against them.*”<sup>7</sup> Ennahda insisted that it will keep the first article of the 1956 constitution. The article enshrines the separation of religion and state, stating that: “*Tunisia is a free, independent and sovereign state, its religion is Islam, its language is Arabic and it is a republic.*” Ghannouchi told journalists that the article: “*is the object of consensus among all sectors of society; preserving Tunisia's Arab-Muslim identity while also guaranteeing the principles of a democratic and secular state.*”<sup>8</sup>

Whilst Ennahda went to great lengths to demonstrate its Islamic credentials to the masses, it went to even greater lengths to demonstrate its moderation to the West. Ennahda founded in the 1980s on

the model of the Egyptian Muslim Brotherhood, over the past two decades has become more comfortable with the ideas of secularism, to the point that it now has more in common with secular parties than an Islamic one. So despite overthrowing Ben Ali, popular frustration remained widespread in Tunisia and Ennahda effectively used the Ummah's Islamic sentiments to come to power and once in power it has presented the impracticality of Islam as a justification for its abandonment.

The people of Tunisia grew frustrated with the delays in the formation of the new and final constitution, alongside the economic struggles that had persisted since Ben Ali's presidency. Matters reached boiling point in February 2013 when Chokri Belaid, a prominent secular opposition leader was assassinated. This triggered mass protests and riots across Tunisia. With the government already struggling to rule, the killing of opposition lawmaker Mohammed Brahmi in July 2013 led to political gridlock. The ongoing demonstrations and public criticism by the secular opposition forced Ennahda to step down in October 2013 and allow a technocratic government to draft the new constitution. By January 2014, the new government had created and passed the long-awaited constitution, which effectively maintained the pre-Arab spring system.

The elections of October 26 2014 saw the reversal of Ennahda's fortunes and the return of the secular groups, including many cronies from the Ben Ali era. Many in Tunisia were united on the post-Ben Ali era, Ali Trabelsi, 38 told Al Jazeera: "*I am not going to waste an hour or so queueing for nothing. Last time I voted [for Ennahda] and I haven't seen any tangible changes. I even think it is going to be worse next time. I'd better earn a few dinars instead of going to vote.*"<sup>9</sup> As the months turned into years Ennahda were unable to deal with any of the pressing issues affecting the lives of the people. Broken promises, paired with a struggling economy and violence for long fuelled cynicism of Ennahda. Everyday issues such as poor rubbish collection and widespread joblessness prompted many to say things were better under Ben Ali. The electoral result on October 26 2014, saw the secular Nidaa Tounis party, also known as Call for Tunisia, win 85 of the 217 seats in parliament, whilst Ennahda saw the reversal of its fortunes, winning only 69 seats. Nidaa Tounis founder and leader Beji Caid Essebsi, an 87-year-old veteran of both the Bourguiba and Ben Ali regimes, won the presidential run-off on 21 December 2014. His return to power means Ben Ali's cronies are back in power.



## Egypt

In the *Strategic Estimate 2014*, we concluded the situation in Egypt as the follows:

**"The situation in Egypt returned to the eve of Mubarak's overthrow, the army was back in power, Mubarak era cronies were also back in key positions and the opposition who posed any challenge to military rule were incarcerated. The Egyptian military under Sisi has worked to completely destroy the MB and every possible threat to their power in order to maintain its role in the country."**

Throughout 2014 Abdel Fattah el-Sisi worked to consolidate his rule with full blessing from the US. Whilst Sisi took power in July 2013, overthrowing the elected Muslim Brotherhood (MB) government, much of the military government's attention was focused on destroying what remained of the MB. Throughout 2014 thousands of people were detained in prison, indeed, the revolutionary youth attend their court hearings in wheelchairs and no one can even reach Tahrir Square. If one says something that upsets the state, he or she is arrested by the police with a ready-made list of accusations that subject one to prosecution, putting one before a court without even hearing one's statement. Such people are put in front of a judge who issues a ruling for imprisonment before defence lawyers get a chance to speak.

In late May 2014 Egypt's presidential elections took place. The election was artificial as there was never any doubt about the outcome. With the full power of the state behind him and no real competition, Sisi won more than 90% of the vote. By June 2014, US Secretary of State John Kerry visited Sisi, endorsing him and giving him America's backing. John Kerry confirmed that US frozen aid will be unfrozen indicating the US was satisfied with the new pharaoh of Egypt. US aid to Egypt has been re-started in December 2014.

During the ouster of Hosni Mubarak back in February 2011, the Egyptian economy has been in virtual freefall. With little in the way of economic policy the Muhammad Morsi regime only made matters worse. It is these conditions that created the necessary public opinion for Sisi and the army to return back into power. Since taking over in mid-July 2013, the army has consolidated its position in the country, removed every possible opposition and resumed its regional role of protecting the state of 'Israel'. There is no counterbalance to the reassertion of state control by the army. The MB is crushed and largely discredited, while secular opposition forces are marginalised and in disarray. Parliamentary elections, to be held by January 2015, at best are a façade. For the time being Sisi and the army have contained the revolutionary forces in the country and maintained the status quo.

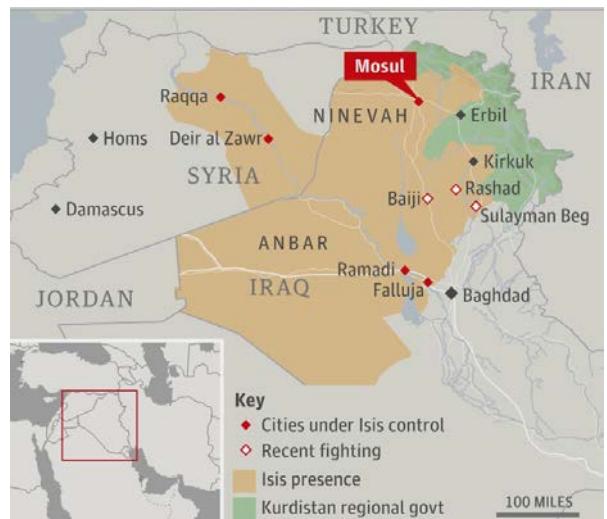
## Syria

In *Strategic Estimate 2014*, we encapsulated the Syrian situation:

**"The regime has lost almost all of the north of the country, the countryside as well as some southern areas. Today the strategic balance is shifting in the battle between the regime and the rebel groups and it is in this context the US is forcing the rebel groups into negotiations with the regime."**

Although the unity and coordination between the multiple rebel groups forced the al-Assad regime to fight across the length and breadth of the country, leading to much success for the rebel groups. This cohesion was already being challenged before the beginning of 2014 and in 2014 these internal differences caused a fracture within the rebel movement. The Islamic State of Iraq and Sham (ISIS) caused a fracture due to their priority of gaining territory rather than fighting the al-Assad regime. As ISIS began launching an increasing number of attacks against any rebel group, the group became a target for other rebel groups. It was this infighting that led to the regime solidifying its gains in Homs.

In July 2014 ISIS declared it had established the Caliphate in Mosul and subsequently made the border between Iraq and Syria obsolete by combining the northern territories of Iraq with Syria. ISIS has used Raqqa and Deir-al-Zour as a base to consolidate its position in North Syria, which includes driving out other rebel groups. The effect of this has been the serious weakening of rebel groups who continue with their main aim of removing the al-Assad regime. Facing al-Assad's forces from the South and ISIS in the North, the rebel groups struggled in 2014 to make progress against the regime.

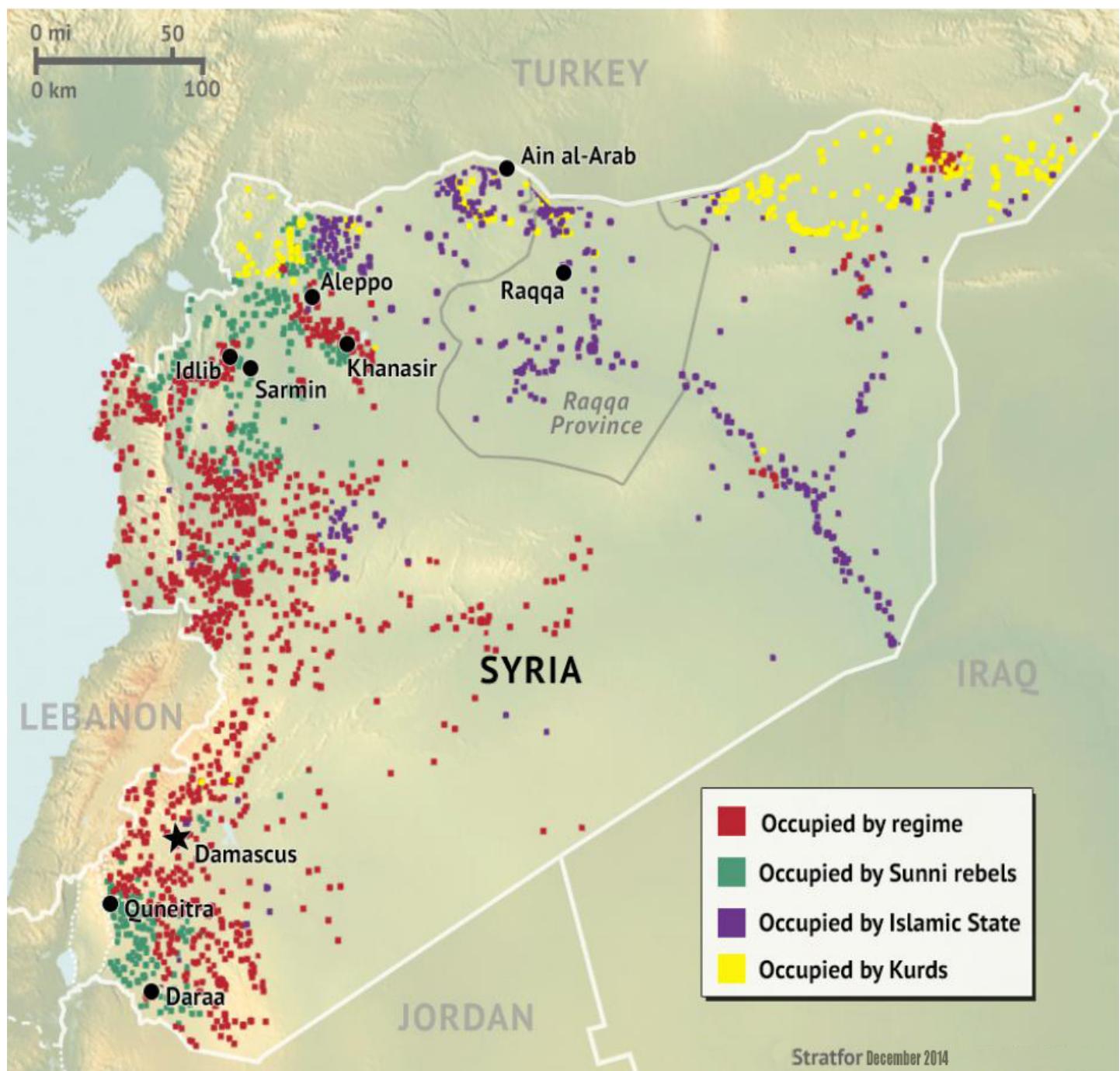


Since the uprising began in Syria the US has failed to develop the nucleus of a loyal secular opposition to enter into negotiations with the al-Assad regime. Stratfor's George Friedman highlighted this: "*One of the interesting things to bear in mind was that the international community, for all its rhetoric about nerve gas and everything else, really didn't want Assad to fall. It wasn't because they liked Assad — they didn't — it was that the alternative had gotten scarier and scarier as the years went on.*"<sup>10</sup> Several Geneva conferences have failed to achieve the development of a loyal opposition that will maintain the status quo. Even though ISIS has been primarily fighting the other rebel groups in Syria, the US still found it essential to intervene as the Islamic sentiments of the uprising still remain strong. This shows the real demarcation in Syria is between those who want to replace al-Assad with a regime in line with their beliefs i.e. Islam and those who want to maintain the status quo. The Islamic nature of the uprising has been a key motivator for the rebel groups and the domestic population, despite bearing almost apocalyptic conditions.

When the US did intervene in Syria in September 2014 many media outlets noted the airstrikes as suspicious as the United States' real aim was not to attack ISIS, but to go after Jabhat al-Nusra.<sup>11</sup> Al-Assad suffered a number of spectacular losses in the summer 2014, chief of these was the loss of the Tagba Air Base, but US airstrikes strengthened the al-Assad regime. The airstrikes assiduously avoided targeting any Assad regime buildings, military forces, or air-defence systems. American fighter jets pilots and their Arab allies faced no Syrian military opposition, and senior Syrian leaders have granted permission for the strikes, saying that the United States and Syria share a common enemy in ISIS. Dr. Bouthaina Shaaban, Bashar al-Assad's political and media adviser highlighted: "*We welcome someone else putting in efforts against these horrible terrorists whom we have been fighting for three years. They have been informing us about the strikes. This is a kind of collaboration.*"<sup>12</sup> Other al-Assad officials also highlighted that: "*the US passed information to them, via a third party, on the place and time of each set of air attacks, and had given the Syrian government assurances that it would not hit the Syrian armed forces, any building connected with state institutions, or civilians.*"<sup>13</sup> Throughout 2014 there was a significant US effort to destroy Jabhat al-Nusra, a minuscule effort to destroy ISIS, and no effort at all to destroy Assad. Harakat Hazm said in a statement: "*The only beneficiary of external intervention in Syria is the Assad regime, especially in the absence of any true strategy to bring him down.*"<sup>14</sup> This was very signifi-

tant as Harakat Hazm, was allied with the CIA-backed Free Syrian Army, which was one of the first rebel groups to receive US anti-tank missiles. That effectively made it one of America's most trusted supposed allies in the Syrian conflict.

The challenge for the US is how do you maintain an illegitimate regime, when the masses are about to reach the fourth year of their struggle to remove him. This direct intervention shows the importance America is treating this question.



## CASE STUDY: The Islamic State of Iraq and Sham (ISIS)

On the first day of Ramadan – 29 June 2014, Abu Mohammed al-Adnani, the spokesman for ISIS declared the establishment of the Caliphate. He called upon all those living in the areas under the group's control, which straddled both Syria and Iraq to swear allegiance to the new Caliph - Abu Bakr al-Baghdadi.

ISIS originated as an insurgent group during the US invasion of Iraq, and for the past decade it has been Iraq's pre-eminent group. Its origins date back to 2003 when the Jordanian war-veteran Abu Mus'ab az-Zarqawi founded al-Qaeda in Iraq (AQI) after having formed *Jammat at-Tawhid wal-Jihad* in 1999. However by 2005 the Sunni 'Awakening Councils' drove AQI out of Iraq.

Nouri al Malaki was the prime minister of Iraq since the transitional government ended in 2006 until his forced departure in 2014. During his reign he became a tyrant, he sidelined the country's minorities and, led a campaign of torture, killing, and severe persecution. As a result many started to protest, with support from Anbar tribes and tribal leaders. Protest camps were set up but Al-Maliki mocked their demands and opened fire on a protest camp in Hawija in late 2013. At this point the protests turned to armed resistance.

A command structure was set up in Fallujah within the first weeks of fighting. A senior leader Major General Montasir Al-Anbari confirmed that the formation of the fighting groups was decided in a meeting of all Sunni groups apart from ISIS. ISIS, he said, asked to join the groups several months after their formation and asked to be part of the Sunni military action. Many reservations were expressed, claimed Al-Anbari, before it was agreed to accept the ISIS request.

However ISIS went beyond what was agreed with the tribal leaders. Major General Montasir Al-Anbari explained: "*Without doubt, though, we are worried about unilateral movements of ISIS because they attacked the city of Telafer and kidnapped the Turkish consul, and they are threatening to head to Baghdad, Karbala and Al-Najaf. All of this, violates the agreement reached between the Sunni rebel groups.....*"<sup>15</sup> So in the middle of an armed struggle against the Malaki government ISIS decided to declare the establishment of Caliphate from Mosul

in Northern Iraq, even surprising the Sunni tribes. When the Syrian uprising started, those fighting in Iraq as part of AQI were sent to take part in the uprising in Syria and stand-off against the Bashar al-Assad regime. Supported by Abu Bakr al-Baghdadi, Abu Muhammad al-Joulani formed Jabhat al-Nusra (Nusra Front) in January 2012. JN had a massive impact in the struggle against al-Assad as its members were battle hardened fighters and conducted many daring raids against the Syrian military forces.

However tensions erupted in April 2013 when al-Baghdadi subsumed Jabhat al-Nusra. Al-Baghdadi named the new and expanded organization the Islamic State in Iraq and the Sham (ISIS). However, within days, al-Joulani, the head of Jabhat al-Nusra rejected the proposal and 'reaffirmed' his allegiance to Ayman Al-Zawahiri, who for Joulani, represented the global Jihad. Matters reached boiling point in early January 2014 when Jabhat al-Nusra took over ISIS' position in northern Syria in conjunction with Ahrar al-Sham.

Military conquest is the central policy of ISIS irrespective of the ground reality. Winning hearts and minds has played virtually no role prior to the declaration of Caliphate and even after the announcement. ISIS has captured areas from the Syrian regime, the Iraqi government, and other competing rebel groups, some via negotiation, but mostly by force. ISIS is now a military adversary to every other faction because it maintains control by eliminating all resistance. Thus it aims to gain legitimacy from seizing territory rather than winning territory through gaining public opinion.

The ISIS Caliphate has also included an exclusionary method of governance. ISIS maintains social control by eliminating all resistance. Many reports coming out from Mosul and in Syria is of descent being dealt with through punishments, including death. Baghdadi said the following about the Shi'ah. Implementing Islam includes their understanding of the creed and as a result many have been accused of apostasy for taking different positions to them. Based on this, courts have been set up and any opposition to ISIS rule or verdicts has been viewed as rebellion and has seen individuals and groups punished with execution.

## Libya

In the *Strategic Estimate 2014*, we concluded the situation in Libya:

**“.....the people of Libya still face immense challenges in the post-Gaddafi landscape. This has been all the more complicated by foreign interference by France and Britain who have their eyes on Libya’s energy wealth.....”**

The euphoria that gripped Libya after the fall of Tripoli in August 2011 and the subsequent death of Gaddafi two months later is now a distant memory. Ever since, Libya has been mired in chaos as militia violence stalks the land and strikes threaten to cripple the oil industry. Violence has continued and economic stagnation is everywhere. The collapse of the Gaddafi regime created a political vacuum which both Britain and the US have attempted to fill. The political situation in Libya is very volatile as both the US and Britain are backing different factions, which has caused a fracture in the country.

When the Arab Spring erupted, Britain’s Foreign Minister William Hague announced that the UK was looking to a post-Gaddafi era. Britain then mobilised a coalition of the willing (primary the West) and the UN to forcibly remove Gaddafi. Britain armed and supported various tribes and militia groups from the East of Libya to march west to the capital Tripoli to overthrow Gaddafi and his regime. After Gaddafi’s fall in 2011, these tribes and militia groups came to dominate Libya’s largest cities, filling the security vacuum left by the collapse of the old regime. Britain with France created the new political leadership in Tripoli. It established the National Transitional Council (NTC) in February 2011, but this temporary government was mainly composed of people from the former Gaddafi regime. Mahmud Jibril, the leader of the NTC, was the head of the Economic Board under Gaddafi while the Chairman, Mustafah Abdul Jalil, was a judge under Gaddafi. Then in July 2012 a permanent government was established — the General National Congress (GNC), with Muhammed Jibril as its head. Britain successfully replaced Gaddafi with another set of cronies.

With new elections due in June 25 2014, America made its move with the emergence of former Major General Khalifa Hifter. Hifter and his forces attacked the capital Tripoli and the parliament. It also launched an operation against the February 17 Martyrs Brigade, which is considered one of the biggest and best-armed militias in Libya. Hifter throughout 2014 consolidated his position and his forces through alliances, particularly with some of the country’s air force, utilising planes and helicopters in his attempt to establish a presence in Benghazi. The Zintan’s militias also aligned with Hifter and so in a very short time his powers grew. Khalifa Hifter was a senior army official who supported the overthrow of King Idris in 1969 that brought Gaddafi to power. Hifter subsequently fell out with Gaddafi over a failed operation in Chad in 1986, where he and his men were captured and jailed. Gaddafi disowned him and his forces to the Chadian authorities. In 1990 America’s CIA negotiated his release and subsequently Hifter spent the next 20 years in Virginia, USA, where he was trained in guerilla warfare by the CIA. The Business Insider reported: “*The likelihood that Hifter was brought in to be some kind of asset is*



*pretty high. Just as figures like Ahmed Chalabi were cultivated for a post-Saddam Iraq, Hifter may have played a similar role as American intelligence prepared for a chance in Libya.”<sup>16</sup>*

Libya is now in the midst of an intense Anglo-American struggle.

## **Yemen**

Yemen also faced an uprising similar to many of the other countries in the region. In 2014 the subsequent architecture that was established was challenged by the Zaidi Houthis of the country. Even though Ali Abdullah Saleh formally stepped down as President and elections took place in February 2012 the political transition in Yemen in no way constituted regime change. The deal between the US, EU, GCC and Saleh merely gave Saleh a dignified exit. Ever since the power-transfer agreement was signed, and despite regular protests demanding that Saleh be stripped of his immunity and that he and his family face trial, Saleh’s family continued to hold many high-level positions throughout the government, business community and security forces. In fact, Saleh himself is still the head of the ruling General People’s Congress (GPC) Party. The elections that took place brought to power Saleh’s long time right hand man — Abd Rabbo Mansour Hadi. The elections in fact only had one candidate – Hadi himself. In this way the Congress party was able to dilute the demand for real change from the people of Yemen and maintain the status quo. The Houthis fought the government on-and-off during the 2000s, and were big supporters of the 2011 Arab Spring uprising against then-President Saleh. Towson University’s Charles Schmitz highlighted the 2011 American-backed deal that replaced Saleh with Hadi didn’t satisfy the Houthis. The Houthis “*had no representation in the transitional government,*” Schmitz said, so they “*regard the transitional government as no different from the old regime that conducted wars against them — in other words, a body that cannot be trusted.*”<sup>17</sup>

What triggered the Houthi takeover of the capital city in September 2014 was the removal of fuel subsidies in July 2014, which was a condition by the IMF for the Yemeni government to receive further loans. The IMF imposed the abolishment of the country’s subsidy system, even though half of the nation’s population lives in poverty. The Houthis played a key role in uprising against Saleh, but they were subsequently sidelined in the development of subsequent transitional and then formal governments. With the price of fuel doubling this led to the Houthis setting up protest camps in the capital, Sanaa. These protest camps spread through the North of Yemen and around the capital Sanaa. President Hadi attempted to appease the Houthis with promises to review the subsidy cuts, but this was rejected by the Houthis. This led to the



security forces shooting dead many Houthi protesters, who were protesting outside the cabinet building in Sanaa. As a result of this the Houthis moved towards the capital, Sanaa in large numbers from the mountains that surround the capital and eventually took over government buildings which included the defence ministry, the army headquarters and the parliament building. President Hadi sensing the danger signed the Peace and National Partnership Agreement, which gave more power to the Houthis in forming the government including cabinet positions.

What has made matters worse in Yemen is the interference of the international community after the uprisings took place in 2011. The US used the war on terror to undermine Ali Abdullah Saleh by accusing Yemen of being a hub for Al Qaeda. Ali Abdullah Saleh attempted to appease the US with a host of security guarantees which allowed the US to carry out drone attacks in the country. The uprising gave the US the opportunity to remove Saleh, who however dug in his heels in the face of demands by his own people to leave. He eventually agreed to a transition deal – led by the Gulf Cooperation Council (GCC) – another US tool. However Saleh was able to transfer power to his own deputy and maintain the position of his party in Yemeni politics. Two days after the rebels took over key state institutions in the capital, Hadi said in a speech at the presidential palace: “*Sanaa is facing a conspiracy that will lead towards civil war,*”<sup>18</sup> Hadi meant that there was an outside hand in the crisis. UK Ambassador to Yemen Jane Marriott visited Hadi on the eve of the Peace and National Partnership Agreement to quell the Houthi takeover of Sana. Marriott reiterated her country’s full support to Yemen until completing the remaining tasks of the transitional phase successfully,<sup>19</sup> i.e. she gave Britain’s full support to Hadi. The EU similarly in a statement on 22 September 2014 said: “*Government institutions must return to the control of the legitimate authorities, under the leadership of President Abd Rabbo Mansour Hadi, the Head of State.*”<sup>20</sup>

The people of Yemen rose up to remove a brutal dictator. The uprising saw the collapse of government institutions and the army as many defected. However real change did not take place in Yemen, only a transfer of power within the ruling elite occurred. As Britain and the US battle it out for the country backing different factions the people of Yemen will continue to suffer as many continue to fight for real change in the country.

