Emerging Economies

The Geopolitics of the BRICS Nations

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INTRODUCTION

BRICS (Brazil, Russia, India, China and South Africa) has emerged as a new multilateral forum, claiming to represent the developing world in reshaping the global financial architecture. The BRICS countries discuss proposals for alternative currencies to the U.S. dollar, establishing a new bank for investment in the developing world and shifting attention from the traditional global economic powers to the emerging markets, particularly in the east and south.

But unlike other economic or political blocs, BRICS did not evolve out of existing trade relationships or develop due to geographic proximity. In many ways, BRICS emerged not from within the member states but from outside. The term BRIC (without South Africa) was coined at the beginning of the new millennium as a clever acronym to list some of the emerging markets and raise attention to the shifting trade and economic balance that would be emerging over the next few decades. BRIC was never seen as a bloc or even as a form of cooperation among the countries listed within the acronym. In fact, the differences in economic patterns and future were explicit within early discussions of the so-called BRIC.

In some ways, the differences among the BRICS countries are more striking than the similarities. Though all have relatively robust rates of gross domestic product growth (though China and India stand quite a bit higher than the others), there are fairly distinct differences both in total GDP and in per capita GDP, as well as the overall sizes of the economies. But each is also structurally very different. The Brazilian economy is fairly sequestered and the Chinese economy is heavily dependent upon international trade. The Russian economy has strong centralized control, with external links primarily in low value-added commodities exports. South

Africa (a latecomer to the club) has a comparatively small economy but a high per-capita GDP, somewhere between Brazil and Russia on the high end and China and India on the low end. Even trade between the five is limited, with much centered on bilateral relationships with China.

Nonetheless, BRICS has emerged as a club, a grouping that seeks to promote itself as the voice of the underrepresented in the global economy, the countering voice to the United States and Western Europe. This emergence occurred in the depths of the global financial crisis, when China and Russia saw the traditional global economic leaders slipping while the developing nations, for the most part, managed to keep their growth rates higher than the developed states. In this incarnation, BRICS is much more political than economic, but even in that realm there are internal disagreements as to the direction of the group. China and Russia are quietly competing over leadership, and India, Brazil and South Africa already had their own South-South club (IBSA), which is now apparently subsumed into BRICS, potentially costing them their voice in the face of the much louder China. There are questions as to why the BRICS members are the ones in the club, aside from the acronym —why not other large emerging countries, particularly Indonesia?

In the end, it is perhaps more significant to look at BRICS not as some economic-political bloc but rather, as originally intended: Individual developing nations that, as they continue to expand economically, will naturally seek to expand their spheres of influence to cover their growing areas of interest. This will inevitably create changes in the structure and balance of global trade and economic activity, not because it is some unified BRICS bloc but because the relations among countries are always shifting and changing. While certainly not a complete picture of these nations, this book offers some glimpses into the strengths, challenges and direction of the members of BRICS as they navigate the waters of economic expansion and global relations.

Stratfor
Austin, Texas
April 13, 2012

A NOTE ON CONTENT

Stratfor presents the following articles as they originally appeared on our subscription website, www.Stratfor.com. These pieces represent some of our best analyses on the BRICS nations' economics, politics and international relations, organized by country in the order in which they were published. Since most of the articles were written as individual analyses, there may be overlap from piece to piece and chapter to chapter, and some of the information may seem dated. Nevertheless, Stratfor believes bringing these pieces together provides valuable insight and perspective on five significant regional players.

PART 1: BRAZIL

The Geopolitics of Brazil: An Emergent Power's Struggle with Geography

July 14, 2011

South America is a geographically challenging land mass. The bulk of its territory is located in the equatorial zone, making nearly all of the northern two-thirds of its territory tropical. Jungle territory is the most difficult sort of biome to adapt for human economic activity. Clearing the land alone carries onerous costs. Soils are poor. Diseases run rampant. The climate is often too humid to allow grains to ripen. Even where rivers are navigable, often their banks are too muddy for construction, as with the Amazon.

As the tropics dominate South America, the continent's economic and political history has been problematic. Venezuela, Guyana, Suriname and French Guiana are fully within the tropical zone, and as such always have faced difficulties in achieving economic and political stability, though the discovery of oil in Venezuela improved that country's economic trajectory. Throughout the tropical zones nearly all of the population lives within a few dozen kilometers of the coast. For the most part, however, those coasts are not naturally sculpted to encourage interaction with the outside world. Natural ports — deepwater or otherwise — are few and far between.

There are, however, two geographic features on the continent that break this tropical monotony.