# America

In *Strategic Estimate 2014*, our assessment on the US position concluded:

**"In 2014 the US remains the world's super power, despite bleeding significantly for the last decade. It has for the moment successfully navigated attempts by the indigenous people of the Middle East to bring real change to the region. With its drawdown in Afghanistan to rapidly take place throughout 2014 the US is well placed to deal with challenges to its power stemming from China and Russia and whatever Britain also throws at it."**

Throughout 2014 the US worked to strengthen its position in the world through taking advantage of opportunities that presented themselves.

## Syria

In *Strategic Estimate 2014*, we encapsulated the US position in Syria in a letter General Martin Dempsey, the Chairman of the Joint Chiefs of Staff and Barack Obama's military advisor, wrote to Senator Eliot Engel:

**"Syria today is not about choosing between two sides but rather about choosing one among many sides. It is my belief that the side we choose must be ready to promote their interests and ours when the balance shifts in their favour. Today, they are not."<sup>21</sup>**

US President Barack Obama confirmed once again the US strategy in a long speech at the UN in September 2014. One passage revealed what the US administration is pursuing, although this aspect of his speech was scarcely reported in the western or Arab media. After calling on political leaders in Middle East to reject sectarian strife, Obama said: "*These steps must be followed by a broader truce. Nowhere is this more necessary than Syria.*"<sup>22</sup> For the US the future of Syria is not without al-Assad but with him. In October 2014 retired Marine General John Allen, who now serves as Obama's special envoy to the global coalition against ISIS, confirmed: "*No. What we would like to see is for the FSA and the forces that we will ultimately generate, train and equip to become the credible force that the Assad government ultimately has to acknowledge and recognize. There is not going to be a military solution here....But the intent is not to create a field force to liberate Damascus — that is not the intent. The intent is that in the political outcome, they must be a prominent - perhaps the preeminent voice - at the table to ultimately contribute to the political outcome that we seek.*"<sup>23</sup>

In 2014 the US intervened in Syria with military strikes and with a small contingent of US troops on the ground. The US from the very beginning was worried about the uprising in Syria. The defection of many army personnel and the demand for Islamic rule and the complete overthrow of the al-Assad regime, unlike the uprisings in other countries in the region, the people of Syria were calling for real change with the complete uprooting of the status quo in the country. The US attempted to thwart the uprising in Syria by labelling the rebel groups as moderate and extreme, by arming some groups over others, by arbitrating ceasefires and negotiations between the regime and

moderate rebel groups. All of these have failed as the Syrian uprising reached four years. The intervention is in reality an admittance of failure to thwart the uprising.

In Syria ISIS has played a key role in creating rebel discord and fracturing the opposition against the regime of Bashar al-Assad, thus aiding US interests. The rebel groups who fought the regime in the north of Syria were already struggling with governance related issues, which included distributing resources, energy, wheat and operating courts. The ISIS incursion into North Syria led to intense and widespread clashes between ISIS and other revolutionary fronts. Even before the ISIS declaration of Caliphate the group viewed itself as a political entity who is ruling over its territories. Military conquest is the central policy of ISIS irrespective of the ground reality. Winning hearts and minds has played virtually no role prior to the declaration of Caliphate and even after the announcement. ISIS has captured areas from the Syrian regime, the Iraqi government, and other competing rebel groups, some via negotiation, but mostly by force. ISIS is now a military adversary to every other faction because it maintains control by eliminating all resistance. Raqqa and Deir-al-Zour remain within ISIS territory which they have now linked to West Iraq which they consider their Islamic State.

Despite this, the people of Syria continue in their struggle to overthrow the al-Assad regime. It is due to this that throughout 2014 the US failed to develop the nucleus of a loyal secular opposition to enter negotiations with the al-Assad regime. Several Geneva conferences still failed to achieve this objective. With ISIS blurring the border between Iraq and Syria the US saw the opportunity to directly intervene in Syria and shape events in line with its interests. Even though ISIS was primarily fighting the other rebel groups in Syria the US still found it essential to intervene as the Islamic sentiments of the uprising still remain strong. This shows the real demarcation in Syria is between those who want to replace al-Assad with a regime in line with their beliefs i.e. Islam and those who want to maintain the status quo. The Islamic nature of the uprising has been a key motivator for the rebel groups and the domestic population, despite bearing almost apocalyptic conditions.

Even though Al-Assad suffered a number of spectacular loses in the summer of 2014, especially with the Tagba air base falling out of regime hands, US airstrikes strengthened his regime. The US airstrikes avoided targeting al-Assad regime buildings, military forces, or air-defence systems. American fighter jets pilots and their Arab allies faced no Syrian military opposition, and senior Syrian leaders granted permission for the strikes, saying that the United States and Syria share a common enemy in ISIS. Dr Bouthaina Shaaban, Bashar al-Assad's political and media adviser highlighted: "*We welcome someone else putting in efforts against these horrible terrorists whom we have been fighting for three years. They have been informing us about the strikes. This is a kind of collaboration.*"<sup>24</sup> Other al-Assad officials also highlighted that: "*the US passed information to them, via a third party, on the place and time of each set of air attacks, and had given the Syrian government assurances that it would not hit the Syrian armed forces, any building connected with state institutions, or civilians.*"<sup>25</sup> The airstrikes were a significant US effort to destroy Jabhut al-Nusra, and a minuscule effort to destroy ISIS, and no effort at all to destroy al-Assad. Harakat Hazm, said in a statement: "*The only beneficiary of external intervention in Syria is the Assad regime, especially in the absence of any true strategy to bring him down.*"<sup>26</sup> This is very significant as Harakat Hazm, which is allied with the CIA-backed Free Syrian Army, was one of the first rebel groups to

receive US anti-tank missiles. That effectively makes it one of America's most trusted supposed allies in the Syrian conflict.

The initial airstrikes also targeted a new dubious group known as 'Khorasan,' which officials say was plotting an imminent attack on US soil. Bizarrely, the history of the Khorasan was virtually non-existent, and US officials never mentioned the group until the week before the strikes began in Syria. Estimated at 50 fighters, the group suddenly became a huge pretext for military intervention, even though an air sortie on September 23<sup>rd</sup> 2014 reportedly killed 30 of them.<sup>27</sup> Andrew McCarthy, a former US federal terrorism prosecutor highlighted in the *National Review* magazine: "*You haven't heard of the Khorasan group because there isn't one. It is a name the administration came up with calculating that Khorasan had sufficient connection to jihadist lore [so] that no one would call the President on it.*"<sup>28</sup> However the global media gave this non-existent group sufficient coverage to deflect any real questioning of airstrike targets. The Intercept's Glenn Greenwald and Murtaza Hussain lambasted the media's handling of this apparently sudden new threat to the world, they said: "*Once it served its purpose of justifying the start of the bombing campaign in Syria, the Khorasan narrative simply evaporated as quickly as it materialized...Literally within a matter of days, we went from "perhaps in its final stages of planning its attack" (CNN) to "plotting as "aspirational" and "there did not yet seem to be a concrete plan in the works" (NYT).*"<sup>29</sup>

The battle for Ayn al-Arab, better known as Kobani, became the symbol of Syria in 2014. It received significant global coverage as major news channels became fixated on the battle for the northern Syrian and Kurdish dominated city. Kobani has gained considerable attention from the Kurdish population in Syria and the Kurdistan Regional Government in Iraq (KRG) who viewed the defence of the town as an existential struggle, even likening it to the Soviet defence of Stalingrad in 1943, which changed the course of World War 2.



Northern Syria is critical as the al-Assad regime long gave up regaining the territory. It is from the North the rebel forces continue launching attacks against the al-Assad regime and work to strengthen their revolution. Despite the anti-Assad rhetoric from the US, maintaining the al-Assad regime and fracturing the opposition against him, is the aim of the US. But on the 4<sup>th</sup> anniversary of the uprising in Syria, the US has struggled to achieve this.

Once again the US is attempting to use the Kurds to achieve its aims. With a large population of Kurds in Northern Syria – a region they call Rojovya, the US with Turkey worked together to establish a small autonomous region for the Kurds right at the heart of rebel held territory. This is why their media blew the battle for Kobani out of proportion, as this was to give credibility for an autonomous Kurdish state in Northern Syria. Both the US and Turkey do not view the autonomous region in the hands of the PKK's Syrian arm – the YPG, but in the hands of the Iraqi Kurdistan Regional Government (KRG). The US created this regional government in Iraq and Turkey has bankrolled it ever since. Through combining the Free Syrian Army (FSA), another Turkish creation,

and the Peshmerga forces from Northern Iraq a moderate force will become the security apparatus for this autonomous region and further fracture the uprising against al-Assad.

At the end of 2014 US attempts to thwart the Syrian uprising continue, but all discussion on the removal of al-Assad has now all but disappeared. ISIS, a Kurdish autonomous region in North Syria dominate discourse, thus the preservation of the al-Assad regime though the regions counties supporting different rebel groups is on track for the US. None of this has however stopped the people from continuing their uprising against the al-Assad regime, but now the rebels have to face off against ISIS and potentially the Kurds in the medium term.

### CASE STUDY: The Kurdish Question – Past, Present and Future

The promises made to the Kurds of a truly independent Kurdish state by the US and the British Empire before them, over the last century, was never serious. Both powers exploited the demands of statehood by the Kurds in order to occupy Iraq. The British Empire wanted to instigate a rebellion against the Ottomans in order to colonise the Islamic lands and for this it supported many nationalistic calls in order to exploit them for its own ends.

The British Empire promised a Kurdish state to Mahmood Al-Hafeed in 1919 in exchange for the Kurds to fight against the Ottomans in Sulaimaniyyah. When Al-Hafeed's rebel group expelled the Ottomans, Britain backed away from its promises and exiled al-Hafeed to India. At the Sèvres Treaty in 1920, in order to frustrate the Caliph Mohammad Waheeduddin, Britain imposed a clause that would establish 'Kurdistan.' But by 1924 Britain had succeeded in dismantling the Ottoman State and it signed the Lausanne Treaty with Mustafa Kemal Atatürk and abandoned the Kurdish state.

The US made similar promises to the Kurds in Iraq, the Kurds sided with the US which

enabled America to occupy Iraq. Whilst a regional government exists in Northern Iraq today, the Kurdistan Regional Government (KRG) in no way represents an answer to the Kurdish question as it is an artificial state which depends upon Turkish finance and exists to keep Iraq ethnically divided.

The Kurds in origin are an ethnic Persian group who historically inhabited the mountainous areas to the south of Caucasus, which came to be known as Kurdistan over time. In the 20th and 21st century the British Empire and America used the Kurds demand for statehood to achieve their own strategic objectives and for these reasons an independent Kurdish state never really materialised. The most flourishing period of Kurdish power was during the 12th century, when Salahuddin Ayubi, united the Muslim lands and recaptured Jerusalem in the crusades. As part of the Islamic lands the Kurds embraced Islam and became the leaders amongst the Muslims. As Muslims, the Kurds became leaders. Every attempt to establish a Kurdish ethnic state, based on Kurdish nationalism, has been a recipe for disaster.

## Iraq

After more than a decade of war in Iraq, the Pentagon announced in August 2014, that the US military launched a series of airstrikes in northern Iraq and some military troops would be returning back to the country. What prompted this intervention was the announcement by ISIS in late July on its establishment of a Caliphate in Mosul.

The George W Bush administration planned from the outset to dominate Iraq by pursuing the de facto ethnic partition of the country into three autonomous, ethnically divided territories of Sunni, Shi'ah and Kurd respectively. Even prior to the 2003 invasion US policy makers for long saw the division of Iraq as the best way to weaken and control the country. A number of rightwing politicians in the 1990s advocated the division of Iraq, many of these avid Neocons went on to take position in George W Bush's government.<sup>30</sup> This division of Iraq became even more important when an insurgency led by a coordinated Shi'ah-Sunni axis nearly brought the coalition troops to its knees. America's occupational authority led by Paul Bremmer established a constitution that recognised the ethnic differences and divided the country into three federal regions. Significant power was transferred away from the central government to the federal authorities and in this way the US successfully divided the insurgency and eventually defeated it. For the US dividing Iraq rather than unifying it was a central strategy of maintaining dominance over the country.

Fallujah and the Anbar province were both at the heart of the insurgency against the US. Successive Iraqi governments marginalised much of the Sunni areas from real power due to their history as a centre of resistance. Nouri al Malaki's prime ministership ensured political and military power in Iraq remained in his personal office. Al-Maliki dominated Iraq's army, special operations units, intelligence and the main government ministries. Al-Maliki has continued to accumulate power through pursuing the elimination of his rivals. In December 2011, al-Maliki banned Sunni Deputy Prime Minister Saleh al-Mutlaq from cabinet meetings and issued an arrest warrant for Vice President Tariq al-Hashimi. Al Maliki has become a tyrant, he filled his government with those loyal to him, mainly composed of Shia's from the South of Iraq and sidelined its minorities and ultimately treated them as second-class citizens, leading a campaign of torture, killing, and severe persecution. Maliki disbanded the *Sahwa* militias, breaking a promise to integrate many of them into the regular army. The Sunnis were completely sidelined and eliminated from government. As a result many started to protest, with support from the whole province and tribal leaders. Protest camps were set up and the people demanded employment, showed their anger at arrests under 'terrorism,' and argued for representation in government. Al-Maliki mocked their demands and opened fire on a protest camp in Hawija. At this point the protests turned to armed resistance.

A command structure was set up in Fallujah within the first weeks of fighting. It consisted primarily of tribal leaders and former army officials under the name of the General Military Council for Iraqi Revolutionaries. This council was led by Sheikh Abdullah Janabi, who also led the Shura Council of Mujihadeen in Fallujah in 2004. He called for cooperation between the various factions in Fallujah. Another senior leader Major General Montasir Al-Anbari confirmed: "*the decision to form the Sunni fighting groups was taken by clerics and tribesmen in the wake of the Hawija Protest Massacre, which was carried out by the Iraqi army; dozens were killed and wounded in the incident.*"<sup>31</sup> Al-Anbari also confirmed that the formation of the fighting groups was decided in a

meeting of all Sunni groups apart from ISIS. ISIS, he said, asked to join the groups several months after their formation and asked to be part of the Sunni military action. Many reservations were expressed, claimed Al-Anbari, before it was agreed to accept the ISIS request.

ISIS went beyond this agreement, Major General Montasir Al-Anbari explained: "*Without doubt, though, we are worried about unilateral movements of ISIS because they attacked the city of Telafer and kidnapped the Turkish consul, and they are threatening to head to Baghdad, Karbala and Al-Najaf. All of this violates the agreement reached between the Sunni rebel groups. However any political solution on the ground that meets the demands of the Sunnis and saves them from Al-Maliki's oppression will be accepted.*"<sup>32</sup>

The initial ISIS declaration of an Islamic State in the North-East provinces of Iraq, which are largely Sunni areas, never threatened America's division of Iraq. As ISIS expanded its authority from Mosul to other Sunni towns, statements from US officials floated around the US 'monitoring the situation.' ISIS then turned its attention to the Baghdad government and despite the capitulation of the Iraqi forces in the North of the country, the US was confident the more capable forces in Baghdad, would fend off any attempts from ISIS.

The initial fall of Mosul and capitulation of the US trained Iraqi army led to just tentative statements by US officials. As ISIS forces marched towards Baghdad and expanded their 'Islamic State,' US officials constantly ruled out 'US boots on the ground.' By August ISIS began launching attacks on northern Kurdish areas of Iraq and advanced to within 40 kilometers from the Kurdish capital of Arbil. At this point, US president Barack Obama authorised airstrikes, justifying this on a humanitarian basis to break the siege of Mount Sinjar. As ISIS had moved beyond the Sunni regions and was threatening both the Kurdish and Baghdad governments America was forced to intervene to protect the architecture it spent significant treasury and blood constructing over the past decade. The US spent most of August and September bombing ISIS targets from the air and on September 23<sup>rd</sup> 2014 the US expanded airstrikes into Syria.

Whilst ISIS do control considerable territory in Iraq, it is unlikely they will uproot the US constructed political system. This is because they were able to gain this territory with the help of the Sunni tribes. One senior leader of the fighters was reported in *The New York Times*: "*These groups were unified by the same goal, which is getting rid of this sectarian government, ending this corrupt army and negotiating to form the Sunni Region.*"<sup>33</sup> Since the departure of Malaki, the Sunni tribes have been negotiating with the government in Baghdad and a deal is in the making. It was the same Sunni tribes who worked with the US to form the Sunni awakening councils that drove out al-Qaeda in 2005.

## CASE STUDY: The Fall of Mosul

Mosul, Iraq's the largest city after Baghdad is the provincial capital which sits on the Tigris River and boasts a population of around 1.8 million. The maths was simple. The Iraqi army had 250,000 troops, its enemy, ISIS, had somewhere around 1,500. The Iraqi army had tanks, planes, and American training. ISIS had never fielded a tank or a plane. Two army divisions were stationed in Mosul. This was around 30,000 troops, there were also 10,000 federal police, 30,000 local police and likely, some Iranian Quds Force officers. However by the end of July 2014, Iraqi officials conceded they had essentially given up on regaining the north of the country to ISIS.<sup>34</sup>

The question is how a force 15 times larger than the 1,500 individuals ISIS could muster were defeated, despite possessing equipment and numbers which even a badly organised army could easily overwhelm such a small force.

Iraqi army officials were aware of an impending attack by ISIS. Lieutenant General Mahdi Gharawi, the operational commander of Nineveh province, of which Mosul is the capital, was in charge of security. He confirmed in multiple interviews that in late May 2014, Iraqi security forces arrested seven members of ISIS in Mosul and learned the group planned an offensive on the city in early June. Gharawi, asked Prime Minister Nuri al-Maliki's most trusted commanders for reinforcements. Senior officers scoffed at the request. Diplomats in Baghdad also passed along intelligence of an attack, only to be told that Iraqi Special Forces were in Mosul and could handle any scenario.<sup>35</sup>

The attack on Mosul began at 2.30am on 6 June 2014; ISIS attacked Mosul from the northwest in convoys of pickup trucks. In southern Mosul, five suicide bombers attacked an arms depot killing 11 soldiers. Battles inside the city proceeded for 3 days until soldiers deserted and fled. There are however too many soldiers and security personnel, who in interviews confirmed, they did not desert – they were

ordered to withdraw. Amir al-Saadi, a soldier from one of the Iraqi Army's divisions in Mosul outlined what happened: "*The army withdrew from Mosul and that withdrawal is the responsibility of the senior commanders. The officer in charge was sitting in his office when I came in with some other soldiers. He told us he had received orders to withdraw from the city as quickly as possible. When he said that, we really thought he was joking. But he wasn't. So we went out and told the others about the orders. That was when we started leaving the base, after changing out of our uniforms into civilian clothes.*"<sup>36</sup>

Lieutenant General Mahdi Gharawi confirmed only three people could have given the final order: Aboud Qanbar, at the time the Defence Ministry's Deputy Chief of Staff; Ali Ghaidan, then Commander of the ground gorges; or Maliki himself, who personally directed his most senior officers from Baghdad. The secret of who decided to abandon Mosul, Gharawi says, lies with these three men. Gharawi says a decision by Ghaidan and Qanbar to leave Mosul's western bank sparked mass desertions as soldiers assumed their commanders had fled.

All the evidence points towards Mosul not being deserted, but orders bring received by soldiers to leave the city, but also to leave their equipment behind. Malaki since he emerged as Iraq's premier consolidated and centralised all the key ministries and departments into his personal office, therefore the decision to abandon the city could only have come from Malaki himself. This would weaken his standing considerably in Iraq and especially from his Shi'ah support base. He would only have done this if the pressure came from the US, as no-one had so much influence to force Malaki into a decision such as this. ISIS has fractured the insurgency in Syria through its actions since its announcement of the Caliphate. The weapons, equipment and money attained from Mosul were the catalyst for this.

## Ukraine

After the fall of the Soviet Union, the West led by the US began working to push its boundaries in Europe eastward, destroying Russia's ability to influence the region. The pro-Western lines moved to the east for the past two decades, via NATO and European expansion, until they pushed hard up against Russia's borders. With the collapse of the Soviet Union, the US worked to dismantle the architecture established by the USSR; it worked to contain Russia by bringing all the former Soviet republics under its sphere of influence and for the next decade through economic aid it economically linked them to the West.

The US openly supported the protests groups during the Orange Revolution in 2005. Massive vote rigging by Victor Yanukovich against the pro-US Viktor Yushchenko, led to the annulling of his electoral victory. Hundreds of thousands of the Ukrainians that had taken to the streets and activists were funded and trained through US NGO's. When Viktor Yushchenko took power he immediately worked for membership of both NATO and the EU. Ties grew stronger between Ukraine and the US after the Orange Revolution, Yushchenko visited Washington in 2005 and was invited into NATO's Intensive Dialogue on Membership (IDM). This was followed by an invitation into Membership Action Plan (MAP).



US influence was set back with the re-emergence of Yanukovych and this is why the US jumped at the opportunity to back the protests against Yanukovych in late 2013 and early 2014, giving another opportunity to weaken Russian influence. Throughout December 2013 and January 2014, US officials openly met with protesters in Kiev Square as well as with protest leaders. So on 14 December 2013, US Senator John McCain visited the Ukrainian capital and met

with key government and opposition leaders. US Assistant Secretary of State Victoria Nuland visited Independence Square in the Ukrainian capital Kiev on Wednesday 11 December and met with protestors. A bugged phone conversation in which a senior US diplomat disparages the EU over the Ukraine crisis was leaked in February 2014 which highlighted the central role the US playing in the post-Yanukovych government. The telephone call was leaked of US diplomat Victoria Nuland speaking to the US Ambassador to Ukraine, the contents revealed how both the EU and the US were relentlessly attempting to destabilize Ukraine. Nuland outlined who should not be the future leaders, and even remarked, "*f\*\*\* the EU.*" She wanted the Ukrainian politician Arseniy Yatsenyuk to become prime minister in the new government, which he did.<sup>37</sup>



By September 2014 the Ukraine conflict became a frozen conflict with the US supporting the government in Kiev, which remained unable to impose its will on the pro-Russian East of Ukraine.

It was here the US attempted to ruin the Russian economy. After the Minsk Protocol was brokered between the Ukraine government in Kiev and the rebels in the eastern Donbass region, in September 2014, US Secretary of State John Kerry visited Jeddah to see King Abdullah at his summer residence. This meeting was reported as part of Kerry's campaign to secure Arab support in the fight against ISIS but Saudi actions immediately after this meeting prove something very different was agreed. The Saudi's raised oil production and cut its crude price. The Saudis produce a barrel of oil for less than \$30 as break-even in the national budget, the Russians need \$105. Shortly after Kerry's visit, the Saudis began increasing production by more than 100,000 barrels daily during the rest of September 2014. In November the Saudi's dropped the price of Arab Light by 45 cents a barrel, sending prices to \$78 a barrel.<sup>38</sup> By the end of 2014 oil prices had fallen to below \$60 a barrel and the Russian economy was in serious trouble.<sup>39</sup>

America's strategy has included the propping up the pro-West government through loans and economic guarantees in order to weed it away from Russia. In March 2014 the US House passed a measure to allow \$1 billion in loan guarantees to Ukraine.

### **US-Iran Rapprochement**

In *Strategic Estimate 2014*, the following was concluded regarding US-Iran rapprochement:

**"The major development in 2013 was the public announcement of the normalisation in US-Iranian ties. Whilst this was considered almost unthinkable since 1979, on November 23 2012 a deal was reached in Geneva and made public by US officials. The agreement was not a final settlement on all outstanding issues, but regarded as a first step."**

The rapprochement between Iran and the US was one of the most significant events in 2013. In 2014 various meetings took place regarding Iran's nuclear program and in November 2014 positive statements were made about an extension to negotiations by both Iranian and US officials. In the long run, the nuclear issue is not as important for either side as the regional dynamics are. Both the US and Iran have always had a working relationship, these negotiations are about finding a way to formalise an agreement that has already been reached by the two sides.

The issues remained more or less the same, centring on questions of sanction relief and the amount of enrichment that can take place. Robert Litwak, a Wilson Center scholar and author of "Iran's Nuclear Chess: Calculating America's Moves, encapsulated the nuclear talks" said: "*In every nation involved, this negotiation is a proxy for something bigger. Here it is a test of Obama's strength and strategy, in Tehran it is a proxy for a fundamental choice: whether Iran is going to continue to view itself as a revolutionary state, or whether it's going to be a normal country.*"<sup>40</sup>

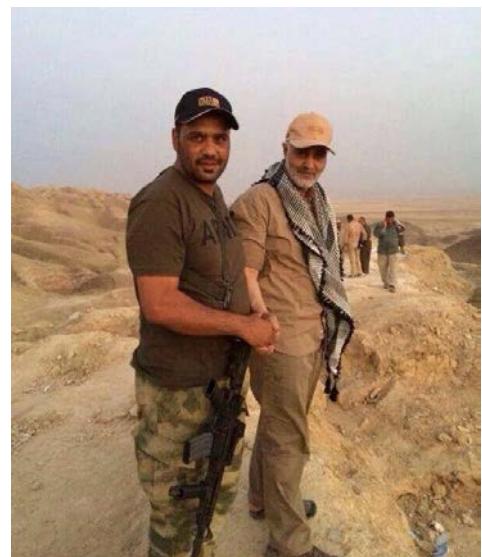
The talks took place after a decade of war in Iraq. When the US invaded Iraq back in 2003 none of its military options ever envisaged a long term US military presence. US military plans envisaged the complete capitulation of the Iraqi army with its precision guided munitions. The US expected Iraqi civilians to welcome them for liberating them from Saddam Hussein. Whilst the Iraqi Army was brushed aside after a month, the welcoming party never arrived and after a year an insurgency began which only got worse as the years progressed. By 2005 the US was marred in an insurgency that it could not end and US military planners started looking for an exit strategy that could save

them face. America dealt with this in three ways: it enlisted the help of regional nations bordering Iraq - Turkey, Syria and Iran. It divided the insurgency by playing on ethno-sectarian divisions and constructed a political architecture with the help of various opportunists, corrupt groups and individuals.

The US has been working for some time to reorient its posture from occupation to reducing its military footprint and consolidating the architecture it has created. This has been in work for two years since US officials announced America's Pivot to Asia – i.e. China is America's main adversary. What made these talks with Iran important and urgent was the Arab Spring and the overt Islamic call in in Syria.

For the moment only the nuclear aspects of US-Iran marriage have been revealed, Iran's support for proxy groups, its role in Syria and US tools in the region have in all likelihood been discussed and will never be revealed. But what is for certain is at this critical juncture in the Middle East it is Iran once again and not Israel or Saudi Arabia that has saved America and its hegemony in the region.

Both Iran and the US, despite their public statements to the contrary are working together on key issues. Iran's Supreme leader made a public statement in September 2014 approving of co-operation with the US authorising his top commander to coordinate military operations with the US, Iraqi and Kurdish forces against ISIS.<sup>41</sup> Both Iran and the US began working together as soon as ISIS took over Mosul. Hossein Amir-Abdollahian, Iran's Deputy Foreign Minister for Arab and African Affairs and Jake Sullivan, adviser to US Vice President Joe Biden engaged in back-channel diplomacy in Oman after the Iraqi army collapsed in the face of the ISIS assault in July 2014. The US and Iran worked behind the scenes to replace former Iraqi Prime Minister Nouri al-Maliki, whom Washington and Tehran hold responsible for the political crisis in Iraq. However, it was the battle for Amerli where US-Iran cooperation made the tactical difference. The extent of Iran's involvement was captured in a photo of Maj. Gen. Qassem Suleimani, the head of the Islamic Revolutionary Guard Corps' elite Quds Force, on the ground in the Iraqi town of Amerli following the successful effort to break an Islamic State siege of the town. Suleimani played a direct role in directing operations straight from the battlefield. Iraqi security forces, Shi'ah militias and Iranian operatives fought ISIS on the ground while US air power took out ISIS targets with airstrikes.<sup>42</sup> In line with the rapprochement between both countries Pentagon spokesman Col. Steve Warren confirmed: "*We believe all countries, regardless of their differences, should work toward the goal of degrading and ultimately defeating ISIL.*"<sup>43</sup>



Talks on Iran's nuclear program have been taking place for the best part of a decade. This is a significant point because both countries are at a stage where US-Iranian diplomacy has become a routine affair. US and Iranian interests in the Middle East have been converging for several years. Whilst some hurdles remain between Iran and the US from normalising relations, they both know

they have to deal with one another in pursuit of their respective aims. The nuclear talks are therefore part of the more important process of finding an arrangement in which they can do so.

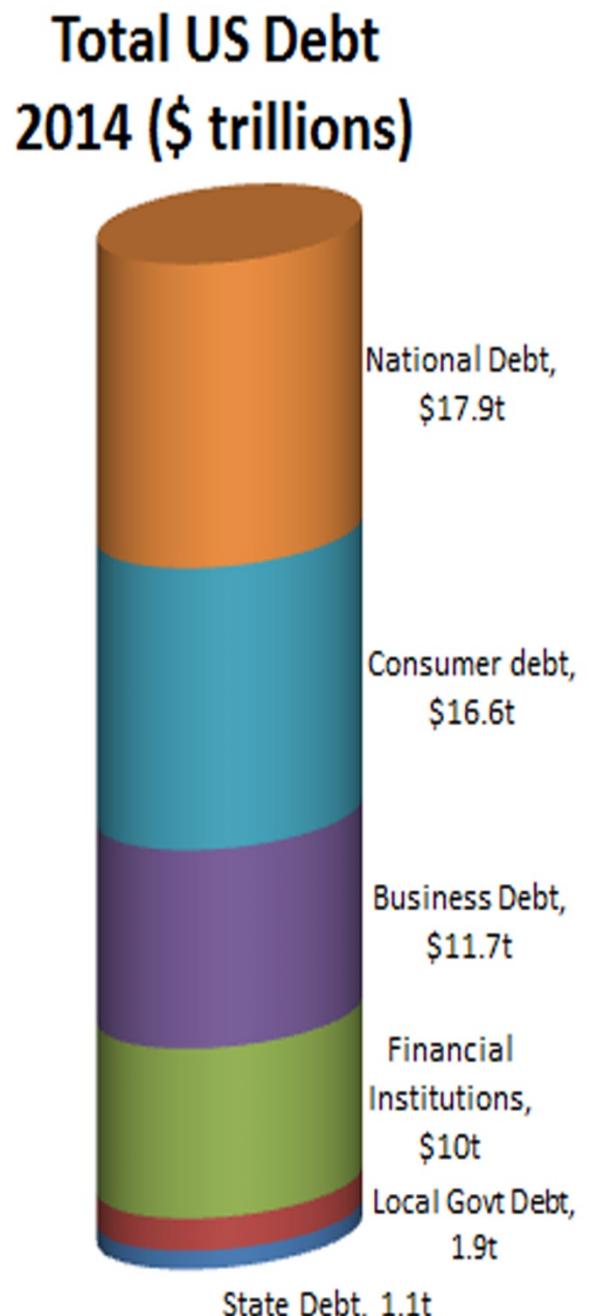
## US Debt

In June 2014 various US banks announced America's total debt had reached \$60 trillion! This level of debt is more than the value of goods and services produced by all the countries in the world put together. That amounts to over \$170,000 debt for every man, woman and child in the US today. This is a staggering situation for the world's superpower and is not sustainable.

In understanding how the US got into this precarious indebtedness it is important to start by looking at Government debt because the Government sets the policies and standards by which other agents in society – consumers and business – interact. The US Government could not have set a worse example in debt management. In the last three decades Federal Government debt has exploded from \$658 billion in 1979 to \$17.9 trillion in 2014 – that's nearly a 20-fold or 1811% increase. Add to this, debt held by state and local governments and total debt held by the US and its agencies, US debt exceeds astronomical proportions. With such a huge stock of debt, it is little wonder that the US Government has to borrow to meet its annual \$2.1 trillion interest payments.

One of the more serious implications of this enormous debt is that the American state frequently shuts down government activities upon reaching an ever-rising debt ceiling forcing teachers, doctors and other state employees to go unpaid, crippling key public services. Despite having a debt ceiling in place to restrict the amount of debt the US government can borrow. However since 1960, Congress has acted 78 separate times to permanently raise, temporarily extend, or revise the definition of the debt limit – 49 times under Republican presidents and 29 times under Democratic presidents.<sup>44</sup> Indeed, the debt ceiling has been raised no less than 91 times since 1940 when it stood at a mere \$49 billion. The US national debt has increased by more than \$7 trillion since Barack Obama has been in the White House.

The US is in the precarious situation that it has to roll its debt over by issuing new debt to repay its old debts. All this continually increases the debt levels and effectively in-debts future generations.



The global economic crisis has exposed the levels of debt the US is drowning in and merely increasing the debt ceiling is just leaving the problem for another day.

The effects of this debt is already affecting US prowess, its military is going through sequestration (spending cuts) which is leading to the cancellation of a number of military platforms. America's ability to conduct its foreign policy could be seriously affected if another nation challenges US ability to repay its debts.

Unless the US is able to reign in its indebtedness, a rival economic power with a major alternative world currency could undermine the dollar's reserve currency status and with it the US's economic standing.

## Conclusions

The US has shown in 2014 why it remains the world's superpower and the nation all the other powers compete with. Despite a decade of war which consumed the US, in 2014 the US has successfully navigated its myriad of challenges and continues to shape the world to serve its interests.

Despite much of the media coverage in 2014, of Iraq falling apart, due to the emergence of ISIS. The US has been able to use this to its advantage. Until the emergence of ISIS, the rebel groups in Syria were fighting the al-Assad regime on the outskirts of Damascus. Even the use of chemical weapons by the regime failed to halt the rebel advance. The ISIS takeover of Mosul and its subsequent expansion has fractured the rebels as ISIS has prioritised territorial control over defeating the al-Assad regime. Today the rebel groups have been forced to fight ISIS rather than the regime and all of this has ensured real change is a distant possibility. America's aim to thwart the revolution and halt the rebel advance has seen success in 2014, but it has not been completely stalled and this remains a problem for the US.

The US has been able to weaken Russia and bring regime change in one of its prized possessions – Ukraine. Whilst this conflict is far from over, Russia's main concern is a country not even within its region. The US has shown Russia that it has multiple resources, tools and strategies at its disposal, if one failed or has gone as far as it can, the US has multiple alternatives to turn to.

At the end of 2014, the US remains the world's superpower. The US continues to navigate the sea of challenges in front of it and has adapted its strategies when they fail or are no longer useful. The US has successfully stalled the Arab spring which has ensured its grip remains on the region.

## 2015

**China** - Despite much fanfare on America's pivot towards Asia, aside from some economic deals such as the Trans Pacific Partnership (TTP) the US has failed to capitalise upon this and contain China's rise in the Pacific. Its occupation with affairs in the Middle East has once again taken the bulk of its time and resources. China has rapidly developed in the last decade from an economic

and military perspective and dwarfs most of the countries in the region. Unless the US puts a halt to this it may find a challenge to its supremacy in this region, sooner rather than later.

**Syria** – In 2014 the uprising in Syria reached four years. The US position has been clear from the outset, the regime must survive at all costs and the uprising must be diverted, divided and thwarted. This can be seen from the rhetoric from Washington being in complete contrast to its actions. However four years on the people of Syria continue with their uprising unabated and refuse to negotiate with the regime or put down their weapons in the face of apocalyptic conditions. US strategies of arming certain groups over others, dealing with certain factions over others and giving cover to the regime to put down the uprising have failed to stop the people of Syria. The Syrian regime despite receiving outside help is virtually bankrupt, its army has shrunk due to defections and the longer this goes on, al-Assad may come to be seen as a liability.

**US Global Reputation** – The US has since WW2 been the worlds superpower and a people the world wanted to imitate. Its prosperous standard of living, cohesive society, opportunity and values of freedom, democracy and justice were idolised world over. However the last decade has seen many US values thrown aside and its reputation tarnished. Abu Ghraib, anti-terror laws that threw aside traditions of presumption of innocence and rule of law and the Senate report on torture have all impacted America's reputation abroad. The global financial crisis has exposed America's wealth fracture and the Ferguson riots and numerous police shootings of black youths also show there are serious problems in US society. If countries like China or another power took advantage of these it would really diminish Americas standing across the world.

# Russia

In our analysis of Russia at the end of 2013 we concluded:

**“.....in 2013 two events took place.....these were political actions that were uncharacteristic of a global power. Russia’s position on US provocations towards North Korea in early 2013 and the chemical weapons agreement with the US over Syria in August 2013 raise a number of questions regarding Russia’s capability in challenging US prowess. Whilst Russia may have global ambitions it lacks the capabilities necessary to fulfil these ambitions. Russia however has many tools in the former Soviet Republics and this is where its strengths are and the reason why Russia is considered a power in the world.”**

In 2014 the US and EU challenged Russia in Ukraine, which is critical for Russia in maintaining a buffer between it and Europe. A new Cold war is now officially in full swing.

## **Ukraine**

Despite being overthrown in the 2005 Orange Revolution Victor Yanukovych became the president of Ukraine after winning elections against the pro-West candidate Yuliya Tymoshenko in 2010. In office, once again Yanukovych steamrollered measures through the legislature with little regard for parliamentary procedure. He got the Constitutional Court to invalidate constitutional amendments adopted during the Orange Revolution. He formally ended Ukraine's attempts to join NATO and agreed to extend the lease for Russia's Black Sea Fleet in Crimea until 2042, from the original withdrawal date of 2017. Russia had once again regained the initiative in Eastern Europe and its most prized possession, Ukraine. However Yanukovych's term as president was characterised by incompetency and authoritarianism and when he backed out from the EU Association agreement in late 2013 protesters took the streets to overthrow him.



By February 22<sup>nd</sup> 2014, Russia's man had fled Ukraine only to show up in Moscow a few days later. What replaced Yanukovych was an interim government led by the three parties that led the protests and who also received considerable support from the EU and the US. The Fatherland party, Udar and Svoboda took power and lawmaker Arseniy Yatsenyuk had already been appointed as prime minister in an EU-brokered agreement before Yanukovych's ouster, and another member of the party, Oleksandr Turchynov, became acting president. What also followed were major defections from the pro-Russian parties in parliament. Many of the party's lawmakers left in an attempt to distance themselves from Yanukovich, becoming either independent members of parliament or joining new blocs. This was a major reversal of Russian influence in Ukraine, Russia needed to react!

Russia reacted to the change in Ukraine's government, as illegitimate and a product of a Western-backed coup, with the swift annexation of Crimea. The last time Russia went to war was against Georgia in 2008, which left the world stunned. Once again the Kremlin used its military deployments to bolster its diplomatic strategy. Russia used a so-called snap military exercise to distract attention and hide preparations for the invasion of Crimea.<sup>45</sup> Then specially trained troops, without identification patches, moved quickly to secure key installations on the Crimean peninsula. Once these were secured, Russian forces cut telephone lines, jammed communications and used cyber warfare to cut off the Ukrainian military forces on the peninsula. This completely disconnected Ukrainian forces in Crimea from their command and control. The skillfulness and agility of how the Russians operated in Ukraine was a far cry from the bludgeoning artillery, airstrikes and surface-to-surface missiles used to retake Grozny, the Chechen capital, from Chechen separatists in 2000. Once this was achieved the Kremlin employed an unrelenting media campaign to reinforce its narrative that a Russian-abetted intervention had been needed to rescue the Russian-speaking population from right-wing extremists who had taken over the government in Kiev. When US officials demanded Russia pull back from Crimea, the Kremlin raised the stakes by massing around 40,000 troops near Ukraine's eastern border.

Russia retained the option of mounting a large-scale invasion of Eastern Ukraine, but the impact of the air and ground forces massed near Ukraine had deterred the Ukrainian military from cracking down in the East and halted the US from providing military support to Kiev. These military deployments gave the Kremlin the ability to dominate negotiations and talk of federalism in Eastern Ukraine became fashionable. The eastern provinces of Ukraine began to operate largely autonomous from the Kiev Government and came under Moscow's influence. Ever since the 'lost decade' after the collapse of the Soviet Union, Russia sought to develop more effective ways of projecting power in the former Soviet republics, where many ethnic Russians reside. Since Vladimir Putin emerged as premier, Russia upgraded its military, giving priority to its special forces, airborne and naval infantry rapid reaction capabilities. These were effectively road tested in Crimea.

With Crimea officially annexed, the Kremlin then began sending small, well-equipped teams across the Ukrainian border to seize government buildings that could be turned over to sympathisers and local militias. Police stations and Interior Ministry buildings, which stored arms were being turned over to local supporters. Russia had effectively initiated a pro-Russian separatist rebellion in the eastern provinces of Donetsk and Luhansk. James G. Stavridis, a



retired admiral and former NATO commander said: “*It is a significant shift in how Russian ground forces approach a problem. They have played their hand of cards with finesse.*”<sup>46</sup>

As a result of being caught off guard as Russia flexed its muscles, the US was unable to impose its terms on the Ukraine crisis. Russia’s strength in the Ukraine crisis was in its covert action combined with sound intelligence concerning the weakness of the Kiev government and their will to respond militarily. Despite Victor Yanukovich being overthrown, Russia has been able to maneuver into a position where any government in Kiev will be unable to operate effectively without Moscow’s support. Russia also cut natural gas supplies to Ukraine in June 2014 in case Kiev didn’t get the message.

### CASE STUDY: Russia-Ukraine Relations: Past and Present

In its recent history Ukraine was the most important republic out of the 15 former member republics of the Soviet Union. Ukraine was one of the Unions largest republics and it remains the breadbasket of Russia. Ukraine’s proximity to Moscow led to the development of its energy resources and the construction of energy infrastructure and pipelines. Due to this Russia currently supplies 80% of Ukraine’s natural gas and most of Russia’s energy to Europe transits through Ukraine. This links Ukraine’s energy directly to Russia’s. Ukraine is crucial to Russia as it’s industrial, agricultural and energy sectors are integrated with Russia’s and it is a buffer between it and Europe. The loss of Ukraine would bring Europe right on its doorstep which would be an existential threat.

Following the breakup of the Soviet Union in 1990, Ukraine’s political scene was dominated by President Leonid Kuchma and the oligarchic groups. Most of oligarchs from eastern and southern Ukraine supported Kuchma and as a result he was elected president in 1994, and re-elected in 1999. Kuchma admitted to the BBC in a documentary in January 2012 that he was an ally of Putin throughout his tenure.<sup>47</sup> His rule was characterised by widespread corruption and murder as he and his associates made billions through acquiring state owned assets.

Kuchma could not run for a third term under the Ukrainian constitution and as a result Russia

backed Viktor Yanukovych in the 2004 elections. Yanukovych hailed from the Donetsk clan, from the coal-rich Donetsk region, that is home to Ukraine’s most lucrative industries. This was also the clan of Ukraine’s richest oligarch Rinat Akhmetov. Massive vote rigging by Victor Yanukovich against the pro-West, pro-NATO and pro-Europe candidate - Viktor Yushchenko, led to the Orange Revolution. Hundreds of thousands of Ukrainians took to the streets and activists funded and trained through US NGO’s led to the annulling of the election result and a re-run where the pro-West candidate Viktor Yushchenko and Yuliya Tymoshenko won. Yushchenko immediately worked for membership of both NATO and the EU, bringing Russia’s nightmare right to its borders.

President Yushchenko soon fell into squabbling with Yuliya Tymoshenko, his main backer during the Orange Revolution over policy and allegations of corruption, by 2006, Yushchenko was forced to reappoint his 2004 presidential election opponent Viktor Yanukovych as prime minister, after Yanukovych’s Party won the most seats in parliamentary elections.

By 2010, although previously overthrown in the 2005 Orange Revolution Victor Yanukovych was the president of Ukraine.

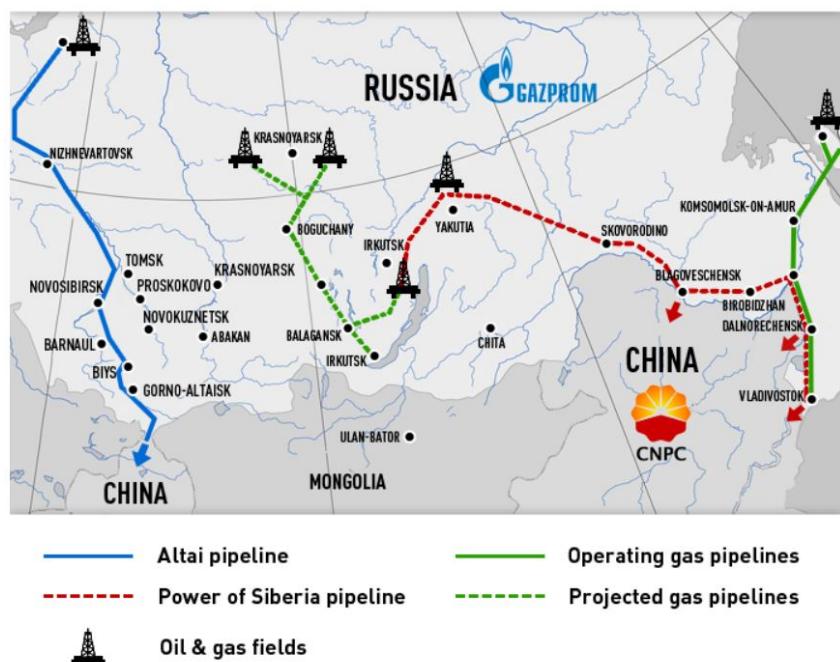
## Asia Pursuit

Over the past few years, Russia has increased its energy, political and economic ties to its eastern and southern neighbors. As tensions between Russia and the West have grown, Moscow fast-tracked this strategy. In 2014 Russia and China strengthened their relationship with several large energy deals, including new pipelines and export terminals.

In 2014 Russia struck, by far, its biggest deal with China. The long-awaited deal on natural gas took place in May 2014 where Russia will supply 38 billion cubic meters of natural gas per year to China for the next 30 years, with the option to raise supplies to 60 billion cubic meters per year in the future in a deal worth \$400 billion. The agreement will enable Russia to launch plans for building the \$42 billion Power of Siberia pipeline, a 4,000 kilometer-long pipeline that will tap two new source fields and run from Siberia to China.

This deal has been on the table for ten years and only came to fruition by the direct intervention of the Russian president Vladimir Putin. A closer examination of the details of the agreement shows that Russia made significant concessions to their Chinese counterparts to clinch the deal. So much so that Russia gave significant sweeteners to clinch the deal and secure its strategic interests rather than a purely economic transaction.

A major concession made by the Russians was the price, gas exported to Europe generally commanded at least \$380 per thousand cubic meters in 2013, but China will only pay \$350 per thousand cubic meters, which is much closer to the \$340 per thousand cubic meters offered by China than the \$400 demanded by Gazprom. This low price comes at a significant cost to the Russian treasury. To give Gazprom room to manoeuvre on price exports of gas, China will be exempt from resource extraction tax. In addition to the low price the colossal amount needed (estimated to be around \$55 billion) to construct the pipeline in some of the most inhospitable environments in the world makes the deal less lucrative for the Russians than first envisaged. Furthermore, an informal ban on foreign ownership of strategic assets was also relaxed allowing Chinese companies to participate in the construction and more importantly ownership of the assets needed to complete this deal, and bearing in mind that this particular pipeline will serve both South Korea and Japan and will attract significant royalties for its owners means this is a major concession by the Russians.



In November 2014, Russia and China signed a memorandum of understanding on a second gas-export route from western Siberia to China's western provinces. The 30-year accord will see Russia ship 30 billion cubic meters of gas to China starting in 2018 and would see Russia gain a big new customer right as it is feeling the squeeze from Western financial sanctions. Whilst this deal is far from complete the two sides laid the groundwork to resolve the host of unresolved issues.

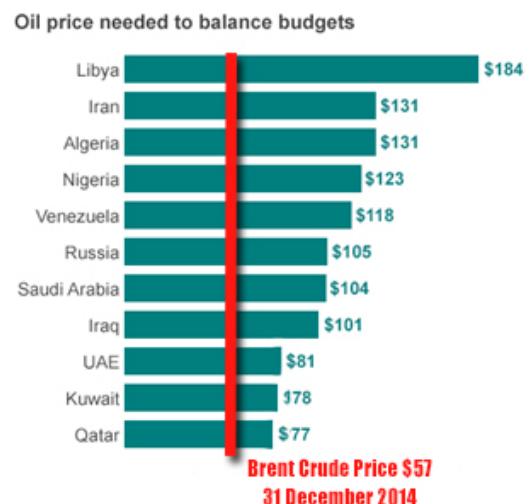
Both these deals are clearly not just an economic transaction but an attempt by Russia to safeguard its long term strategic and economic interests. By 2020, China will source 25% of its natural gas demand from Russia. Russia will then be selling more gas to China than they are now sending to Europe.