The first is the Andean mountain chain. The Andes run along the continent's western edge, giving rise to a handful of littoral and trans-mountain cultures physically separated from the continent's eastern bulk and thus largely left to develop according to their own devices. Colombia and Ecuador straddle the tropics and the Andes, with their economic cores not being coastal, but instead elevated in the somewhat cooler and dryer Andean valleys, which mitigates the difficulties of the tropics somewhat. Farther south are the arid transmountain states of Peru and Bolivia. Peru has achieved some degree of wealth by largely ignoring its own interior except when seeking resource extraction opportunities, instead concentrating its scant capital on the de facto city-state of Lima. In contrast, landlocked Bolivia is trapped in a perennial struggle between the poor highlanders of the Altiplano and the agriculturally rich region of the lowland Medialuna.

The combination of mountains and jungle greatly limits the degree to which states in this arc — from French Guiana in the northeast to Bolivia in the southwest — can integrate with each other or the outside world. In all cases, basic transport is extremely difficult; tropical diseases are often a serious issue; there are few good ports; agricultural development is both more labor and capital intensive compared to more traditional food-producing regions; humidity and heat hinder conventional grain production; and the ruggedness of the mountains raises the costs of everything.

Historically, the only way these states have achieved progress toward economic development is by accepting dependence on an external (and usually extraregional) power willing to provide investment capital. Without this, these states simply lack the capital generation capacity to meet their unique and staggering infrastructure challenges. Consequently, the broader region is severely underdeveloped, and the residents of most of these states are generally quite poor. While some may be able to achieve relative wealth under the right mix of circumstances, none has the ability to be a significant regional — much less global — power.

SOUTH AMERICAN CLIMATE

The second exception to the tropical dominance of South America is the temperate lands of the Southern Cone. Here, the summers are dry enough to allow traditional grains to ripen, while cooler weather — especially winter insect kills — limits the impact of disease outbreaks. Unlike the scattered populations of the Andean region, the Southern Cone is one large stretch of mostly flat, moderately watered territory. The bulk of that land lies in Argentina, with significantly smaller pieces in Uruguay, Paraguay and Brazil. The only remaining country on the continent is where the temperate Southern Cone overlaps with the Andean mountain zone: Chile, one of the world's most physically isolated states. It takes longer to fly from Santiago to Lima than it does to fly from London to Moscow, and longer to sail from Santiago to Buenos Aires than it does from New York City to London. Chile consequently does not participate significantly in the politics of the Southern Cone.

In stark contrast to the mountains and jungle that dominate the majority of South America, the Southern Cone flatlands are the best land on the continent. Their flatness, combined with their natural prairies, lowers the cost of construction, and the temperate climate makes them rich agricultural zones. But the real advantage lies in the region's river structure. The Parana, Uruguay and Paraguay rivers combined with the Rio de la Plata — a massive estuary that empties into the Atlantic between contemporary Buenos Aires and Montevideo — are all navigable for a great portion of their length.

Moving goods via water costs about 10 to 30 times less than moving the same goods by truck. Such riverine transport systems therefore generate massive amounts of capital with little difficulty compared to land-transport systems. Collectively, this river network overlaying the agricultural flatlands is known as the Rio de la Plata region.

These rivers are particularly valuable for agricultural regions such as the Rio de la Plata. Wheat, corn, soybeans and the like suffer from a weak value-to-bulk ratio — oftentimes transporting them great distances can only be done at an economic loss. Water transport allows for foodstuffs to cheaply and easily be brought not just downstream but to the ocean and then the wider world. Russia presents a strong contrast to the Rio de la Plata region. Its famines often directly result from the inability to bring foodstuffs to the cities efficiently because its navigable rivers are not well situated — meaning foodstuffs must be transported by truck or train.