## Economy

The stand-off with the West over Ukraine is having serious repercussions for the Russian economy, which has for long been a key tool in Russia's internal cohesion and power projection abroad. Despite possessing large currency reserves and an economy valued at over \$2 trillion, this has only masked Russia's economic vulnerability.

Russia is blessed geologically and geographically, with its vast territory containing the world's largest proven natural gas reserves, second-largest proven coal reserves, third-largest known and recoverable uranium reserves and eighth-largest proven oil reserves. The taxes and duty from Russia's energy reserves makes up 50% of the Russian government's budget (80% from oil and 20% from natural gas) and constitute 35% of Russia's GDP. Almost all of Russia's \$500 billion exports are mineral and metal related. The energy sector is the primary pillar of the Russian economy.

The dependency on energy has hit the Russian economy hard as the Ukraine crisis has seen the west use energy and economics as a tool to hurt Russia. The fall in oil prices from over \$100 in early 2014 to below \$80 by November 2014 hurt Russia. The Russian budget relies on oil prices remaining above \$105 a barrel. Russia loses \$2 billion per dollar when the price of oil drops below this level. Due to the large role energy production and exports play in the Russian economy this has led to growth to completely stall in 2014 and on 2<sup>nd</sup> December 2014, the Kremlin's deputy prime minister, Alexi Vedev revealed the Russian economy will fall into recession in 2015.<sup>48</sup> Anton Siluanov, Russia's finance minister confirmed at an international financial and economic forum in Moscow on Monday December 1<sup>st</sup> 2014, falling oil prices were costing Russia up to \$100 billion a year, while Western sanctions had hit the country by \$40 billion.<sup>49</sup>



Sanctions from the West have created a sour investment climate leading to foreign investment to fall by half and capital flight of \$76 billion in 2014. This is affecting the regional governments in

Russia and demands for assistance from the Kremlin for capital injections, has led to Moscow's debts skyrocketing. The Kremlin's 10-year defence spending plan of \$77 billion is now in serious jeopardy.

Moscow has attempted to deal with this by dipping into its cash reserves. Moscow has \$582 billion in reserves. The Kremlin used \$130 billion in 2014 to aid Russian markets and currency and these reserves will likely decline very quickly similar to the 2008 financial crisis when it spent \$220 billion to prop up the economy.

Concerns over Russia's financial stability has erupted into public battles between the various Kremlin factions. The security circles are being blamed for failures in Ukraine, while the liberal economic circles are being blamed for the sour economy. Many personalities and groups are putting their own positions (and financial revenues) before the betterment of the state. But Putin's 15 years of success at balancing the clans came during times of rebuilding and resurging for Russia is now being called into question. Russian Finance Minister Anton Siluanov, a key figure in the liberal economic clans, publicly called on Putin to cut Russia's ambitious defence spending program in October 2014.<sup>50</sup> While Siluanov's argument against defence spending was financial, Putin also had to consider the security and political ramifications of such a decision. Russia's continued struggles in its borderlands will require a robust military. Moreover, Putin is using the defence budget to appease Russia's various security and defence circles.

## Conclusions

In *Strategic Estimate 2014*, our conclusion was that despite possessing global ambitions Russia lacked the capability to fulfil these and challenge the US in all the theatres in the world. In 2014 the US with the EU directly challenged Russia in its core and after a year of to and from it is humbling Russia. As Ukraine is integrated into Russia from an economic and agricultural perspective it is of great strategic value to Russia, losing it will have global ramifications for the country.

In the long term Russia has been successful in shifting its dependency on energy sales to Europe and for the next 60 years China will be a reliable customer for its energy. In the short term Russia will need to deal with problems closer to home if it is ever to pose a challenge to the US. It should be borne in mind that Russia has historically been a power in the world despite periods of extreme instability at home. As Russia's key resources are centralised and as Russia's security services are prepared to clamp down on any challenges to the Kremlin. Russia can always maintain a sizeable position abroad despite internal instability.

## 2015

**Economic issues** – Russia faces a number of serious economic issues that can no longer be concealed and will have to be dealt with in 2015. The Russian economy is weakening because of reduced industrial output and a decline in investment and consumer spending. Putin in 2013 announced the Kremlin would cut the government's budget by at least 5% for the next three years and run a budget deficit in 2014. The modernisation and privatisation programs, which the Russian people viewed favorably, were to bring in possibly hundreds of billions of dollars in investment and

advanced technology over the next few years. But these plans depended on European investment, and Europe's various financial and economic crises have forced many to backtrack on their commitment to Russia's programs. The Kremlin in 2015 will have to find alternative methods to stimulate the economy.

**Beyond the Periphery** - In 2015 Russia will need to build its capacity to challenge the US beyond its region. Russia has commercial relations with Syria, Iran and many nations on the African continent but needs to change these into political influence. Russian ties with Iran are deep and span decades which include arms sales as well as its nuclear reactors and weapons. However the US has been able to build political ties, which Russia has failed to do so. In 2015 and beyond, Russia needs to begin building its capacity beyond its region if it wants to challenge US hegemony.

**Responding to the US** – US Secretary of State John Kerry pushed King Abdullah of Saudi in September to secure his support to raise oil production and cut its crude price. This is crippling Russia's economy. Russia needs to respond in 2015 with equally strong action. It could refuse the payment for its oil and gas in dollars which would hurt the US economy or it could arm the Syrian rebels which the US has looked to sideline. Whatever the outcome, the conflict over Ukraine is at stake.

# China

In *Strategic Estimate 2014*, our conclusion of China was:

**“China is at the fringes of its low-wage, high-growth era. This economic model has now run its course and a move to domestic consumption as an economic engine is needed. In 2014 its internal challenges can no longer be overlooked. Decades of rapid economic development has exposed the countries Achilles heel and now painful reforms are necessary.”**

Throughout 2014, the Chinese government struggled to manage a deteriorating economic situation and the riots in Hong Kong have once again laid bare China's internal cohesion problem.

## Economy

In previous assessments of China, we concluded that the economic model used by China was reaching an end and numerous painful changes would need to be made, just to maintain what China has achieved. In 2014, China initiated some changes, but the signs of trouble ahead are now unmistakable. The global financial crisis in 2008 brought China's economic model of low wages and aggressive exports to an end. This economic model drove numerous other aspects of China's economy, social stability and foreign policy and all are at risk if a stable transition is not made. The projects that depended on this model were:

- China created Special Economic Zones (SEZ) in the coastal Guangdong and Fujian provinces that were designed to attract foreign investment in low-end manufacturing by offering cheap land, labour and a variety of tax and other incentives. This in turn gave China access to foreign currency and tax revenues to develop the interior of the country.
- China kept the value of its currency artificially low, which made it cheaper to purchase consumer goods – far cheaper for the world than anyone else. By China undercutting the world, aside from keeping Chinese factories open, this also meant most Chinese citizens had a job. When Chinese citizens have jobs, this deals with domestic social unrest which has long plagued China.
- The Chinese government used the national banking system to serve the Communist parties objectives. The nation's large savings were funnelled through banks to firms through subsidised rates. In order to qualify for such loans firms were required to maintain high employment in order to maintain social cohesion.
- 159 large State-Owned Enterprises (SOEs), provide the key inputs from utilities, heavy industries and energy resources that facilitate the private sector. The aggressive outward investment strategy, driven by SOEs and state banks with massive pools of cash allowed China to spread across the world looking to expand markets, employ services and buy up resources.

The global financial crisis in 2008 destroyed China's export sector. The crisis brought to an abrupt end three decades long export boom that the Chinese government micromanaged through years of systematic wage repression and huge subsidies. As a result of the crisis, the portion of China's GDP tied to exports collapsed, from nearly 40% in 2007 to below 24% today. To avoid economic

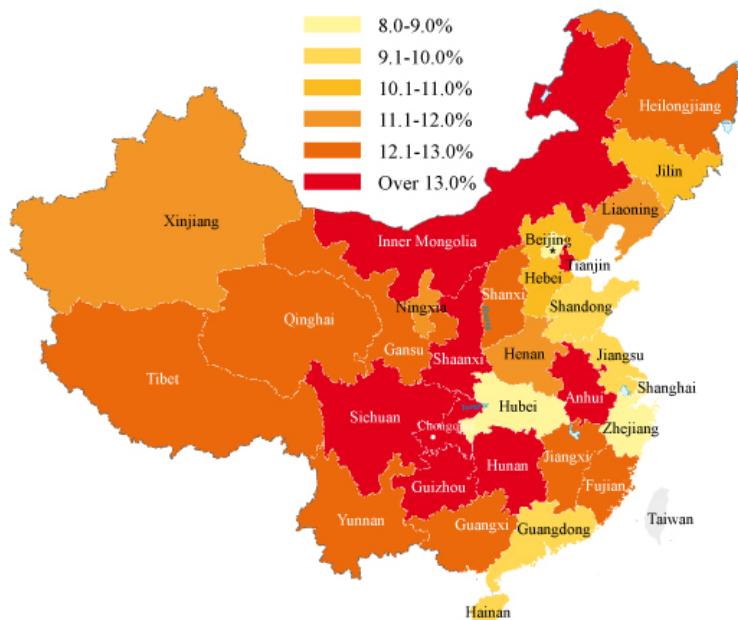
collapse (a regular feature in China's 4000-year history) Beijing kept the economy on life support through massive expansion of state-led investment into housing and infrastructure construction. This created a housing boom.

Today, 47% of China's GDP comes from investment, fixed capital formation into infrastructure development. The majority of that is either directly or indirectly related to housing construction. Currently 34% of China's GDP comes from household and private consumption, Beijing is looking to boost this very low consumption base and lower its heavy reliance on investment. In effect Beijing is looking to restructure and rebalance the country's economy away from exports and government investment to internal consumption.

This transformation faces multiple hurdles.

Restructuring an economy is usually a long, gradual and evolutionary process. Whilst many countries have achieved this, it took them decades to make the transition, some took half a century. China is looking to achieve this within a decade, which is an extremely tall order. Changing the components that drive the economy is one thing, but in China's case it will have to shift regional components of the economy in terms of how they function together. The last three decades have been entirely driven by exports from coastal provinces.

The coastal region as a result is interlinked with the global economy; it has seen most of China's rapid development and enriched a new breed of merchants, all at the expense of the rest of China. Most of China today remains largely agrarian, has little infrastructure and lives in poverty. The wealth China has made is in the hands of a few. According to the Institute of Social Science Survey's 2014 China Welfare Development Report, published by a research institute in Peking University, 1% of China's households owned 33% of the nation's wealth.<sup>51</sup>



Since the global financial crisis began in 2008 the Chinese government has made efforts to rebalance the economy towards a more-developed urbanised interior, where a population of 700 million people, who are not really involved in the economy. It did this through massive investment into real estate to develop clusters in the interior. This has created a huge property bubble as the government pumped credit into this sector to mitigate the drop in exports. From 2008 to mid-2014, Chinese GDP doubled on official figures. In that same period, also on official figures, the volume of outstanding bank loans almost tripled. This is close to \$9 trillion in new debt issued by state banks. From mid-2008 to mid-2014, Credit Suisse estimates Chinese private wealth increased only about \$5 trillion. In comparison, the US added a hefty \$6.5 trillion in federal debt from 2008 to mid-2014. Against that, though, net private American wealth soared \$22 trillion.

### CASE STUDY: Japan

Japan's lack of mineral resources drove it to import resources, add value to them and then export the resulting products for economic growth. Very little of the process actually took place on the island country. Japan used its banking industry just as China is today in order to make it globally competitive. The Japanese government ensured subsidised loans at below market rates for any firm willing to import raw materials, build products, export products and employ citizens.

Profitability did not come into the equation because the state ensured that such operations were indirectly subsidised by the financial system. More loans could always be attained. Eventually the Japanese economy collapsed under the weight of trillions of dollars of non-performing loans. The ever-mounting tower of debt consumed all available capital. The Japanese economy has never recovered.

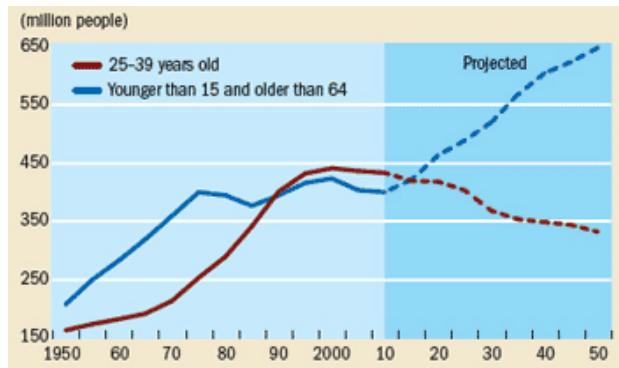
China has imitated this finance and export strategy as a means of powering its development and holding together a disparate country. However the Chinese application of the strategy faces the same bad-debt problem that Japan's did. This strategy was pursued to hold together the nation, its failure will lead to social breakdown and not just economic meltdown

With the risk of the real estate bubble bursting, the government has withdrawn credit and this has kept this system working for 6 years. But the pumping of credit into the economy is not having the same effect as it used to. With slumping economic conditions much of the new real estate is sitting empty causing property markets and housing-related construction activity to decline across virtually every region in China. This has already caused localised property crises which are wrapped up into local debt. At some point this will become a systemic nationwide crisis. The stimulus into construction, infrastructure and real estate which was meant to keep the economy afloat due to the fall in exports has created another crisis. The main strategy for the moment to transform the economy is credit and investment; however, their effectiveness is already diminishing.

Central to the transformation of the county has been Chinese premier Xi Jinping's anti-corruption drive. Whilst these are not the level of the 'great purge,' it is unprecedented in China for the last two decades. While economic reforms include investment in the interior of China, political reform will require clearing out the obstacles to reform and reshaping the foundations of the Communist party. Currently, around 200,000 officials all across China have been probed or detained. These are officials from every level of government and across at least five or six different sectors and within some of China's most powerful bureaucratic institutions. The military has also been part of the anti-corruption drive. A purge of the army has also begun which is aimed at giving Xi control over the military so that he can use the military as a vehicle for his reforms. The sheer size of this anti-corruption drive will inevitably lead to instability as those losing power will fight back.

The last hurdle is demographics.

China will need to urbanise much more of its population if it is to increase domestic consumption. It will need to house, employ, care for and educate most of its population if it hopes to create more consumers by 2030. Within the next decade however, over 25% of China's population will be over the age of 60, compared with under 15% today. In that time, the portion of China's population too young or too old to work will rise from around 38% to 46%, with the balance of China's dependent population shifting substantially from young to old. At the same time, China's working-age population (20-59) is set to decline by as much as 80 million people. The shift to internal consumption will require a drastic increase in worker productivity just to sustain growth rates even remotely close to present levels.



## Hong Kong

In October 2014 China faced another pro-democracy protest, rekindling memories of the Tiananmen Square massacre in 1989. Back then the Beijing government called in the army and slaughtered thousands of people to clear the streets. The memory of this use of force, and decades of subsequent suppression, kept the pro-democracy advocates quiet. Hong Kong is a special case because for over a century it was ruled by the British and was returned to Chinese control in 1999 to fulfil the treaty by which Britain controlled the city.

This history created different attitudes amongst the people of Hong Kong, even though they are ethnically Chinese. Located at China's doorstep along the Pearl River Delta, Hong Kong has long acted as a bridge between mainland China and the West. Historically, when China has been inward-focused, Hong Kong has served as one of the few channels through which the mainland could communicate and trade with the outside world. When China opened up, Hong Kong served as a crucial facilitator. The mainland still relies on Hong Kong for trade and foreign investment due to the city-state's position as a regional trade and logistical hub.

Hong Kong helped facilitate the Chinese mainland's economic opening over the past three decades. The city of Shenzhen, located immediately to Hong Kong's north, was developed as China's first special economic zone with the introduction of some market reforms, and the Pearl River Delta has become a global manufacturing hub. Hong Kong has long boasted a free port and a Western-style regulatory system, making it an ideal gateway for foreign investment in the mainland.



For many in Hong Kong the core values of the city-state are its vibrant civil society, free speech and rule of law — all inherited from the days of British rule. This belief has created a great degree of political consciousness, especially in the years since Beijing's takeover. Hong Kong's populace has

therefore always been sensitive to any attempt by Beijing to undermine the city-state's democratic system.

However the Chinese mainland economy has outpaced Hong Kong's in recent years and key cities such as Shenzhen, Shanghai and Guangzhou have become China's bridges to the outside world, marginalising Hong Kong. For decades, Hong Kong was characterised by its vibrant civil society, liberalised economy and rule of law, features that were not always reconciled with traditional Asian culture. Hong Kong's population has a strong desire to preserve the qualities that set the enclave apart from mainland China: political autonomy, financial liberalisation and relatively democratic institutions. This desire has grown more prominent over the past decade, during which Beijing's political dominance and cultural and economic influence in the city-state have grown.

The unrest began in June 2014 due to a referendum on greater democracy for Hong Kong. Around 22% of registered Hong Kong voters cast electronic ballots in the non-binding poll. Most people voted for more democracy. Since Hong Kong returned to China in 1997, Beijing has controlled who can run for office and directly appoints most officials. Beijing has long suppressed demands for more democracy in Hong Kong. The government has made it very clear that there will never be true democracy in Hong Kong but the locals refuse to stop agitating for just that.

Due to China's sheer size maintaining social cohesion has always been a colossal challenge. Many of China's outer provinces such as Inner Mongolia, Manchuria, Xinjiang and Tibet have been controlled through brutal methods with a large security apparatus spying on residents. Beijing needs to keep Hong Kong in check; ensuring protests do not spread to other mainland provinces, who have long been marginalised. Any heavy handedness will become a rallying cry from the world, especially with many dissidents residing in Hong Kong. Hong Kong leader CY Leung accused "external forces" of involvement in the territory's pro-democracy protests. In a TV interview, Mr Leung said the rallies, which have paralysed parts of the territory for three weeks, were "*out of control*" even for organisers.<sup>52</sup>

In the end, on December 15<sup>th</sup> 2014 police dismantled the last remaining road occupation, and a prominent student activist, Joshua Wong, appeared in court with about 30 other arrested protesters. "*We achieved something,*" said Teresa Liu, a student who said she had regularly stayed at the camp since Sept. 29. "*We achieved international notice, and since we got notice, China has no excuse to hide anymore.*"<sup>53</sup> But the Hong Kong government gave no substantial concessions, and the protest movement increasingly succumbed to exhaustion and internal fractures.

China succeeded in the end to derailing this pro-democracy protest, but similar uprisings are far from over.

## Military ascent

China's military ascent continues to make headlines around the globe. China continues to use its military to consolidate its position in the region and protect its economic supply lines around the globe. But for China to be a regional and then global power it will need to develop its military in order for it to meet the multiple challenges it will have to navigate.

From a doctrine perspective prior to the 1990 Gulf war the People's Liberation Army (PLA) was oriented towards a protracted total and nuclear war which was based on the premise of a Soviet invasion of China. By the end of the 1980's, PLA strategists concluded that local, limited wars triggered by disputes over maritime and land territories were more likely than a massive foreign invasion of China. The more likely war scenario for the PLA would be a medium-sized local war. The 1990's witnessed the collapse of the Soviet Union and the first Gulf war. The result of 1991 war between the US and Iraq led to a major rethink in Chinese military doctrine. China's forces lagged far behind most of the world in military development and was utilising platforms developed in the 1950's. The annihilation of the Iraqi army, which was similarly equipped and followed a similar doctrine to the Chinese military proved to Chinese leaders that modern precision weapons could quickly obliterate soviet era equipment, and that the standoff afforded by these systems ensured minimal casualties to the military force using them.

As a result, China's armed forces underwent modernisation in order to bring them on par with the world's powers. Mao's doctrine of 'human wave attacks' - having more soldiers than your enemy has bullets was replaced with a relatively smaller armed force emphasising new technologies. Recognising the need to reform, China has ever since been undergoing a Revolution in Military Affairs (RMA), which emphasises a C<sup>4</sup>ISR (command, control, communications, computers, and intelligence) systems. Today, China's leaders have sustained this ambitious and broad-based military modernisation program intended to transform the PLA into a modern force.

China's defence industry is today comprised of 11 state-owned enterprises related to ordnance, aviation, space, shipbuilding, nuclear weapons and electronics production. Following two decades of defence-industrial reforms each of these ministries was transformed into corporations. China's industrial base is now in its third decade of military modernisation. After attempting to domestically produce all of the weapons needed to equip the country's military for much of the 1960s and 1970s. China then turned to purchasing weapons systems and related components and technologies from the major military equipment producers of the world in the 1990's. Since the 1990's China has attempted to improve design and manufacturing processes so as to produce better-quality weapons domestically while importing key systems to fill short-term needs.

## **Infantry**

China fields the world's largest armed forces, with a standing army of over 2.2 million personnel. China's ground forces constitute the largest branch of 1.7 million active personnel – 70% of China's combined forces. China's ground forces continue to undergo significant modernisation and restructuring to deal with potential threats and enhance its land warfare capabilities.

China's ground forces have moved towards smaller and more mobile forces. It has disbanded dozens of heavy divisions and created smaller brigades – producing a core of mobile mechanised forces and motorised functions. China has also inducted 'special mission battalions' for quick-reaction missions and rapid deployment. However China's ground forces still faces significant challenges in shifting from internal security to external expansion. China's army is primarily configured as a domestic security force, which has been a necessity due to the countries history of

internal tensions. Having been designed for internal security, China's ground forces are doctrinally and logically disinclined toward offensive operations. Using a force trained for security as a force for offensive operations leads either to defeat or very painful stalemates. The PLA was built to control China, not to project power outwards. Since the 1980s, the Chinese have been attempting to transfer internal security responsibilities to the People's Armed Police, the border forces and other internal security forces that have been expanded and trained to deal with social instability. But despite this restructuring, there remain enormous limitations on China's ability to project military power on a scale sufficient to challenge the US directly.

## Airforce

China's air force remains in transition from two decades of modernisation. The sheer size of China's geography requires a large fleet of modern fighters, bombers and significant airlift capability.

China's fleet consists of both older aircraft fielded in the 1980s, and newer designs introduced in the 1990s and later. The thousands of J-6 fighters that once made up the fighter fleet have been retired. The current inventory is composed primarily of third and fourth generation fighter jets. Most of the military products of China's aviation sector are obsolete by western standards. Some fighters and attack aircraft still produced in China are based on 1950s-era Soviet designs. Whilst these are inexpensive to maintain and relatively fast and agile, the performance of these aircraft fall well short of those being produced in the US, Russia, Europe, and Japan in terms of acceleration, rate of climb and weapons load.

Since the late 1990s, China has begun producing progressively more-advanced aircraft in a strategy to replace its ageing fleet with indigenously developed platforms. China has increased the number of its modern, fourth-generation aircraft from 50 to 600 since 2000, even as it has reduced the size of its overall air force from 3,000 combat aircraft to around 2,000. Military modernisation is about smaller but more up-to-date force structures and this is what China has been pursuing. Over the next decade the J-10, J-11 and J-20 will predominantly make up China's fleet.

However, problems remain. For the moment China lacks the long range and air lift capability needed for a nation the size of China. The bombers that China produces are medium bombers that are based on a 1950s-era Soviet design. China does not produce long-range heavy bombers. To date, China has also been unable to produce and indigenously design a jet transport. The main reason why China does not produce heavy bombers or jet transports is because it has been unable to produce an indigenously designed and developed jet transport engine. Turbojets lack the power and fuel efficiency needed to propel large aircraft over long distances. No Chinese-produced engine has yet been accepted for installation on a long range and heavy plane.<sup>54</sup>

## Navy

Since the late 1980s, China has been seeking to develop a 'blue water' navy force capable of operating in the regions beyond its offshore waters. The modernisation of its navy has become all

the more important as China relies on the sea lines of communications (SLOC) to secure the country's global network of energy resources and trading activities.

During the 1980's China modified first-generation, Soviet-designed vessels using newer naval technologies and then built second and third generation ships based on indigenous designs whilst incorporating mainly foreign weapon systems. This led to the development of the Jianghu-class frigates. The period also saw the upgrading of the Wuhan-class conventional submarines and modification of several Luda III-class destroyers. In the 1990s China purchased four Sovremenny-class destroyers from Russia and put into service 10 new classes of indigenously built destroyers and frigates (some of which are variations of one another) that demonstrate a significant modernisation of PLA Navy surface combat technology.

China since the mid-1990s has acquired 12 Russian-made Kilo-class non-nuclear-powered attack Submarines (SSs) and put into service at least four new classes of indigenously built submarines, including a new nuclear-powered ballistic missile submarine (SSBN) design called the Jin class, a new nuclear-powered attack submarine (SSN) design called the Shang class, a new SS design called the Yuan class and another (and also fairly new) SS design called the Song class. The Kilos and the four new classes of indigenously built submarines are regarded as much more modern and capable than China's aging older-generation submarines.

China has recently commissioned into service its first aircraft carrier—the *Liaoning*, which is a refurbished ex-Ukrainian aircraft carrier, previously named Varyag, that China purchased from Ukraine as an unfinished ship in 1998. During the next decade China is likely to fulfil its carrier ambitions, becoming the last permanent member of the UN Security Council to obtain a carrier capability.



Although China is designing and building increasingly sophisticated warships, Chinese naval shipbuilders still need to import key components or modules, such as propulsion systems, navigation and sensor suites, and major weapon systems, to outfit these vessels. Such a reliance on imported subsystems creates systems-integration challenges, as well as security concerns stemming from dependence on foreign suppliers.

Although the People's Liberation Army (PLA) is undergoing mechanisation, it remains largely a light-infantry force. It consists of approximately 200 combat brigades, operates about 7,700 Main Battle Tanks and about 5,000 Armoured Personnel Carriers (APCs) and infantry fighting vehicles. The remainder of the PLA Army consists mostly of foot soldiers or motorised infantry. The majority of the weapon systems operated by the PLA Army are still based on obsolete designs, but some (e.g., the Type 98/99 main battle tanks) are comparable in capability to the most-advanced systems used by the militaries of other countries.

China's navy operates around 60 submarines (most of which are conventionally powered), 30 destroyers, 45 frigates, and a large number of smaller combatants. China's navy has no operational

aircraft carriers (until the *Liaoning* is launched) but maintains around 800 shore-based naval aircraft. As is the case with the army, the majority of platforms operated by the navy are outdated, but a few are modern systems comparable in capability to those operated by the US military.

China's air force operates approximately 1,800 combat aircraft, fewer than 20 strategic-transport aircraft, fewer than 100 theatre airlift aircraft, and 10 aerial-refuelling aircraft. As is the case with the Army and the Navy, the majority of these platforms are outdated, with only a few modern systems comparable in capability to those operated by the US military.

China has made significant progress in modernising its armed forces but the balance of military power between the US and China is still predominantly in favour of the US. Unless the US develops a whole new generation of weapon systems, in the next decade this lead will in military terms become insignificant, as the technology gap will not be sufficient to negate tactics and numerical superiority. If tensions escalate across the Taiwanese straits, US intervention cannot be guaranteed to succeed or even to occur. The shifting military balance has made the possibility of war between China and the US a remote possibility. The more important consequence of the modernisation of the Chinese military is the proliferation of advanced weapon systems to third parties which complicates the hitherto gunboat diplomacy that has characterised US foreign policy in the previous century.

## Conclusions

In successive *Strategic Estimates*, our assessment of China's position in the world was questionable due to the sustainability of its economic growth. In *Strategic Estimate 2014*, we concluded China's economic model has run its course and how this is navigated will have repercussions not just for China, but for the world.

In 2014 China began the opening gambit of the colossal task of restructuring its economy. The outcome of this will have ramifications within China, its region and the global balance of power. As China undergoes this process, it is on the verge of its population decline where its workforce will only get smaller. As China's rise has been predicated upon its economic development a stable and rapid transition is needed. With a country of over 1 billion people, this is a tall order.

China effectively needs to shift its economic drivers, wealth and progress to its vast interior which has been a bystander in China's three decades development. For China to play an effective role in its region and beyond stability internally is crucial. The outcome of this transition will also impact its military as China attempts to modernise, develop indigenous military platforms and become self-sufficient.

As matters stand at the end of 2014, China is a regional power and poses a challenge to the global super power in its region. China currently poses no challenge to the US global position, which remains well beyond its reach. If China is able to transform its economy and develop global ambitions then it would pose a challenge to the global balance of power.

## 2015

**Maritime development** - Whilst China has intensified its naval activity, it is becoming increasingly constrained by its limited global logistics framework, particularly in terms of underway replenishment assets (ships that can refuel other ships moving at sea) and available ports for resupply and maintenance. While China could adequately support its fleet operations in the East and South China seas given its current fleet train, Beijing's expanding global deployments in particular are beginning to task its supply ships. In 2015 and beyond, China will need to invest in new replenishment ships and expand the number of resupply ports it currently has. China's maritime capability is critical to its strategic success as it attempts to protect its rapid economic development.

**Internal Cohesion** - China has for long suffered from an internal cohesion problem and in 2014 this has become worse. Zhou Xiaozheng, a senior professor from the Institute of Law and Sociology at Renmin University of China explained the reality in China "*Don't forget, China's current success is built on 300 million people taking advantage of 1 billion cheap labourers. And the unfair judicial system and the unfair distribution of wealth are making the challenges even greater.*" Due to China's economic woes the Communist regime has attempted to deflect attention by raising the spectre of terrorism. As China attempts to restructure its economy, the internal cohesion remains a big problem. As Hong Kong has shown foreign interference could spread in China if this problem is not solved.

**Pollution** - The one metric that sums up the country's problems is pollution. Only three of 74 Chinese cities monitored by the government met minimum standards for air quality in 2013. Polluted air, desertification, toxic waterways, soil erosion are big problems China suffers from. China suffers a long, long litany of man-made environmental problems, much of it related to its coal addiction. China now burns 47% of the world's coal. It is now a common sight to see thousands of dead, bloated pigs floating down the river that supplies Shanghai with its drinking water. Air pollution in Beijing is so impenetrable the US Embassy's air quality measuring station can only call it "beyond index." Industrial towns where rates of cancer are so high they're known as "cancer villages." The problem lies in the fact that the Chinese government values economic development at any cost. In 2015 and beyond China will need to address this.

# European Union

In *Strategic Estimate 2014*, we concluded:

**"In 2013 the EU struggled to create growth and deal with the debt that many of its members are unable to repay. All of this is now causing unemployment to grow which in turn is leading to social issues such as the rise of right wing groups in a number of EU nations."**

Throughout 2014 the EU has continued in its attempts to solve the economic crisis, with mixed results and as an entity the EU turned its attention to Ukraine during 2014.

## Economy

When the EU crisis began in 2010 Germany led the solution to the crisis. It used the crisis to introduce controls on the fiscal systems of EU member states as well as restrictions on their national budgets. Germany imposed austerity as the only way to resolve the crisis on the continent and kept out any other potential solutions. This meant European nations would need to cut their budgets and balance their books.

For the first few years all eyes were on the European periphery. Emergency summits were held and extraordinary measures were taken to prevent Greece from collapsing and leaving the eurozone, as well as Portugal from defaulting on its debt and Spain's banks from collapsing - some of which did. Bailouts were distributed, promises of intervention on debt markets were made and economic reforms were requested. But the European periphery continues to struggle. Half the stores in Athens' main shopping streets are closed, many Portuguese live on poor salaries and more than half of Spanish job seekers cannot find one. In 2014 it was not the PIIGS economies (Portugal, Italy, Ireland, Greece and Spain) that were holding the EU down but its core member – Germany who is now technically into its second recession in recent years. Due to this France and Italy questioned Germany's leadership in Europe and the European Union's deficit and debt targets.

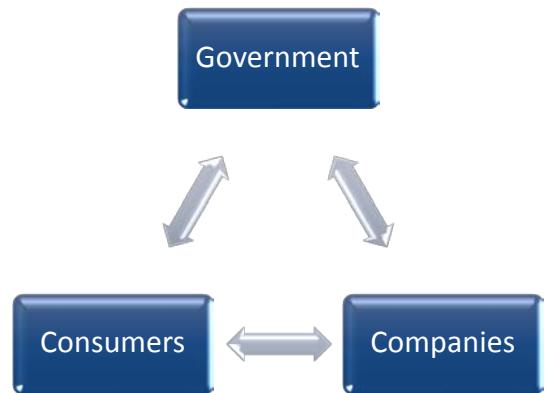
Germany incorporated fiscal responsibility (balanced government budgets) into the fiscal compact treaty, signed in 2012. The fear of a eurozone collapse was so strong that Germany was able to make certain demands. The treaty established strict targets when it came to debt and deficit, giving the European Commission additional powers to oversee national budgets (this process started in 2011). However, France challenged the system, while Italy directly ignored it.

Germany is facing serious economic challenges at home. In 2014 economic activity was down as well as industrial production. With the German economy reliant upon exports and export

destinations facing their own economic woes, the European debt crisis is now affecting Europe's heavyweight.

In France, the Francois Hollande government is deeply unpopular and internal dissent is threatening the ruling Socialist Party. All of this is leading to the continued growth in popularity of the anti-euro, right wing National Front, who in 2014 got its first ever seats in the Senate.

The problem at the centre of Europe is the strategy to use Austerity to solve the crisis, this has only made it worse and the longer Germany holds the continent hostage the worse the economic climate will get. This is because in the middle of an economic crisis European nations are not spending but cutting expenditure. When the economic crisis began in 2008 individuals cut spending and companies laid off staff and also cut spending and halted plans of expansion due to the negative economic climate. In this environment governments across the continent also cut spending, rather than expand it, so no segment of the economy was spending, which would create economic activity. Modern western economies depend on spending, it is spending that creates jobs and incomes; and in turn incomes create spending.



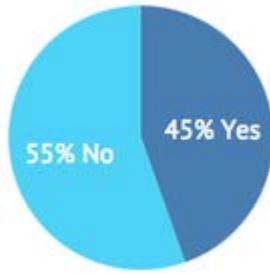
Spending is made up of private sector spending (households), corporate spending (businesses) or government spending. If, for one reason or another, the private sector or businesses reduce their spending, then total spending can only be kept up by the government increasing its own spending. If the government simultaneously reduces its own spending, then the amount of activity in the economy is bound to fall. This is exactly what has taken place in Europe. Government spending has been cut, in the name of reducing debt and national deficits and this has dragged the whole economy down as no segment of the economy is spending and generating economic activity.

Europeans leaders have argued there austerity strategy has worked as there has been some growth since 2008 and that austerity should be seen as a long-term plan not a short-term one. This however, has been due to stimulus spending and quantitative easing (QE) – (pumping money into the economy) – which a country with its own money creating central bank can do, but which the European Central Bank currently lacks a mandate for. The growth that has taken place in Britain throughout 2014 is due to this and is not sustainable. This is why every time the British economy and every other country that pursued QE and stimulus spending saw some growth, but then stagnated as it was unsustainable. Attempting to kick start economic growth with stimulus and QE are merely high-octane boosts and temporary measures. They are designed to kick-start stalled economies, not to fuel sustained economic growth. The growth that is achieved is just the inflated results of stimulus and QE measures achieving their intended effect of being temporary.

Debt and deficits across Europe will not be solved without growth, but austerity undermines all of this. This is why unemployment continues to rise in Europe and this is leading to a political crisis which is leading to more of the continents population becoming Eurosceptic.

## Euroscepticism

Separatist tensions in Europe were clearly visible in 2014. Scotland's referendum was for leaving the United Kingdom, but its reasons for this were the same as all of the separatist movements across Europe – economics. The European sovereign debt crisis, which continues to plague Europe, is leading to calls by various regions to secede from their unions. The UK like many of its European counterparts implemented strict austerity against their populace as they bailed out their banks, but smaller regions believe they can do better economically if they are independent than as a region of a larger state. The ability to tailor economic policies closely to their own needs can give a small country a better chance of success than the one-size-fits-all strategies of a larger state.



In the end the Scots voted to remain with the UK by an overall vote of 55%. Nearly half of the 4.2 million electorate voted to secede. Secession calls have not permanently been put to rest in the UK and the Westminster government will have to fulfill its promise of further devolution to Scotland.



Prior to the Scottish vote the Italian region of Veneto, which includes the city of Venice, held an online referendum to secede from Rome. Italy has long been divided on a north-south axis due to historical developmental differences. The northern regions are some of the richest of Europe and represent Italy's financial and industrial center. The south has traditionally been agriculture-based and ignored by the north in terms of infrastructure and investment. Due to this numerous separatist movements have emerged in Italy. The referendum was not legally binding, as it was not recognised by either the national government or the local regional government. The goal of the unofficial referendum was to rally popular support for a bill calling for a legally binding referendum. The result was even beyond the most optimistic supporter of 'repubblica Veneta.' With a 73% turnout, 89% of the citizens of Venice voted for their own sovereign state.<sup>55</sup>

In November 2014, Catalonia with Barcelona as its economic hub was due to have its own referendum to secede from the unitary state of Spain. Catalan nationalism has been exacerbated by the European economic crisis, with Catalonians believing the deficit driven economic policies of the Madrid government are failing them and they would prefer to go it alone. The Madrid government was able to block Catalonia's



independence referendum at the Constitutional Court, making the whole vote illegal. The independence referendum was then replaced by a non-binding consultation with a definitive vote to be held at some point in the future. The ballot on 9<sup>th</sup> November 2014 consisted of two questions: “Do you want Catalonia to become a State?” and “Do you want this State to be independent?” The second question could only be answered by those who had answered ‘Yes’ to the first one. The turnout ranged between 37% and 41.6% and 80.8% of the cast votes supported the Yes-Yes option. Whilst Catalonian and Scottish secession has been driven by economics, many movements across Europe based on ethno-sectarian lines have for long wanted independence, often using violent means. Modern Belgium was created in 1830 essentially as a buffer state between Europe’s super powers France, Germany and the UK. As a result, the country is inherently fractured and consists of three highly distinct communities: Wallonia, in the south, is mainly French-speaking and has historical ties with France. The Flemish-speaking communities in the northern region of Flanders share historical ties with the Netherlands. A small German-speaking community lives in the east near the German border.



The EU’s inability to solve the economic crisis has led to unconventional parties to win considerable seats in national parliaments and form coalition governments as Europeans are losing faith in conventional parties. With Germany imposing strict rules on how national budgets can be used and funded, secessionist calls will only grow and this presents another political challenge to the European Union project.

## Ukraine

After the fall of the Soviet Union, Europe began to push its boundaries on the continent eastward, destroying Russia’s ability to influence the region. The pro-Western lines moved to the east for the past two decades, via NATO and European expansion, until they pushed hard up against Russia’s borders. Since the collapse of the Soviet Union Europe has been expanding East and worked to bring all the former Soviet republics into the union. The EU was very successful at this as Russia was in internal chaos. With many former Soviet republics joining the EU, the EU was able to establish a large pro-EU support base. It was this support base that overturned the electoral result in 2005 in the Orange Revolution.



The EU had been negotiating with Ukraine for several years over closer integration with the bloc. Ukraine formally joined the ‘Association Agreement’ - which is the political arm of the integration process, while the Deep and Comprehensive Free Trade Agreement (DCFTA) embedded within the association agreement represented the economic component. These agreements served Europe’s aim to bring countries not yet ready to begin formal accession closer to the bloc. Ukraine was working to integrate into the EU, but progress was extremely slow, due to the internal divisions in Ukraine.

When protests began against Yanukovych, due to him backing down from the EU association agreement in November 2013, Europe openly supported the protest groups in order to bring down the pro-Russian government. EU officials were openly meeting with protestors in Kiev square, on 11<sup>th</sup> December 2014 Catherine Ashton, the EU’s foreign policy commissioner, met with opposition leaders.<sup>56</sup> It was the foreign ministers of France, Germany and Poland representing the Western camp that brokered the deal between Yanukovych and the protesters, not the protest leaders, envisioning a new national unity government with constitutional changes to hand powers back to Parliament and early elections.

When Russia annexed Crimea, the EU responded with sanctions against Russia. Europe’s sanctions prohibited state-owned Russian banks from buying or selling bonds and equity in the European Union, placed an embargo on new arms sales, prohibited exports of dual use goods (software and technology that can be used for both civilian and military purposes) to Russia and restricted the export of certain energy-related equipment and technology to Russia.

By May 2014 the EU was able to bring to power the pro-EU candidate Petro Poroshenko as president of Ukraine and he immediately signed the EU agreement that Yanukovich had abandoned as well as a financial assistance package with the International Monetary Fund. This solidified Ukraine’s pro-EU status.

## **Conclusions**

Europe made significant gains in 2014 in stealing one of Russia’s most prized possessions – Ukraine. The conflict over Ukraine is far from over and its clear Russia is in for the long run despite sanctions by the EU. The whole of Europe is beholden to Germany, who expects changes to be made to maintain the EU in the form Germany sees fit. Germany has imposed austerity on member nations and as far as it’s concerned there is no other solution to the crisis on the continent other than reducing the continents debts and government budget deficits.

The economic crisis on the continent will only deepen if the existing course continues to be pursued; even though Germany constantly helps member states in trouble, this is unsustainable. At the end of 2014, Europe remains in a quagmire due to the political demands of Germany.

## Case Study: Germany

Germany is at the Centre of the European continent. It is not Brussels, London, Amsterdam or Paris that will determine Europe's fate, but Berlin. Europe cares about Germany like Asia does about China. Germany is the world's fourth-largest exporter and at \$3.4 trillion, the world's 4<sup>th</sup> largest economy. Germany is at the Centre of its regional trade bloc. Whilst Germany trades on a global basis, it has a special and mutual dependency on its region. Germany depends on exports. Germany's exports were equivalent to 51% of its GDP, or about \$1.7 trillion, in 2013.

Germany created a manufacturing colossus that outstrips the German public's capability to consume. Germany cannot increase domestic consumption as its already consuming at near capacity. Germany overcame this by constructing the European Union and the eurozone and making the whole continent its domestic market. With the single market it institutionalised this.

Therefore, economic viability for Germany depends on maintaining exports. No matter how much they import, their exports maintain domestic social order by providing a significant source of jobs right away, rather than in some future scenario. This also means Germany unlike most nations regularly posts trade surpluses rather than deficits.

The problem with an export-driven economy is that the exporter is the hostage of its customers. Germany's well-being depends not only on how it manages its economy, but on how its customers manage their own economies. If the

customer's economy fails, the customer cannot buy. It doesn't matter whether the problem is a policy failure or a downturn — the exporter will pay a price. Germany is a special case, as the European Union is a trade bloc and a single market, German imports will always be cheaper than any other non-European exporter. This is why Germany will always defend the EU as its fate is directly linked to the union. However Germany does not directly run the EU national economies, but through the economic crisis on the continent it has imposed terms such as



determining member states national budgets and the conditions for bailouts

Germany is currently dealing with the fact that its customers' appetite for goods are declining - whether because of price competition or because of economic decline. Europe is in economic turmoil. Southern Europe is suffering from massive unemployment, and the rest of Europe is experiencing slower economic growth, no growth, or even decline. Demand in

this market is essential to Germany, and it is difficult to maintain demand under these circumstances. Germany's fate rests with the survival of the EU.

## 2015

**Scepticism** – In 2015 the EU will need to deal with the scepticism that continues to grow in size and scope. Euroscepticism or Anti-EUism is the body of criticism of the European Union and opposition to the process of political European integration, that not only exists but is growing throughout the political spectrum. In 2014 the highest levels of EU officialdom were rattled by victories and major gains for Eurosceptic and populist parties in countries that included Britain, France, Spain, Italy, and Greece, following May's European elections. National governments work with the EU but then undermine it in order to appease domestic public opinion and it is this that has allowed far right groups and anti-EU groups electoral success. These parties act like a virus from the inside and constantly undermine the EU as it tries to function in the worst economic crisis for decades.

**Immigration** – Whilst the EU established the free movement of labour and migration within its borders this is now the number one concern of EU citizens. National governments within the EU constantly peddle anti-immigration propaganda, even though they signed up to the EU's single market. Across Europe, the number one concern for the electorate is immigration and anti-immigration parties have seen significant electoral success as a result of this. For many, migration is Europe's biggest problem. Many believe the big waves of immigration into Europe over the past 20 years led to fractures in national communities, strains on infrastructure and resources and in a few extreme cases, the radicalisation of minorities in both the immigrant and indigenous populations. But the reality is with many EU nations in population decline, immigration is needed to just maintain their workforces at current levels. In 2015 and beyond, the EU will need to contend with this as politicians within their own countries criticise immigration for electoral success.

**New Economic Direction** – Whatever the rhetoric, whether it is stimulus or austerity, both strategies have failed to end the global economic crisis. Stimulus has just created artificial growth which tapers off once it's worked its way through an economy, leaving a nation in the same state it was prior to the stimulus. Austerity has led to government to halt the economic engine when it should be stimulating the economy. This is why unemployment continues to rise. In 2015, despite what the statistics say, a change of strategy is needed.

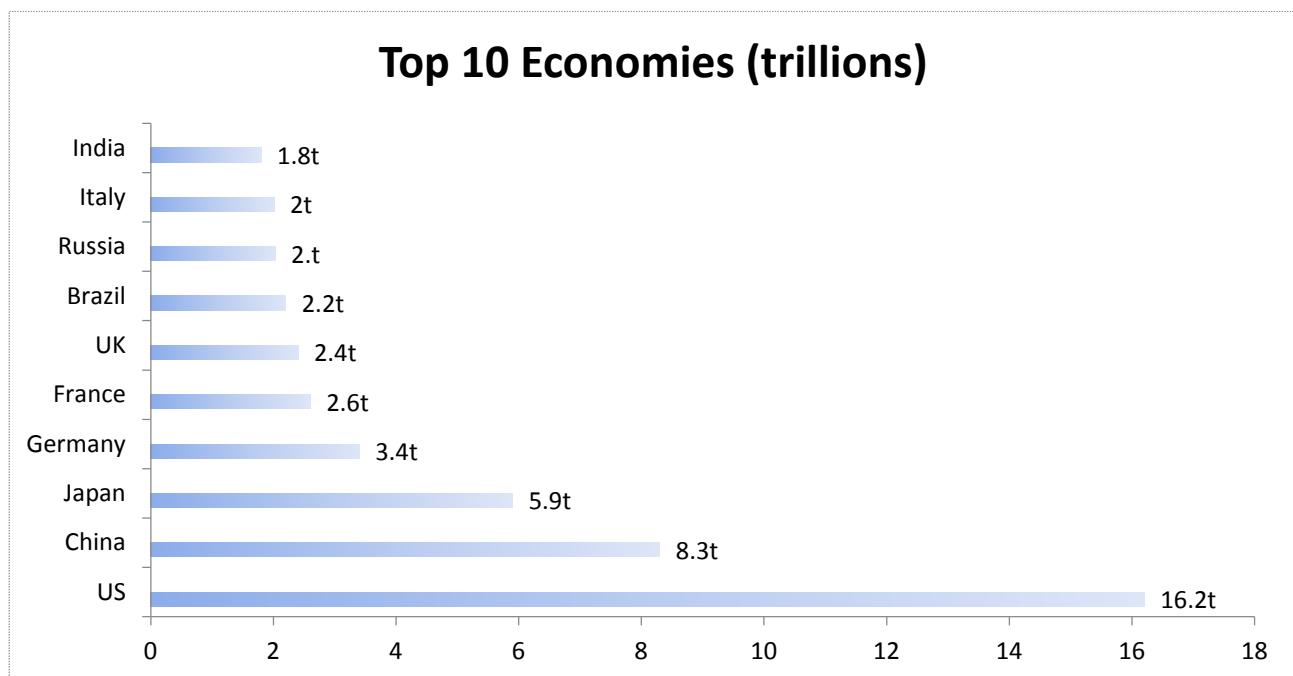
# Global Economy

Our assessment of the global economy in 2013 was:

**"After 6 years, the underlying factors that lead to the global economic crisis still remain. Although the fall in the global economy is slowing, the global economy is not improving. Statistics and data can be easily manipulated, but when unemployment, borrowing and lending, production and wages are analysed these all continue to fall even if GDP is improving."**

Despite economic growth in 2013, much of this was artificial and not sustainable on closer inspection. In 2014 very little has changed as the global economic crisis reached its seventh anniversary, a point highlighted by the UK Prime Minister David Cameron at the G20 summit in November 2014. David Cameron issued a stark message that: "*red warning lights are flashing on the dashboard of the global economy,*" in the same way as when the financial crash brought the world to its knees seven years ago.

## Trillion dollar economies



The top 10 trillion dollar economies represent 63% of the global economy, with the US economy by far the largest. They drive the global economy and in an economic downturn they would drag the globally economy down with them. Analysing them individually highlights why the global economy struggles to grow.

**US** – The world's largest economy began 2014 with its economy shrinking nearly 3% in the first quarter. Whilst unseasonal wintery weather was blamed for the poor results, the failure of the US economy to sustain a healthy recovery 7 years after the financial crisis has exposed fundamental flaws in the world's largest economy. Whilst the US economy did grow for the remainder of 2014 a closer examination shows the factors driving growth are artificial and not sustainable. US household expenditure, consumer expenditure, in fact all metrics of spending are barely rising. Highlighting US third quarter GDP figures Krishna Memani, chief investment officer at Oppenheimer Funds said: "*The components may not be as strong as the headline number shows, the housing sector registered only a 1.8 percent gain, down from an 8.8 percent increase last quarter. And military spending, which jumped a whopping 16 percent, is notoriously volatile.*"<sup>57</sup> The main driver of the US economy has been the Federal Reserve tapering program of Quantitative Easing (QE). Quantitative easing entails central bank printing money through a bond-buying program. The US announced the end of this program in October 2014 after printing up to \$85 billion a month at its peak. Whilst it remains to be seen if the US economy can stand on its own feet, what is clear that the growth that has been achieved to date has been stimulus and Quantitative Easing (QE) driven and without these it remains to be seen if the growth achieved in 2014 is sustainable.

### CAST STUDY: Quantitative Easing (QE)

Central banks try to stimulate the economy, indirectly, by cutting interest rates. Lower interest rates encourage people to spend, not save. But when interest rates can go no lower i.e. they reach 0%, a central bank's only option is to pump money into the economy directly, by quantitative easing (QE). The way the central bank does this is by buying assets - usually government bonds - using money it has simply created out of thin air. The institutions selling those bonds (either commercial banks or other financial businesses such as insurance companies) will then have "new" money in their accounts, which can then boost the economy as it will be lent to other businesses or invested further. This was first tried by Japan's central

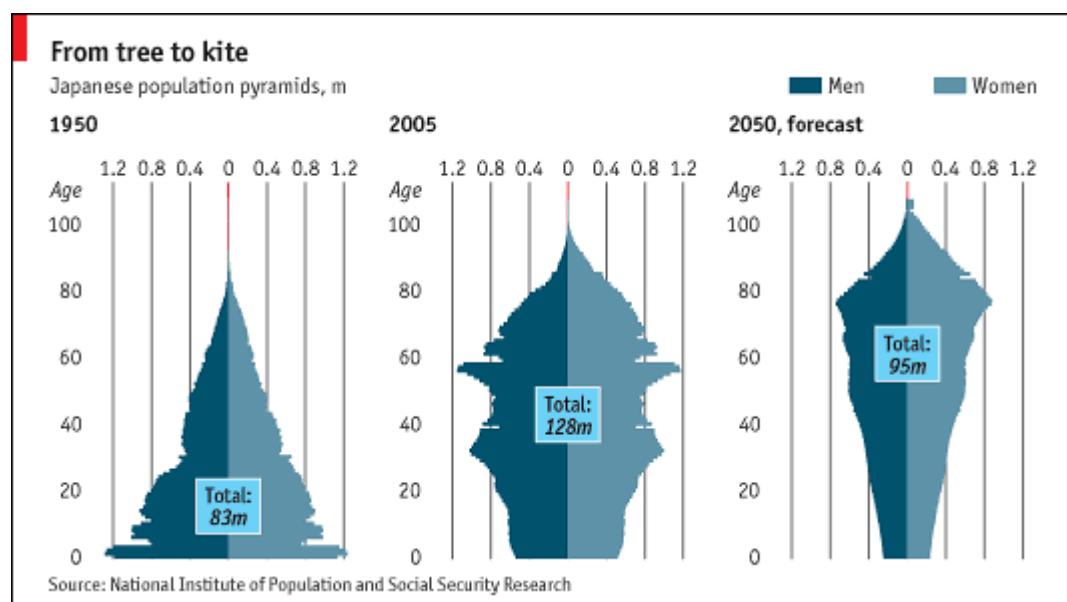
bank in the 1990's to get it out of a period of deflation following its asset bubble collapse. Central banks do not have to literally print money, it is all done electronically today. As most of the wealth in the West is held by a tiny segment of the population, the effects of the economic crisis have been more severe to the vast majority who are on average salaries or who usually borrow to live. QE does not put money into the hands of the ordinary man or those that need it most, but it places it the hands of banks (who caused the financial crisis). As the economic prospects currently are negative, banks have used this new money created out of thin air to cover their losses rather than lend to the public. In effect QE is a bank bailout. The

fundamental problem with this tool is once the money works through the economy, the people end up where things stood prior to QE. This is

why western economies keep growing and then going into recession as QE created artificial growth that is not sustainable.

**China** – The Chinese economy has been hit hard by the economic crisis. Its export markets were hit hard as they all fell into recession and the fall in Chinese exports was replaced with an expansion in real estate and infrastructure investment by the central government, this has now created a bubble in China's real estate sector. China is now working to transform its economy from exports to internal consumption which means China's integration into the global economy will become looser, and manufacturing will have to give way to services as the main economic engine. China's contribution to the global economy will only reduce, going forward.

**Japan** – The world's third largest economy went into recession again in 2014. This is the fourth occasion since the global economic crisis began in 2008 that Japan's economy has shrunk. Japan's



economy has never recovered from the asset bubble collapse in the early 1990's which led to Japan's lost decade. Japan's economy has been caught in a cycle of gradual economic decline caused by two factors. The first is Japan's aging, declining population that has led to falling consumer spending, and thus falling prices for domestic consumer goods, which has all institutionalised deflation. The second is the world's continued perception of the Japanese economy as a stable haven for investment, leading to strong demand for — and thus an increased value of — the yen. Japan has tried for decades to promote spending by keeping interest rates at virtually 0%. Multiple monetary stimulus programs have gained Japan the world's most indebted country by GDP at 244%.

**Germany** – Germany is at the centre of a regional trade bloc and as a result is the world's fourth largest exporter, making it dependent on such exports. Germany's exports were equivalent to 51% of its gross domestic product, or about \$1.7 trillion, in 2013. Germany created an industrial plant that far outstrips the country's capacity to consume. Germany's economic viability depends on maintaining exports. No matter how much Germany imports, their exports maintain the domestic

economy by providing a significant source of jobs. The problem with an export-based economy is that the exporter is at the hostage of its customers. As the global economy is still recovering from the global economic crisis most economies have seen cuts in consumption and imports and in the case of Europe, Germany who is the largest exporter has been adversely affected. Demand in Europe is critical to Germany and as the continent is largely in recession it is not surprising that the German economy is moving into recession.

**France** – The economic crisis hit France hard as it was owed much of the debt from the PIIGS economies. Since President François Hollande became president in 2012, France hasn't managed two successive quarters of economic growth. The former Socialist Party leader's program of more regulation, higher spending and punitive taxation – not least his 75% top rate of income tax, which has seen a flood of wealthy French professionals move to London. The only aspects of the French economy growing are unemployment, national debt and the government deficit. Welfare spending represents the largest in the world with French debt fast approaching the level of the PIIGS economies. At the heart of the French crisis is the fact that an ultra-rich 10% of the French population own over 60% of the nation's wealth, half of the French population only possess a mere 2% of the nation's wealth. This is why social welfare programs have been a central feature in the French economy in order to maintain social cohesion.

**Britain** – The country's service sector accounts for 73% of the economy, but for the past 15 years its economy depended almost entirely on three sectors - finance, housing and the public sector. Between them, they employ about 33% of the workforce but have accounted for 120% of employment growth. In other words all the other parts of the British economy have, in aggregate, been shrinking during those boom years. With the global financial crisis originating from the financial sector, this engine driving the British economy shut down. The only way to have averted a recession was for other sectors of the economy to become driving engines in order to replace the financial sector, real estate and the public sector. The problem Britain has is its specialisation towards the financial sector, this has left the economy narrowly focused, unbalanced, and at risk from financial shocks. As the financial sector stagnated and dragged the whole economy down with it and bailouts and Quantitative Easing (QE) temporarily picked up the economy, but these were never permanent or sustainable. This is why the UK economy constantly comes out of recession and begins growing only to fall into recession as it is QE that is driving the economy and not organic growth.

**Brazil** – Brazil has historically suffered from a crumbling economy, with periods of military rule and hyperinflation as successive governments attempted to print their way out poverty through expanding money supply. By the 2000's Brazil was built around exporting commodities and minerals to the US and Europe. The parallel rise of China and its demand for energy and minerals changed the equation for Brazil's economic architecture. This has resulted in China becoming Brazil's number one import partner, which in turn has led to cheap Chinese goods flooding the Latin American nation at the expense of its own industries. Brazil is once again at the end of an economic model, but in order to become a dynamic economy with consistent growth spending on infrastructure will need to increase, it will need to radically reform an education system that produces far too few skilled workers and engineers, ease high taxes and outdated regulation and curb corruption.

**Russia** – Russia's economy is largely commodities driven with extensive reserves of the world's key minerals and resources. Russia is the largest global exporter of most of the commodities needed for industry. Despite an economy valued at \$2 trillion the Russian economy is heavily reliant on energy and its associated services with energy prices. As oil prices are falling, Russia's economy has struggled throughout 2014 and will in all likelihood shrink in 2015 due to its dependence on energy prices.

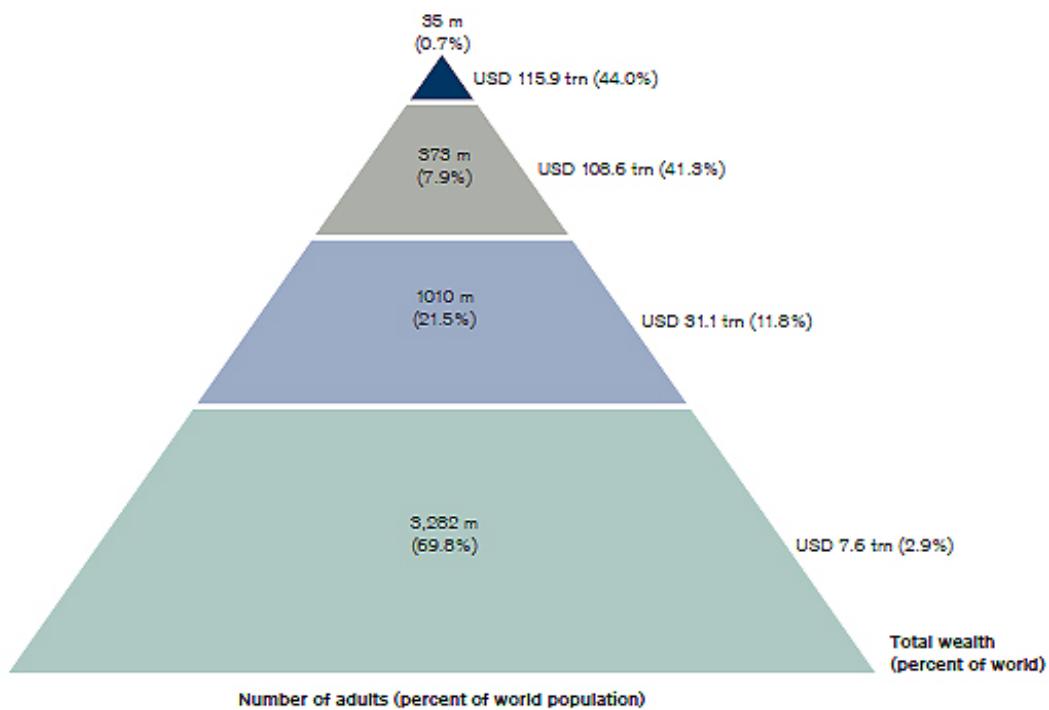
**Italy** – Italy's troubles are due to its regional composition. When the country was united in the 19th century, three distinct regions were brought together, the republics of the North, the central Papal States surrounding Rome, and the southern Kingdom of Sicily. These were extremely distinct regions to function as a single country as a result cultural divides have remained impervious to change. Italy's economy is today dominated by the North and Centre, whilst the south holds over 30% of the country's population. Unemployment, crime, and black market labour are also concentrated in the South. Italian industry specialises in the mid-to-low consumer goods which China and other nations produce more cheaply. Over the last two decades Italy's debt has grown to \$2.6 trillion, well in excess of the economy. Until these structural issues are resolved, Italy will remain in an economic slump.

**India** – India's economy is the odd one out in that it has not been affected by the global economic crisis. The improvements in the manufacturing sector and mining sector and large government investment in infrastructure is leading to Indian growth being driven by domestic sources rather than the global economy. As India represents only a small fraction of the global economy its growth will not be enough to drive the global economy, which will be weighed down by the other trillion dollar economies.

## Wealth Distribution

In 2014 various reports analysing the size of global wealth and its distribution came to one extremely startling conclusion. An Oxfam report in January 2014 confirmed almost half of the world's wealth is now owned by just 1% of the world's population. It concluded that just 85 people own as much wealth as half of the world's population – which is over 3 billion people.<sup>58</sup>

In October 2014, Credit Suisse published its annual global wealth report confirming the global wealth fracture. It confirmed around 30% of the global population owns 97% of the world's wealth. It also concluded a mere 22% owned 85% of the world's wealth and sitting at the top with 44% of the world's wealth was less than 1% of the world's richest people.<sup>59</sup> These are startling statistics, despite the global economy generating over \$72 trillion, the largest in world history. However, most of this wealth is with the few, with half of the world's population owning a mere 3% of global wealth.



Despite the global economy reaching \$72 trillion at the end of 2013, the largest in world history and global trade worth \$36 trillion, (again, the largest in world history) never have so few been so rich and never have so many been so poor. The Oxfam report is a chilling reminder of the depths of wealth inequality across the globe; widening inequality has created a vicious circle where wealth and power is concentrated in the hands of a few, leaving the rest to fight over crumbs.

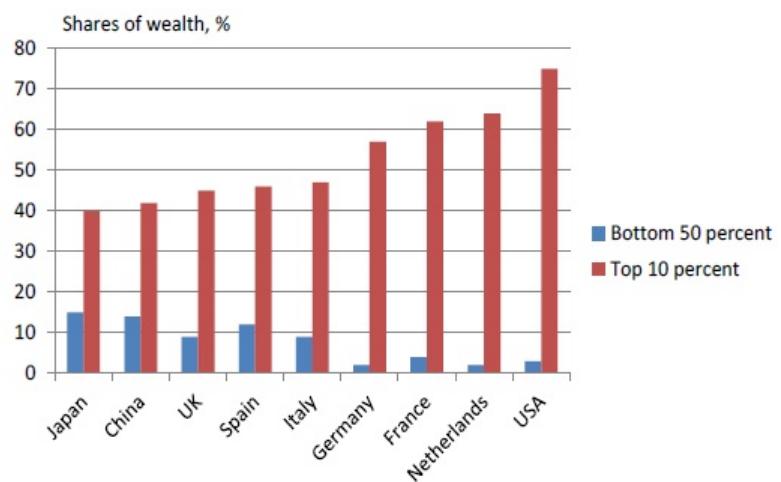
Capitalism has been the dominant global economic system for decades. It has organised the global economy and dominated wealth distribution but has failed in distributing wealth in any equitable manner. Even in the birth place of Capitalism and today's epicentre, Europe and the US, wealth distribution remains a massive failure.

Richard Robbins in his award winning book ‘Global Problems and the Culture of Capitalism’ encapsulated the situation: “*The emergence of Capitalism represents a culture that is in many ways the most successful that has ever been deployed in terms of accommodating large numbers of individuals in relative and absolute comfort and luxury. It has not been as successful, however, in integrating all in equal measure, and its failure here remains one of its major problems.*”

As capitalism solely focuses on economic growth and increasing GDP it left the distribution of wealth to the free market. In effect Capitalism as an economic system has no specific position on distributing wealth aside from leaving it to the invisible hand in the free market – which is not working for most of the world. The trickle-down effect which was meant to make wealth flow from the top to the bottom remains as elusive as ever and is in fact worse today than Victorian Britain.

One of the main reasons for this economic inequality is because the rich have huge influence upon political leadership and political institutions. These have become undermined as governments overwhelmingly serve the interests of economic elites to the detriment of ordinary people. The Oxfam report recognizes the curse of capitalism – money and politics, “*Since the late 1970s, weak regulation of the role of money in politics has permitted wealthy individuals and corporations to exert undue influence over government policy making.*”

**Shares of net wealth held by Bottom 50% and top 10%**



Source: IMF and Jefferies International

The reformation separated religion and politicians but left money and politics intact. It is money that should have been separated from politics rather than religion. The rich have been able to preserve such a status quo as the lowest tax rates, the best health and education and the opportunity to influence are handed down to their children. Without a concerted effort to tackle inequality, the cascade of privilege and of disadvantage will continue down the generations. Economic growth today amounts to little more than a 'winner takes all' windfall for the richest.

Capitalism has no solutions to wealth distribution, more economic growth, changing tax regimes and tackling tax avoidance are merely skirting around the real issue. This is a systemic issue and merely reforming capitalism will just perpetuate the problem. Despite describing the inequalities of capitalism, even Oxfam accepted the sad realities of capitalism, “*Some economic inequality is essential to drive growth and progress, rewarding those with talent, hard-earned skills, and the ambition to innovate and take entrepreneurial risks.*”

Capitalism only has one view towards wealth distribution, namely leaving this to the free market. A number of countries seeing the failure of the invisible hand have turned to the visible hand of the state and have achieved mixed results. It has been over two decades since the collapse of the Soviet Union, when liberals celebrated capitalism's unilateral position. This was however a false dawn as the inefficiencies of communism merely gave way to the very efficient capitalism – for the rich only. Capitalism has no doubt created immense wealth, but it should also be certified with enriching so few whilst condemning so many to a life of misery.

In order to maintain the status quo, governments on behalf Capitalist elites have offered scraps to the wider public. The minimum wage is an example of this, the debate on raising the minimum wage is once again being led by the right who have a disproportionate influence on government. Intellectual discourse is dominated by free market liberals and this has ensured alternatives have little air time and presence. Despite the worst recession since the great depression, liberals have continued to argue that Capitalism is the best system we have and laid blame to greedy bankers

rather than any discourse on why Capitalism constantly crashes. Similarly, with the collapse of communism on its 25 anniversary in 2014, the failure of communism is still present in the minds of many people. The victory in the Cold war for many is proof of Capitalism superiority be it political, social or economic.

Capitalism's Achilles heel is its inability to distribute wealth equitably, this has only got worse since the demise of Communism.

## Conclusions

Whilst the global economy has seen some growth ever since the global economic crisis began back in 2007, this has been largely driven by emerging economies such as Brazil, Russia and India and not nations such as the US, China or Germany. The emerging nations, between them have accounted for 75% of total growth in the world economy over the past five years. These nations in 2014 saw their economies run out of steam as they were being driven by mineral resource mining or basic goods manufacturing, which was cheaper than anyone else. On its own this was never organic or sustainable. This is why global economic recovery has been slow and choppy as the worlds advanced economies have struggled to grow. The global system currently operates on the western economies importing from cheaper emerging economies, who in turn export such goods that generate other economic activity in the West. For the moment Western economies are struggling to grow, which is being compounded by austerity and stimulus. The emerging economies that picked up the slump in growth in 2014 began crumbling; talk of a rebalancing in the global economy is now out of the question.

## 2015

**Deflation** - With the fall in global oil prices, weakening bank credit and depressed manufacturing activity, nearly all signs suggest the global economy is heading into deflation territory. All of this actually proves that demand for goods and services is not there and this is why inflation rates are now falling after QE and stimulus has worked through the global economy. Without consumption to drive the global economy, prices fall as consumers cut off spending in the hope of getting even cheaper prices which is deflation – the opposite to inflation. All this means manufacturers have plenty of stock they cannot sell, and when they do it is with prices below their manufacturing costs. The world premier economies need to manufacture real growth and consumption from somewhere in 2015.

**Global debt and Growth** - The total burden of world debt, excluding the financial sector, has risen from 180% of global output in 2008 to 212% in 2014. Despite debt being at the centre of the 2008 economic crisis, debt remains at similar levels. Japan, Sweden and Canada lead the worlds with debt as a proportion of GDP. The UK remains the fourth most highly indebted major economy in the world, with total non-financial debt of 276% of GDP. The US is not far behind with debt of 264% of GDP. The real stand-out is China, which since the crisis began has seen debt spiral from a very manageable 140% of GDP to 220% and rising. This shows that the growth that has taken place during the economic crisis has been by more debt. Unless other economic drivers are found for the

global economy the excessive debt cannot be worked off through growth, restraint and inflation, adjustment will eventually be forced much more divisively through default.

# MINT

In 2014 ‘MINT’ entered the global political lexicon, alongside the BRIC nations. Mexico, Indonesia, Nigeria and Turkey (MINT) became countries considered most likely to assume a place at the high table of economic success and political power. Tipped to follow Brazil, Russia, India and China (BRIC) they are considered to teeter on the cusp of potential greatness. In *Strategic Estimate 2015*, we assess their political and economic prospects.

## Mexico

Mexico as we know today was established in the middle of a lake that filled the Valley of Mexico. Mexico City was originally the Aztec capital of Tenochtitlan. The Aztecs were one of the weakest tribes in the region and they built the city literally right out of the water, using stone and lime to construct temples and grew crops on platforms in the middle of the lake. By 1521 the Spanish colonialised most of the Americas. The Spanish colonisers built a canal linking the Valley of Mexico to the Tula river system. The project effectively drained the lake but left the city with numerous problems, including severe foundational instability and vulnerability to earthquakes. Despite its location, Mexico City remains the core of modern day Mexico. Mexico has a small and limited core territory surrounded by mountains, deserts and jungles, making it difficult to control and defend if attacked from the outside.

Mexico controlled both North and South America and was the dominant economic and military power on the continent for centuries under the Spanish Empire. By 1821 Mexico had severed the control Spain had exercised on its North American territories. The new country of Mexico was formed from much of the individual territory that had comprised New Spain. This included all of Texas and the territory that became the modern US states of Arizona, California and New Mexico. But the Mexican War of Independence fragmented the already weakening country and shifted the balance of power in favor of the US. The first two decades of independence were rife with instability, a coup, civil war and the suspension of the consultation took place. A number of regions declared independence and in 1836, the Texas War for Independence led to Texas joining the United States. This led to Mexican-American War, which began in 1846 and lasted for two years. The conquering of Mexico City in 1847 by the United States ended the war, with the United States taking nearly half of Mexico's total original territory -



all of Texas and the states today known as Arizona, California and New Mexico. With the US having received Florida from Spain earlier in the 19th century, the two wars led to huge territorial losses for Mexico. This was how the border as we know today between Mexico and the US was defined.

## Economy

Mexico has consistently struggled with sustaining economic development. Mexico lacks both a concentrated breadbasket as well as a navigable river network. Mexico's northern neighbor – the US has the Mississippi River which bisects the US agricultural heartland. Access to international markets cost only as much as it takes to build a boat. Mexico, by contrast, must invest a great deal of capital for its road and rail networks. In their 300 years of ruling Mexico, the Spanish failed to develop any substantial transport networks, leaving the newly independent Mexico to start from scratch.

With the lack of transportation infrastructure, Mexico's first decades of development were difficult. The cost of transporting goods from producing areas to consumer markets was extremely expensive making profits for private investment extremely small. Developing any transportation network requires a massive amount of capital, which means Mexico started out its independent state with no choice but to go deep into debt – which historically has been a curse for the country. Once Mexico is able to secure an influx of capital, from its history, it has been able to develop its economy and expand. But without domestic capital reserves or indigenous resources, Mexico's development has been cyclical in nature, with booms followed by crashes. Being a neighbor to the world's super power and the world's largest economy (The US has been the world's largest economy every year since 1872)<sup>60</sup> has resulted in Mexico becoming a low-end manufacturing hub for US manufacturers. Today, Mexico exports nearly \$1 billion goods a day to the US, which makes it the US's single-largest source of imports and its third-largest trading partner. Mexico's economy now depends on exports. It is an important trade power measured by the value of merchandise trade and is also the biggest exporter and importer in Latin America. Nearly 90% of Mexican exports and 50% of its imports are traded with the US and Canada.

## CASE STUDY: North America Free Trade Agreement (NAFTA)

NAFTA reached its 20<sup>th</sup> birthday in 2014, this was when the North American Free Trade Agreement between the US, Canada, and Mexico was implemented. In the US, hundreds of thousands of jobs were lost, and there was downward pressure on US wages. This was not like the European Union's (pre-eurozone) economic integration, which allocated hundreds of billions of dollars of development aid to the poorer countries of Europe so as to pull their living standards up toward the average.

The most basic measure of economic progress, especially for a developing country like Mexico, is the growth of income (or GDP) per person. Out of 20 Latin American countries (South and Central America plus Mexico), Mexico ranks 18<sup>th</sup>, with growth of less than 1% annually since 1994.

For Mexico, NAFTA resulted in domestic industries being dismantled as multinationals imported parts from their own suppliers. Local farmers were priced out of the market by food imported tariff-free. Many Mexican farmers simply abandoned their land and headed north.

Although Global giants spent billions of dollars turning Guadalajara into a manufacturing hub for the information technology industry, these

investors came because the city was already a centre of technology. I.B.M., Hewlett-Packard and others had come in the 1960s and 1970s when Mexico's market was closed. After NAFTA, the new factories imported parts from their global suppliers, wiping out local companies that had sold printed circuit boards or assembled computers under tariff protection. Things grew worse when the tech bubble burst, the American economy cooled and the companies moved to China, where they could pay even lower wages. Once China entered the World Trade Organization, Mexico lost much of the edge in exporting to the United States that NAFTA had given it.

For Mexico, NAFTA helped to consolidate the neo-liberal, anti-development economic policies that had already been implemented in the prior decade, enshrining them in an international treaty. It also tied Mexico even further to the US economy, which was faced some major crises in the two decades that followed: the Fed's interest rate increases in 1994, the US stock market bust (2000-2002) and recession (2001), and especially, the housing bubble collapse and great Recession of 2008-9 had a bigger impact on Mexico than almost anywhere else in the region.

Mexico's economy is worth \$1.2 trillion making it the 14<sup>th</sup> largest economy in the world. The service sector is the largest component of the economy at 70%, followed by the industrial sector at 25% and agriculture comprising the remaining 5%. The Mexican labor force is estimated at 38 million of which 18% is occupied in agriculture, 24% in the industrial sector and 58% in the service sector. Mexico's demographic profile is among the world's most promising. Its labor force is expected to grow by 58% by 2030, while China's is forecast to decrease by 3% over the same period.

Despite the size of the economy, poverty and income disparity has always been a persistent problem in Mexico. By the Mexican government's own measurements, today, 17% of Mexico's population – 20 million Mexicans (equivalent to the population of Syria), live below the poverty line. However international institutes put the rate closer to 50% of the population.<sup>61</sup> A tiny elite control most of the country's wealth. Only 10% of the country's population owns 25% of the country's wealth. A

smaller group of 3.5% of the country's population control 12.5% of nation's wealth. The world's richest person, Carlos Slim controls 8% of the country's wealth (0.008 of the population owns 8% of the nation's wealth).

It is not surprising many leave Mexico for the US. These migrants to the US fortify the US labour market and help to curb US wage inflation. These workers send back over \$20 billion worth of remittances every year to Mexico and it is unlikely this is being reinvested into Mexican economy.

Mexico's industrial sector has made some progress in becoming self-sufficient. From aerospace engineering in Queretaro to footwear assembly in Guanajuato. Unlike China, Mexico has not solely focused on low-cost manufacturing. High-tech exports account for 17% of the Mexican economy, while cars amount to 25% of Mexican exports. Mexico's industry does not just function as a mere assembly manufacturer, its industry produces technologically complex components and engages in some research and development. Some large industries of Mexico include Cemex, the world's largest construction company and the third largest cement producer.

The lack of broad based economic drivers has led drug trafficking trade to be a large economic driver. Although difficult to measure, the drug trade brings tens of billions of dollars annually into Mexico and provides thousands of jobs. These profits are laundered and reinvested throughout the economy, with significant involvement in the tourism and construction industries.

## **Energy**

Mexico's energy sector has languished after decades of underinvestment. Although Mexico has significant potential offshore reserves in the Gulf of Mexico, the 1917 constitutional nationalisation of all mineral resources reduced Mexico's access to foreign capital and technology to invest in new exploration and production. The country's early petroleum development costs were borne by foreign investors, but those assets were nationalised and the industry became a critical income stream for the state. The demands of the state budget combined with a poor tax collection system have kept the state dependent on oil. Oil was in many ways the key to keeping the Mexican political system running without having to make difficult reforms.

Oil production reached its peak at 3.8 million barrels per day (bpd) in 2004 and has been on the decline since, falling to 2.9 million bpd in 2011, with only marginal new production scheduled to come online. Exports peaked at 2.1 million bpd in 2003, and fell to 1.5 million bpd in 2011. Mexico requires a new wave of capital and technology, which will likely have to be foreign in origin, if it is to maintain or increase its energy revenues.

## CASE STUDY: Mexico's Cartels

Although violence between and within the cartels gains considerable media attention, at their core they are businesses and not politically motivated groups or militant organisations. It is not violence but business factors that drive their interests. The most important business factor is the economics of the cocaine trade.

Cocaine is derived from the leaves of the coca plant, and three countries -- Colombia, Peru and Bolivia - account for all the coca harvested in the world. According to figures from the UN Office on Drugs and Crime, coca farmers in Colombia receive \$1.30 for each kilogram of fresh coca leaf. In Peru and Bolivia, where the leaf is air-dried before being sold, farmers receive \$3.00 per kilogram. One kilogram of cocaine base can then be converted into roughly one kilogram of cocaine hydrochloride, which is commonly referred to as cocaine.

As cocaine progresses from the production site to the end users, it increases in value. According to figures provided by the Colombian National Police, a kilogram of cocaine can be purchased for \$2,200 in the jungles in Colombia's interior and for between \$5,500 and \$7,000 at Colombian ports. But the price increases considerably once it leaves the production areas and is transported closer to consumption markets. In Central America cocaine can be purchased for \$10,000 per kilogram, and in southern Mexico that same kilogram sells for \$12,000. Once it passes through Mexico, a kilogram of cocaine is worth \$16,000 in the border towns of northern Mexico, and it will fetch between \$24,000 and \$27,000 wholesale on the street in the US.

As Mexico sits in-between Latin American and Cocaine's biggest market – the US, this makes Mexican supply lines a very lucrative business. There has been a thriving two-way flow of contraband goods across the US-Mexico border

since its inception. Mexican organised crime groups have been involved in the smuggling of marijuana to the US market since the early 1900s. As US demand for illicit drugs increased in the second half of the 20th century, Mexican organisations branched out to become involved in smuggling other types of drugs,

Mexico was a secondary route for cocaine compared to the primary route through the Caribbean. As a result, the Colombians pocketed the lion's share of the profit made on cocaine trafficked through Mexico and the Mexicans received a fee on each kilogram they transported. As US interdiction efforts, aided by improvements in aerial and maritime surveillance, curtailed much of the Caribbean cocaine flow in the 1980s and 1990s, and as the Colombian and US governments dismantled the Colombian cartels, the land routes through Central America and Mexico became more important to the flow of cocaine.

This increase in the importance of Mexico allowed the Mexican cartels to gain leverage in negotiations, by the 1990s the increasing importance of Mexican organisations to the flow of cocaine to the US allowed the Mexican cartels to become the premier player in the cocaine trade.

Cocaine is a product that has a very limited and specific growing area. Consequently, that distinct coca growing area and the transportation corridors stretching between the growing area and the end markets are critically important. With a business model of selling cocaine at over 10 times the cost of acquisition - and even greater over the cost of production - it is not surprising that the competition among the various Mexican cartels for the smuggling corridors through Mexico to the US has become is extremely aggressive.

## **Conclusions**

Mexico suffers from numerous problems. The country's poor education system continues to create a shortage of skilled labor. Organised crime continues to be a high-visibility issue that slows foreign investment, even as the current Mexican administration seems to have toned down some of its predecessor's more aggressive policies. Mexico has some of the world's worst income disparity and poverty.

This can be overcome as China was in the same situation in 1979 on the eve of its opening up era. China was able to overcome this situation due to its strong political leadership who was willing to make the difficult decisions. Mexico's political leadership has used the classic tool for managing its situation. Since poverty imposes limits to domestic consumption, Mexico became an exporter. It exported \$349 billion in 2011, which means it derives just under 30% of its GDP from exports. This is just above the Chinese level and creates a serious vulnerability in Mexico's economy, since it becomes dependent on other countries' appetite for Mexican goods.

Mexico's politicians have also failed to deal with the borderland area with the US. The borderland is a region of ongoing warfare between groups competing to control the movement of narcotics into the US. To a great extent, the Mexicans have lost control of this borderland. Mexico's politicians view this is a manageable situation. The borderland is distinct from the Mexican heartland. So long as the violence does not overwhelm the heartland, it is tolerable. The inflow of money does not offend the Mexican government. More precisely, the Mexican government has limited resources to suppress the trade and violence, and there are financial benefits to its existence. The Mexican strategy is to try to block the spread of lawlessness into Mexico proper but to accept the lawlessness in a region that historically has been lawless.

Mexico is also dwarfed and integrated into the large US economy. To a large extent Mexico is a cheaper place for US manufacturers to make their goods. Mexican manufactures (there are not a lot of them) also look to export what they manufacturer rather than produce for their domestic market.

There are significant hurdles Mexico will need to overcome if it is to be a regional power or economic power. This will require strong political leadership which has been notably absent in Mexico's history. Mexico will remain an economic player for the foreseeable future, anything more than this will require some radical changes to take place.

## Indonesia

Modern Indonesia is spread across a chain of thousands of islands between Asia and Australia. The Indonesian archipelago has been an important trade region since at least the 7th century, when Hindu and Buddhist kingdoms traded with China and India. Muslim traders began trading with the region from the 8<sup>th</sup> century and between the 10<sup>th</sup> – 13<sup>th</sup> centuries Islam had taken hold in the region and today Indonesia has the world's largest Muslim population of 273 million. European powers began colonising the region from the 1500 onwards. The Portuguese, British and Dutch competed with each other to monopolise trade in Spices.



In 1602 the Dutch established the Dutch East India Company (VOC) and became the dominant European power. Following bankruptcy, the VOC was formally dissolved in 1800, and the government of the Netherlands established the Dutch East Indies as a colony and remained for the following three and a half centuries. Most of the colonial period, Dutch control over the archipelago was of coastal strongholds, only in the early 20th century did Dutch dominance extend to what was to become Indonesia's present boundaries. The Japanese occupation during the Second World War (1941) ended Dutch rule. Two days after the surrender of Japan in August 1945, Sukarno, an influential nationalist leader, declared independence and became the country's first president. Sukarno played a key role in maintaining the Japanese occupation forces and gaining local acceptance of the occupation. The Dutch returned in 1945 to claim back their former colony, with the help of the British. Although they won back most of Indonesia, they were unable to defeat the people and due to the emergence of the US as the new superpower it pushed out the Europeans from the region.

Modern Indonesia consists of 17,508 islands, about 6,000 of which are inhabited. These are scattered over both sides of the equator. The largest are Java, Sumatra, Borneo (Kalimantan) (shared with Brunei and Malaysia), New Guinea -



Irian Jaya (shared with Papua New Guinea) and Sulawesi. 58% of Indonesia's 273 million population, reside on the island of Java. Indonesia's location on the edges of the Pacific, Eurasian, and Australian tectonic plates makes it the site of numerous volcanoes and frequent earthquakes.

Despite this, Indonesia is in a strategic location astride and along major sea-lanes from Indian Ocean to Pacific Ocean.

It also means it is ethnically a highly diverse nation, with around 300 distinct native ethnic groups and 742 different languages and dialects. Economic development has also been diverse with some islands relying on agriculture and a handful of large islands seeing urbanisation.

## **Politics**

On independence, Indonesia was an extremely poor country and the subsequent political leadership failed miserably in marshalling the large population and the nations many resources to better the country. Much of Sukarno's rule from 1949-1965 was full of rhetoric, but his biggest failure was the economy. On independence, Indonesia's infrastructure was devastated by a decade of war and rebellion, industry was needed to build the components and machinery that could rebuild the nation. As Indonesia consisted of so many islands, a transportation network was needed to link the thousands of islands. Indonesia was also not meeting its food needs. Sukarno economically crippled the country. It nearly went bankrupt as its exports decreased while its debts and inflation increased. Sukarno spent the limited funds Indonesia had on public monuments, stadiums and buildings and for private luxuries for himself and his four wives. But natural resources were left undeveloped. As far as Sukarno was concerned the government was his personal property.

Sukarno's support base was the PKI communists, who he used to balance the army. By 1965, the PKI was the largest communist party in the world outside the Soviet Union and China. Penetrating all levels of government, the party increasingly gained influence at the expense of the army. In 1965, six of the most senior generals within the military and other officers were executed in an attempted coup. Within a few hours, Major General Suharto, commander of the Army Strategic Reserve (Kostrad), countered the coup. Suharto immediately murdered hundreds of thousands of people and imprisoned religious groups in order to consolidate his rule. The army also targeted all communists and effectively destroyed the PKI. Although he remained president, the weakened Sukarno was forced to transfer key political and military powers to General Suharto, who by 1968 formally became president. He remained the president of Indonesia until 1998.

When Suharto was pushed out from power in 1998 (due to the mass protests due to the economic meltdown known as the Asian financial crisis), despite some economic development his rule was really one of pervasive and large-scale corruption, repressive and militarised rule. Suharto and his family became notorious for controlling state enterprises and taking kickbacks for government contracts, for siphoning money from state charities and for committing gross violations against its own people.

## **Economy**

The Indonesian economy was developed during the Suharto era. With the aim of fast-tracking economic development Indonesia surged ahead with IMF and World Bank policies with considerable help from the 'Washington Consensus,' economists. Through privatisation (which largely went to Suharto's family and supporters), Foreign Direct Investment (FDI) and through

much of its natural resources being put on sale. Thus export driven growth was pursued. Indonesia moved from being the world's largest rice-importing nation to a rice exporter. During the 1970s, oil was a major export and a significant source of foreign exchange.

As a result of this policy, Indonesia came to rely on large foreign inflows of capital. A lot of the FDI made use of Indonesia's low-wage environment to produce cheap goods demanded by Western markets. Much of the FDI went into the recovery of the nation's natural resources — oil and natural gas, copper, gold and coal — but much of the money from this was taken by the foreign companies that did the work and expatriated abroad.

Whilst the Asian financial crisis in 1998 derailed this model and unseated Suharto himself, subsequent Indonesian leaders have continued with a hybrid version of the export driven economy. Indonesia remains a commodity driven economy.

Indonesia's economy is worth nearly \$900 billion just under 50% of this is generated from industry. Services represent 38% of the economy, whilst agriculture represents 14%. The country has a labour force of 120 million with 47% employed in services, 38% in agriculture and 22% in industry. The bulk of Indonesia's population is of workforce age and whilst the over 65+ category will increase Indonesia's workforce is expected to remain a large segment of the population for the foreseeable future.

Indonesia's economy is driven by wholesale and retail, construction, food crops, oil and gas and quarrying, with exports and domestic consumption evenly balanced. Indonesia exports \$200 billion and imports \$185 billion annually. Commodities and natural resources make up the bulk of Indonesia's exports. But poverty remains high in the outer islands. Despite this, Indonesia is the world's 4<sup>th</sup> largest fisheries producer and fresh fruit producer. It also remains the world's largest producer of tropical fresh fruit, cinnamon, coconuts, cloves, nutmeg, maze and cardamoms.

Despite being the world's largest producer of tin, mining 114,000 tons a year, manufacturing disproportionately benefits Java, Bali and Sumatra due to the better infrastructure of the inner islands. Economic disparity and the flow of natural resource profits to Jakarta has led to dissatisfaction and even contributed to separatist movements in areas such as Aceh and Papua (Irian Jaya).

Indonesia possessed 3.6 billion barrels of proven crude oil reserves as of January 2014. Indonesia's fuel production has declined significantly over the years, owing to aging oil fields and lack of investment in new equipment. As a result, despite being an exporter of crude oil, Indonesia is now a net importer of oil products. It had previously subsidised fuel prices to keep prices low, costing \$7 billion a year. Indonesia produces 882,000 barrels per day (bpd), but consumes 1.6 million (bpd). It only has the ability to refine 1 million (bpd). Despite this Indonesia is the world's largest coal exporter after Australia and along with Qatar and Malaysia it is one of the world's largest exporters of Liquefied Natural Gas (LNG). As the largest and most populous archipelago in the world, providing modern energy access is an important challenge, currently 27% of the population lacks access to electricity.

## **Conclusions**

Based on its size and endowment of natural resources, Indonesia has the ability to become an economic powerhouse and possibly a regional power. It is in one of the most strategic locations in the world and if it were to unify or annex Malaysia it will control the area between mainland China and Indo-China all the way to Australia. This sea route is critical for the global economy.

This future requires policies very different to the ones pursued by successive leaders and governments since WW2. Indonesia is not built upon its strengths and even exports has not been utilised to develop Indonesia internally. This shows the challenge for Indonesia is in reality political rather than economic. Sukarno and Suharto bankrupted the nation and this is what has caused the internal fracture between different ethnic groups. The policies pursued by successive governments actually held the nation back. If these can be overcome, Indonesia could emerge a regional economic and political power.

## CASE STUDY: 1997 Asian Financial Crisis

By 1997, Asia attracted almost half of total capital inflow to developing countries. The economies of Southeast Asia maintained high interest rates attractive to foreign investors looking for a high rate of return. As a result the region's economies received a large inflow of hot money and experienced a dramatic run-up in asset prices. At the same time, the regional economies of Thailand, Malaysia, Indonesia, the Philippines, Singapore, and South Korea experienced high growth rates, 8-12% GDP, in the late 1980s and early 1990s. This achievement was broadly acclaimed by economic institutions including the IMF and World Bank, as the Asian economic miracle. But then the story turned sour.

From 1985 to 1995, Thailand's economy grew at an average of 9% per year. In May 1997, the Thai baht was hit by massive speculative attacks as investors tried to cash in on their money. By withdrawing their cash in large sums the currency collapsed, this set off a domino effect where financers lost confidence in the region and began moving their money out in large sums leading to the infamous Asian financial crisis. The only country in the region to survive the fall out was Malaysia as it was not under the control of the IMF's structural adjustment program and had placed restrictions on capital withdrawal from its country which meant speculators could not affect the country. The rest of the region left their economies open hence they were unable to do anything when speculators withdrew

their capital, thus proving globalisation was the problem.

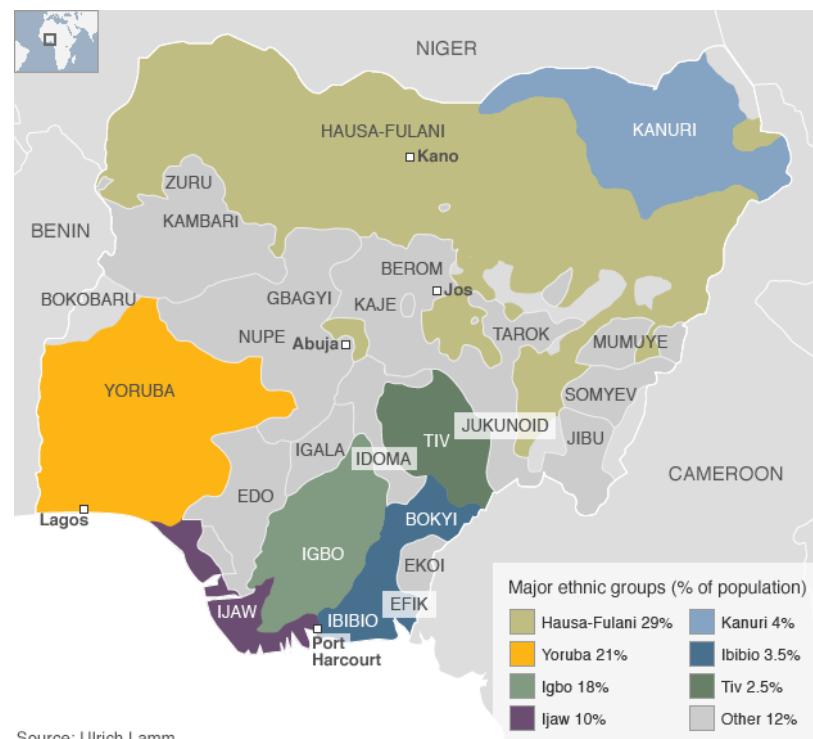
When pressures on the Indonesian rupiah became too strong, the currency was set to float freely starting from August 1997. Soon it began depreciating significantly. By 1<sup>st</sup> January 1998, the rupiah's nominal value was only 30 percent of what it had been in June 1997. In the years prior to 1997 many private Indonesian companies had obtained unhedged, short-term offshore loans in dollars, and this enormous private-sector debt turned out to be a time bomb waiting to explode. The IMF arrived in Indonesia with a bailout package totaling \$43 billion to restore market confidence in the Indonesian rupiah. In return it demanded fundamental financial reform measures: the closure of 16 privately-owned banks, the winding down of food and energy subsidies, and it advised the Indonesian Central Bank (*Bank Indonesia*) to raise interest rates. But this reform package turned out to be a failure. The closure of the 16 banks (some controlled by Suharto's cronies) triggered a run on other banks. Billions of rupiah were withdrawn from saving accounts. The financial crisis turned onto a full social and political crisis due to the Suharto's failure in dealing with any aspect of the crisis. His removal of all subsidies in 1998 led to mass riots, On 14 May 1998, Suharto stepped down from the presidency when all politicians refused to join a new reorganised cabinet.

## Nigeria

Nigeria was first discovered by the Portuguese in the 15<sup>th</sup> century and was then visited by other travellers from the Netherlands, Britain and France. The port of Lagos was used for the purpose of slavery from 1450 – 1897. In 1885, Britain declared the West African region as its colony and by 1914 the area between the Gulf of Guinea, the great Sahara region of Chad, Benin to the West and Chad, Cameroon in the East was named Nigeria.

Nigeria was created on tribal faultlines by Britain. This was to ensure the different regions never fully united into a cohesive whole. This was a general colonial policy by all the colonialists. Britain ensured its grip upon Nigeria's oil wealth through the Royal Dutch Shell Company, which today still produces 50% of Nigeria's oil wealth. Nigeria's military from its inception has protected the oil infrastructure and has also ruled the country for most of its post-independence history.

When Nigeria gained independence in 1960 it consisted of some 250 tribes with no distinct national identity. The largest three tribes, which remain today are the Hausa and Faulani in the North of the country. The majority of these tribes remain Muslim today and comprise anything between 30% - 50% of Nigeria population. The Youruba tribes in the central and Southern region account for a quarter of the country's population, the majority of whom are Christian, with a sizeable Muslim minority. The South-Central region remains inhabited by the Igbo tribes. Britain left Binyan Namadi Azikoi from the Igbo tribe in power in 1960.



Source: Ulrich Lamm



Most of Nigeria's regions have arable lands that allow the country to support Africa's largest population of 170 million people. Each region has a dominant ethnic group. Various ethnic groups vie for control over the Niger Delta region because of its abundant reserves of oil and natural gas. The Niger Delta region itself is home to the Ijaw people who have exerted disproportionate influence over the country's politics as seen with the election of Goodluck Jonathan as president in 2011. Nigeria's capital, Abuja, was intentionally located in the country's center to promote its neutrality. Managing the competition for natural resources between these ethnically divided regions is Nigeria's primary challenge.

By the late 1990's Nigeria rose in importance for the US as it attempted to diversify its oil dependency from Middle Eastern oil. The US entry into Nigeria began when it called for elections in 1997. The US has attempted to counter the British grip through democracy which would weaken the military's hold on the nation which has protected British interests.

## **Economy**

Nigeria's economy has been hindered by years of military rule, corruption and mismanagement whether it was military or civilian rule. During the oil boom of the 1970s, despite significant oil revenues, major infrastructure was funded through accumulating debt. With the fall of oil prices during the 1980s, oil glut Nigeria struggled to keep up with its loan payments and eventually defaulted on its principal debt repayments, limiting repayment to the interest portion of the loans. Arrears and penalty interest accumulated on the unpaid principal which increased the size of the debt. Nigeria's debt represented 60% of its economy, but in 2006 Nigeria was given a debt write-off if it implemented a host of free market policies.<sup>62</sup> Today Nigeria's debt is around 11% of the economy.

Nigeria's economy is currently valued at \$522 billion. Agriculture overwhelmingly dominates the economy representing 40%. Manufacturing represents 15% and services represents 30%. Oil on its own represents 14% of Nigeria's economy.

48 million of the country's population constitute the workforce. 32% are employed in the service sector, whilst 30% are employed in agriculture, which is the largest segment of the economy. 24 million people remain unemployed. The proportion of children below the age of 15 in 2010 was 44%, or 73 million. Every year nearly 5 million people will be joining the workforce until 2050. According to the United Nations, the population of Nigeria will reach 440 million by 2050. Nigeria will then be the 3rd most populous country in the world. In 2100, the population of Nigeria will reach nearly 1 billion.<sup>63</sup> Nigeria will have significant demographic advantages with a large workforce, but this could become a curse if the economy does not grow in parallel.

Agriculture is Nigeria's dominant sector, but this is shrinking in size as the country's energy resources come on line. Nigeria was once a large net exporter of food, but now imports a large quantity of its food products. The country's agricultural products fall into two main groups: food crops produced for home consumption, and exports. Prior to the Nigerian civil war, the country was self-sufficient in food, but this changed after 1973. Bread made from American wheat replaced domestic crops as the cheapest staple food.

Despite this, Nigeria ranks sixth worldwide and first in Africa in farm output and it is the world's largest producer of Cassava, citrus fruit, peas, Karite nuts, melonseed, taro and yams. Nigeria's problem with agriculture is not the lack of Agriculture, but production levels remaining low, due to the lack of government investment in technology and the fact that what is produced is exported, with imports mainly fulfilling domestic needs. An increase in domestic agricultural production would make Nigeria self-sufficient once again.

Yield Gaps of Selected Crops in South West Nigeria <sup>64</sup>			
Crop	Actual (Mt/Ha)	Potential Yield (Mt/Ha)	Gap, %
<b>Maize</b>	1.5	7.0	367
<b>Rice</b>	2.5	5.0	100
<b>Cassava</b>	12.0	45.0	275
<b>Yam</b>	11.36	30.0	164
<b>Cocoa</b>	0.4	1.0	150
<b>Tomato</b>	6.9	20.0	190

## Oil

Nigeria has substantial reserves of both oil and gas. Nigeria produces over 2.5 million barrels of oil day and consumes only 300,000 barrels a day. Around 2.2 million (bpd) are exported. Nigeria has 37 billion barrels of oil in reserve. Nigeria like much of the African continent lacks oil refineries. Nigeria's refinery capacity is only 445,000 (bpd), as a result, it exports crude oil, only to import refined oil again later at an additional cost. Nigeria is the largest holder of natural gas proven reserves in Africa and the ninth largest holder in the world. Nigeria produces 1.2 Tcf of natural gas, ranking it as the world's 25th largest natural gas producer.

Despite agriculture dominating domestic economy, oil and gas combined still account for about 95% of exports and 80% of the governments revenues. This leaves the economy vulnerable to oil price or crude production volatility. Nigeria has the second largest oil reserves in Africa after Libya and is the continent's primary oil producer.

Nigeria's oil industry has a number of advantages over the other oil producers on the African continent. Firstly, the country's oil is of a high quality and generally sells at a premium to Brent, the North Sea benchmark crude. Nigeria is the largest producer of sweet oil in OPEC. This sweet oil is similar in composition to petroleum extracted from the North Sea. The countries light crude is popular with US and European refiners as it is easily processed into fuel products. Another advantage for the Nigerian oil industry relates to the country's geographic location. Nigeria is well located to supply oil markets in North America, a major source of global demand. Nigeria's production costs are also low due to this factor. The International Energy Agency World Energy Outlook concluded that Nigeria's production costs in ultra-deep water fields can reach \$30/bbl compared to onshore costs of around \$15/bbl. In contrast, it cost around \$40 to produce one barrel of oil in Angola.<sup>65</sup>

Despite these resources, 70% of the population lives below the poverty line and as a result fuel subsidies are needed so locals can purchase petrol.

## Conclusions

Although Libya has larger oil reserves than any other country in Africa, Nigeria produces most of the continent's oil. Nigeria also has a wide array of underexploited mineral resources which include natural gas, coal, bauxite, gold, iron ore, lead and zinc. Despite the huge deposits of these natural resources, the mining industry in Nigeria is still in its infancy. Half of Nigeria population remains in

poverty despite the country possessing such mineral wealth. The north of the country is largely savannah grassland which supports farming. Much of Nigeria has arable land, which alongside its energy reserves should make it easy to support Africa's largest population of 170 million people. However the tribal design of the nation has led to decades of infighting, coups and counter coups as each dominant tribe attempted to exert influence over the other. Western and Eastern corporations have their eyes on the countries coveted resources which has further complicated matters. Looking ahead, Nigeria will have to settle its internal ethnic divisions and astutely manage its oil revenue to deal with its projected population of 440 million people by 2050.

## Turkey

The Ottomans ruled the vast Islamic Khilafah from modern day Istanbul. They dominated the Islamic world and the Mediterranean from 1500, only ending with World War I. Modern Turkey straddles Europe and Asia. It straddles the land bridge linking south-eastern-most Europe with south-western-most Asia. Most of Turkey's territory lies on the Asia side of the Bosphorus, occupying the entirety of the Anatolian plateau. Turkey sits on the intersection between the East and the West, it also straddles energy consumers and energy producers.

Turkey's entry into the global economic elite has been in parallel to the rise of Recep Tayyip Erdoğan. Since Erdogan rose to power he aligned himself with the business elite and has turned Turkey into an export driven economy. Erdogan travelled to China, Brazil, India, Russia and the African continent with plane loads of businessmen and women in order to promote Turkish business interests. Turkey has a foreign policy premised on 'zero' problems with neighbours which is a big departure for a country that had long endured conflict on its restive borders - with Syria, Georgia, Armenia, Iran, and Iraq and which had run a mostly statist, closed economy until the 1980s.

Turkey began liberalising its economy and aggressively pushing trade with Central Asia and the Middle East under Erdoğan. Erdoğan has also been able to deal with the small but influential secular class who control key political, civil society, legal and military positions. By weakening them he has been able to push through his policies.

Whilst Turkey has strong fundamentals and diverse mineral wealth, its economy has not been built upon this or been driven by these over the past decade. Credit expansion has been the driver of the past decade of prosperity. High domestic interest rates attracted short-term foreign capital. That pushed up the value of the Turkish lira, making imports cheaper and sparking a boom in demand for foreign goods. This influx of short-term foreign money - known as hot money - meant that the prosperity relied on speculative investors from abroad. The banks aligned with the AKP, that is, the four Shari'ah-compliant banks (or participation banks), increased their consumer loans at a much faster rate than the conventional banks. In 2011, consumer loans by the Islamic banks rose by 53%, compared to 36% for commercial banks. This is why in the past two years, the ratio of debt to disposable income in Turkish households rose from 35% to 45%.

This growing demand was far in excess of what domestic industry could satisfy. As credit demand rose, it funded imports rather than domestic purchases. These imports were mainly for durable consumer goods, rather than capital goods for industry. Capital goods contribute to future productivity, whilst durable goods are consumed as soon as they are received. But much of the growth in the past decade has masked a fragility - a dependency on external debt, which, at a moment of crisis can leave a country dangerously exposed to market volatility and the whims of investors. Short-term investment from abroad has surged in recent years, while long-term investment has fallen.

Turkey needs \$200 billion a year to finance its current account deficit and maturing foreign debt. Since the start of the 2013, 60% of this sum has been financed by this hot money. Another 20% came from banks borrowing from abroad. Turkey's external debt stands at \$413bn, or about 51% of GDP.

Turkey has an economy worth \$820 billion, driven by the services sector which constitutes 63% of the economy and industry which represents 27%. Turkey has a labour force of 49 million with 48% working in services and industry and agriculture both constituting 25% each. 25% of Turkey's population is under working age and over the next 15 years will join the workforce. Turkey's workforce is set to grow and its overall population is forecasted to reach 84 million – the largest in Europe.

Europe remains the biggest market for Turkish products, accounting for 50% of the country's exports. Most go to Germany, France, and Eastern Europe, where Turkish companies are among the leading producers of cars, televisions and home appliances. Erdoğan's export-focused approach has included billions of dollars of business for construction companies building universities, malls and hotels for the governments of the Middle East. Turkey is the world's largest cement exporter and its construction sector is second only to that of China.

Turkey's largest industrial sector is petroleum refining. Turkey has very limited energy resources, but because of its strategic location between Europe and Asia and between oil consumers and oil producers, it is crossed by several major oil and gas pipelines. Turkey's geographical location makes it a natural transhipment route between the major oil producing areas in the Middle East, Central Asia, and the Caucasus on the one hand, and consumer markets in Europe on the other. Oil is shipped via super tankers through the Bosphorus, the narrow strait that connects the Black Sea to the Mediterranean Sea. Botas, a joint Turkish-Iraqi venture with its headquarters in Ankara, created a system of oil pipelines running from Iraq to Turkey, thus bypassing the Persian Gulf.

Oil and natural gas production in Turkey has remained negligible while the country's demand for hydrocarbons has risen rapidly. Turkey imports nearly all of the liquid fuels, hard coal and natural gas it consumes. Coal, which makes up about 26% of Turkey's energy consumption, will remain a significant part of Turkey's energy mix as the country tries to exploit more of its domestic reserves. However, domestic coal production continues to fall short of demand. Unable so far to attract the needed investment to boost coal production at home, Turkey has been importing roughly 16 million metric tons of hard coal each year from Australia, Colombia, the United States, Russia and South

Africa. Natural gas will be the biggest contributor to Turkey's energy import bill. About half of Turkey's electricity comes from natural gas-fired power plants, and this amount will likely grow as Turkey seeks out cheaper and cleaner modes of power. Turkey's energy consumption has already risen from 129 billion kilowatt hours in 2002 to 240 billion in 2012 (for comparison, Italy produced about 295 kilowatt hours in 2012). Most industry estimates see Turkey nearly doubling its electricity consumption over the next decade. In fact, Turkey is second only to China in its growing demand for electricity and natural gas for its power generation. Russia is by far Turkey's largest natural gas supplier, currently supplying nearly 60% of Turkey's natural gas imports — and that percentage is expected to grow.

Turkey has been self-sufficient in food production since the 1980s. As a result Turkey is the world's largest producer of:

- hazelnuts, cherries, figs, apricots, quinces and pomegranates,
- the second largest producer of watermelons, cucumbers and chickpeas,
- the third largest producer of tomatoes, eggplants, green peppers, lentils and pistachios,
- the fourth largest producer of onions and olives,
- the fifth largest producer of sugar beet,
- the sixth largest producer of tobacco, tea and apples.
- the seventh largest producer of cotton and barley,
- the eighth largest producer of almonds,
- the ninth largest producer of wheat, rye and grapefruit, and
- the tenth largest producer of lemons.

## Conclusions

Turkey has for long pursued economic policies which have created bubbles in the economy. Turkey's location and resources are its strengths and an economy built around these will be a much more stable and sustainable economic path to chart.

Where Turkey excels over the other MINT nations is its political ambitions. Erdogan and the crop of leaders around him have political ambitions of making Turkey a regional power. Whether its Syria, Iraq, the Caucuses or the Palestine conflict, Turkey is needed for any agreement, policy or outcome to be achieved. Turkey's leadership despite possessing the military capability (unlike the other MINT nations) has developed soft power tools such as its economic card, link with the Muslim world and providing a safe haven for rebel groups (such as the Free Syrian Army (FSA)) in Syria.

Whilst Turkey's current model has run out of steam, Turkey possesses ample mineral resources and now significant economic development to transfer to a more sustainable economic model. This will give the Turkish political leadership the ability to project power in the region and beyond. The only economic aspect Turkey needs to overcome is its dependency on foreign energy. This can be overcome by searching aggressively for off-shore reserves.

# Conclusions

At the end of 2014 the US remains the world superpower and maintains a balance around the world which protects America's array of strategic interests. The US was able to foment unrest which toppled Russia's man in Ukraine and ever since has installed a regime loyal to it. It has at the same time crippled Russia both financially and economically and it remains to be seen the impact this will have on Russia. In the Middle East, the US has been able to use ISIS to achieve its aims of thwarting the Arab spring, dividing the rebel opposition against the government in Damascus and having maintained the position of Basher al-Assad. Despite a decade of war in Afghanistan and Iraq, the US has been able to transition away from a large US military presence to smaller Special Forces which will protect America's political architecture composed of opportunist and loyalists.

America's main competitors – China and Russia faced significant issues and challenges domestically in 2014. Whilst Russia was able to freeze the conflict in Ukraine this has cost it dearly from an economic perspective and unless it can overcome this, Russia's position at the end of 2015 may be very different to where it is now. China continues to work on transforming its economy – a colossal task but its political vision remains regional and only economic beyond this. The two nations that compete with the US in 2014 were unable to pose a significant challenge on US prowess.

The global economic crisis – now in its seventh year continues to hurt many nations. In Europe, austerity continues to hurt most nations and as spending continues to fall, European nations are caught in a downward spiral. Germany continues to hold the whole of Europe to ransom in order to maintain its position as the continents premier nation. In the US once again the economy was in recession in early 2014, but sustainable growth remains as elusive as ever.

Despite much fanfare regarding the rise of the MINT nations, similar publicity existed around the BRIC nations and aside from Turkey from amongst the MINT nations, the others have some way to go to even reach levels where their domestic politics and economies allow them to dabble in foreign policy adventures and have a say on global politics.

At the end of 2014, the US remains the world's superpower. It has managed to navigate the myriad of challenges to maintain this dominant position. Whilst challenges remain in places such as Syria, the US continues to develop strategies and plans and adjusts them based on their success or failure.

# 2015

**New US aircraft carrier** - The first in a new generation of US aircraft carriers is due to launch in 2015. Aircraft Carriers as a part of Carrier Strike Group (CSG) are the key to US dominance of the world's oceans. A CSG is centred on an aircraft carrier, which projects US naval and air power. The US currently has 10 active aircraft carriers, which are of the Nimitz class. The lead ship of this class, was commissioned in 1975, and USS George H.W. Bush, the tenth and last of the class, was commissioned on 10 January 2009. From 2015 this ageing fleet will be replaced by the Gerald R. Ford-class. This new class of ship includes some major improvements over previous generations. These include: increased automation, electromagnetic aircraft launch systems to replace previous steam mechanisms, increased stealth, a new type of nuclear reactor for more efficient power consumption, high tech radar and flight control, as well as the ability to carry the new F-35 Lightning II fighter jet. Ten carriers are commissioned in total, at a cost of \$14bn each (including research and development). The 10th and final ship is scheduled to be launched by 2040.

**The Eurasian Union** - The Eurasian Union (EAU) is due to officially come into existence on January 1<sup>st</sup> 2015. The political and economic union will consist of Russia, Belarus, Kazakhstan, Armenia and Kyrgyzstan. It will create a single economic market of 171 million people and a gross domestic product of \$3 trillion. The idea, based on the EU's integration, was brought to attention in October 2011 by then-Prime Minister of Russia, Vladimir Putin, in an effort to consolidate Russia's position in Eurasia. With the Russian economy in crisis and tensions in Ukraine, this union will play an important role in Russia's future strategy.

**Egypt Parliamentary Elections, March 2015** – The Arab spring has been completely reversed in Egypt. As the sole candidate in the presidential election in May 2014, he institutionalised his position as dictator of Egypt. In the midst of economic turmoil parliamentary elections will be held from February 2014 – March 2014. With the Muslim Brotherhood boycotting the election, two main camps will be the primary forces participating in the vote. The first camp is the al-Nour Party, which came in second place behind the Muslim brotherhood in the 2011-12 parliamentary elections, but has sided with Sisi all the way. The second camp is the country's highly fragmented anti-Islamic camp. There is also an effort to form a centrist coalition led by former Muslim Brotherhood leader and presidential candidate Abdel Moneim Aboul Fotouh, who is trying to gather other moderate forces. Sisi and the military need to find a replacement for the defunct former ruling National Democratic Party.

**Turkey General Election, June 2015** - Turkey will head to the polls in June 2015 to elect 550 new members of the countries grand assembly. A majority of 276 seats is needed to form the government and the Justice and Development Party (AKP), since it emerged in power in 2002 has won the elections well in excess of a simple majority. This allowed its leader Erdogan to push through many reforms. The rules of the AKP limited Erdogan to three terms as prime minister, which would have ended in June 2015. However Erdogan gave up the prime minister's position and ran for the president's position in August 2014, which was the first time the position was directly elected by the people and not parliament. The problem Erdogan now faces is his position does not

possess the powers the Prime Ministers role did. Erdogan's supporters have talked of rewriting Turkey's constitution to give the presidency greater powers. Erdogan has weakened the army's grip on power and used the state security to suppress opposition to his Pro-US agenda, but with the president lacking executive power, a constitutional change will be needed. This requires the drafting of a new constitution, which has to be passed through parliament with at least a three fifths majority and then successfully passed via a public referendum. The AKP currently is 3 seats short of 330 to propose constitutional changes to a referendum without the support of other parties in parliament. All of this will take place with Erdogan continuing his efforts to strengthen his party at the expense of the secular elements.

**Nigeria Elections, February 2015** - President Goodluck Jonathan positioned himself for re-election and has been supported by several elements of the party leadership. In December 2014 Jonathan ran unopposed in the People's Democratic Party (PDP) primaries, receiving the nomination of the party. Issues such as Niger Delta militancy and the Nigerian military's challenges in combating Boko Haram in the northeast will be essential to the political posturing of either party's candidate. Since the emergence of the PDP in the early 2000's America's influence has grown in Nigeria due to the party's pro-US position and the expense of Britain.

**European Election** - Key members of the European Union, including Sweden, Spain, the UK and possibly Greece, will hold elections in 2015. Europe's economic crisis is slowly but steadily eroding the political systems of many countries on the Continent. New actors are emerging and threatening the supremacy of the traditional players. Alliances and events that seemed impossible only a few years ago are now being openly discussed across Europe. On December 3<sup>rd</sup> for example, Sweden announced it would hold early elections, partially because of political moves from the far right. In Spain, the ruling center-right party is openly discussing the possibility of entering an alliance with its traditional center-left rivals to prevent a protest party from taking over. The current norm in Europe would have seemed impossible only five or six years ago. Most people would not have believed that unemployment in Spain or Greece could go above 25% or that nationalist, protest and Euroskeptical parties would become key players in European politics. In most cases, these countries will see outcomes nobody would have thought possible in 2008.

**Uzbekistan Presidential Elections, December 2015** - Constitutional changes made on 27 March 2014 in the Uzbek parliament were unique in the history of the country. Since the collapse of the Soviet Union, all powers have been firmly in the hands of the president – Islam Karimov. On this occasion many powers were transferred to the Uzbek parliament and the Prime Ministers position was also given additional powers. Karimov created a regime founded on a small number of influential persons who hold top state offices and control different sectors of the economy. Islam Karimov is now 75 years old and is aging and suffered a severe heart attack on 19 March 2013. Although there was a media black-out on this issue, he was absent for many days from public life. When he did appear a week later, many considered the man to be his double. Karimov eventually resumed his duties, however his health problems have contributed to competition among the different clans in the country to succeed him.

A serious investigation launched in Sweden against Gulnara Karimova, daughter of Islam Karimov in 2013, where she is suspected of receiving a \$320 million bribe, by a Swedish-Finnish company for access to Uzbekistan's telecoms market. This was been deeply embarrassing for Karimov internationally and also ended any possibility of his daughter succeeding him in the elections that are due to take place in 2015. Karimov has closed many television channels and radio stations that belonged to his daughter and froze her bank accounts. She is now in prison. These unprecedeted events have seriously harmed the president's image and indicate that the system built by Karimov is collapsing and that he may be losing control of the situation.

It should be remembered that Karimov is a volatile person in respect he never sticks to what he says and it is unlikely he will want to give up power. There are likely three candidates to replace Karimov if he does not run for president:

**Rustam Azimov** – who is charge of Uzbekistan's state-controlled economic and financial system.

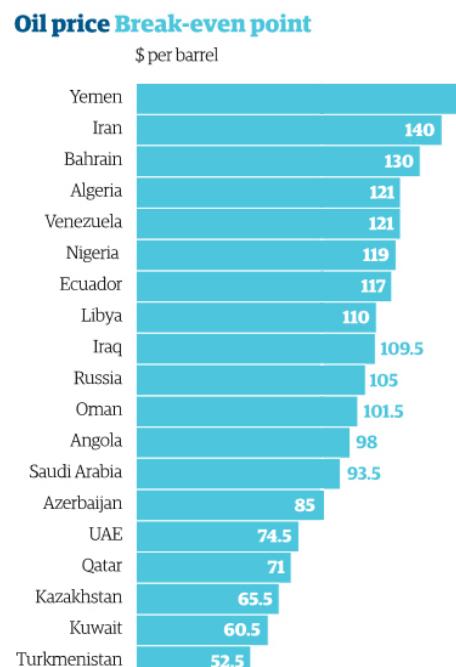
**Shavkat Mirziyayev** – the prime minister since 2003, and responsible for domestic affairs. He controls the different regions in Uzbekistan.

**Rustam Inoyatov** - is one of the president's long-time advisers and Karimov's partner in oppressing the people. He is in charge of the secret service.

Due to his closeness and access to Karimov it is likely Inoyatov will gain more power as Karimov nears his end.

The amendments to the constitution appear to be an attempt by Karimov to spread power as he nears his end. Whether he goes through with these amendments remains to be seen as Karimov is a dictator only interested in power for himself. However internal disputes within his own family and clans in the country are getting bigger as there are no clear successors to Karimov.

**Oil Crisis** - When oil prices move in either direction, there are winners and losers. High oil prices are good for oil producers, as they make more profits, but bad for oil consumers who have to pay more. Low oil prices are good for oil consumers as they can consume more as the price of oil is cheap. But this eats into the profits of oil producers. Oil producers around the world receive most of their budget revenues from oil and energy sales and have a breakeven oil price which balances their budgets. When oil prices falls below this point, then government revenues are affected, government expenditure is affected and energy dependent economies as a whole are also affected. In the space of a year oil prices have fallen from around \$130 per barrel to around \$80 per barrel, a fall of over 50%. As oil is the world's most important commodity it affects a countries standing in the



world, and as we can see with Russia it is leading to its collapse. In 2015, nations dependent on oil will need to deal with falling oil prices.

**Libya Crisis** - For three years, Libya has been without a functioning government, police force, or army. The country has been ripped apart by warring ex-rebels who helped oust Gaddafi. Various rival factions have emerged who are vying for control of Libya. On one side is the newly elected parliament that has been banished to the eastern city of Tobruk — supported by the fractured remains of Gaddafi soldiers who defected during the uprising. On the other side is Libya Dawn, a self-described revolutionary coalition of militiamen and politicians that originated in the Western city of Misrata. Then there is an army faction led by former General Khalifa Haftar, who has rapidly emerged a powerful figure. In 2015 all these factions will battle it out for the country.

**Yemen Crisis** - Houthi tribesman stormed Yemen's capital city, Sana'a and occupied government buildings in the summer of 2014 that included the defence ministry, the army headquarters, the parliament building, the central bank and the national radio station. The Houthis are a tribe from amongst the Zaidis (who follow Shi'ah fiqh) and the Zaidis represent 40% of Yemen's population. For decades the government in Sanaa marginalised and repressed the Zaidis, who were left to administer their rugged and resource-poor province in Saada, North Yemen. The Houthis who joined the uprising against Ali Saleh were sidelined as his crony Abdu Rabu Mansour Hadi took over and has maintained the isolation of the Houthis. This is what caused the stand-off in the summer of 2014. With the US supporting the Houthis by not considering them a terrorist group but a legitimate political actor and Britain supporting the existing government, this stand-off is set to heighten in 2015.

**US Afghan Departure** – After 13 years of war, nearly 2000 military deaths of its servicemen and costs of around \$3 trillion, the US will end its mission on 1<sup>st</sup> January 2015. The Taliban still control most of the country, the Afghan central government remains incompetent and corrupt and the countries US trained national army is in no position to maintain order. Negotiations with the Taliban never materialised and the US will leave a country that remains in disarray. To deal with this the US will leave around 13,000 troops in the country under a new two-year mission named Resolute Support, which began on January 1<sup>st</sup> 2015. It remains to be seen if the US constructed political architecture remains standing in 2015.

**Disintegration of Sykes-Picot** - Sir Mark Sykes and Francois Georges-Picot were British and French diplomats who redrew the map of the region between the Mediterranean Sea and Persia after World War I. They invented countries like Lebanon, Jordan, Syria and Iraq. Some of these nation-states are in turmoil and their sustainability is now a pertinent question. With conflicts flowing across international boundaries and central governments becoming mere factions amongst many other factions, the region is where it was 100 years ago. The Middle East as we know it was crafted to divide and weaken the Muslims. Weak groups and ethnicities that would remain loyal to the west were brought to power. This is why countries such as Kuwait, Jordan and Lebanon are artificial nations. In Syria today, Basher al-Assad is just one faction amongst many and in Iraq the government in Baghdad is struggling to be more than just another faction. In 2015 the fragmentation and the crippling of national governments will erode the Sykes-Picot Middle East

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