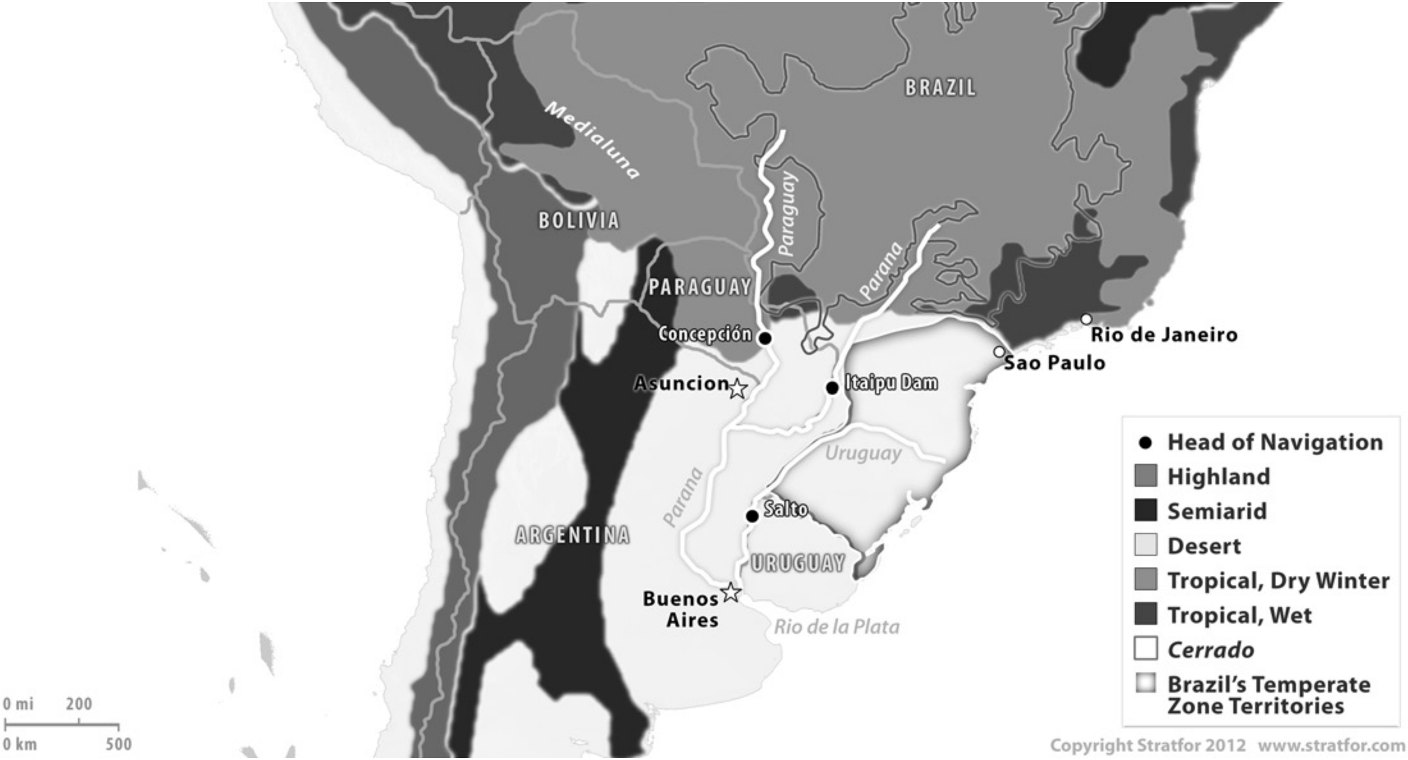
The most important geographic fact on the continent is that the Rio de la Plata region's rivers are navigable both independently and collectively via a system of canals and locks. Only the Greater Mississippi River network of North America has more kilometers of interconnected maritime transport options. This interconnectivity allows greater economies of scale, greater volumes of capital generation and larger populations, and it greatly enhances the establishment of a single political authority. In contrast, the separate rivers of the North European Plain have given rise to multiple, often mutually hostile, nationalities. Argentina controls the mouth of the Rio de la Plata and the bulk of the navigable stretches of river. This leaves the Uruguayans, Paraguayans and Brazilians at a disadvantage within the region. (Brazilian power is greater overall than Argentine power, but not in the critical capital-generating geography of the Rio de la Plata region.)

The Brazilian Geography

Most of Brazil's territory does not lie within these Southern Cone lands. Instead, roughly one-third of Brazil's 8.5 million square kilometers is composed of vast tracts of challenging jungle, with the Amazon Basin being the most intractable of all. While there are many potential opportunities to exploit minerals, they come with daunting infrastructure costs.

South of the Amazon Basin lies a unique region known as the cerrado, a vast tropical savannah with extremely acidic soils. However, because the heat and humidity is far less intense than in the jungle, the cerrado can be made economically viable by brute force. The cost, however, is extreme. In addition to the massive infrastructure challenges — the cerrado lacks any navigable rivers — the land must in essence be terraformed for use: cleared, leveled and fertilized on an

RIO DE LA PLATA REGION



industrial scale to make it amenable to traditional crops. There is also the issue of distance. The cerrado is an inland region, so shipping any supplies to or produce from the region comes at a hefty transport cost. Brazil has spent the greater part of the past three generations engaged in precisely this sort of grand effort.

Luckily for the Brazilians, not all of Brazil's lands are so difficult. About 600,000 square kilometers of Brazil is considered traditionally arable. While this represents only 7 percent of the country's total land area, that still constitutes a piece of arable territory roughly the size of Texas or France. All of that land lies in the country's southern reaches. But much of that territory lies in the interior, where it is not easily accessible. Brazil's true core territories are less than one quarter of this 7 percent, about the size of Tunisia, straddling the area where the tropical zone gives way to the temperate lands of the Southern Cone. These areas formed the core of Brazil's original settlements in the early colonial period, and these lands formed the population core of Brazil for the first three centuries of its existence. As such, the topography of these lands has had an almost deterministic impact on Brazil's development. Understanding that topography and its legacy is central to understanding what is empowering Brazil to evolve — and hampering Brazil from evolving — into a major power in the years to come.

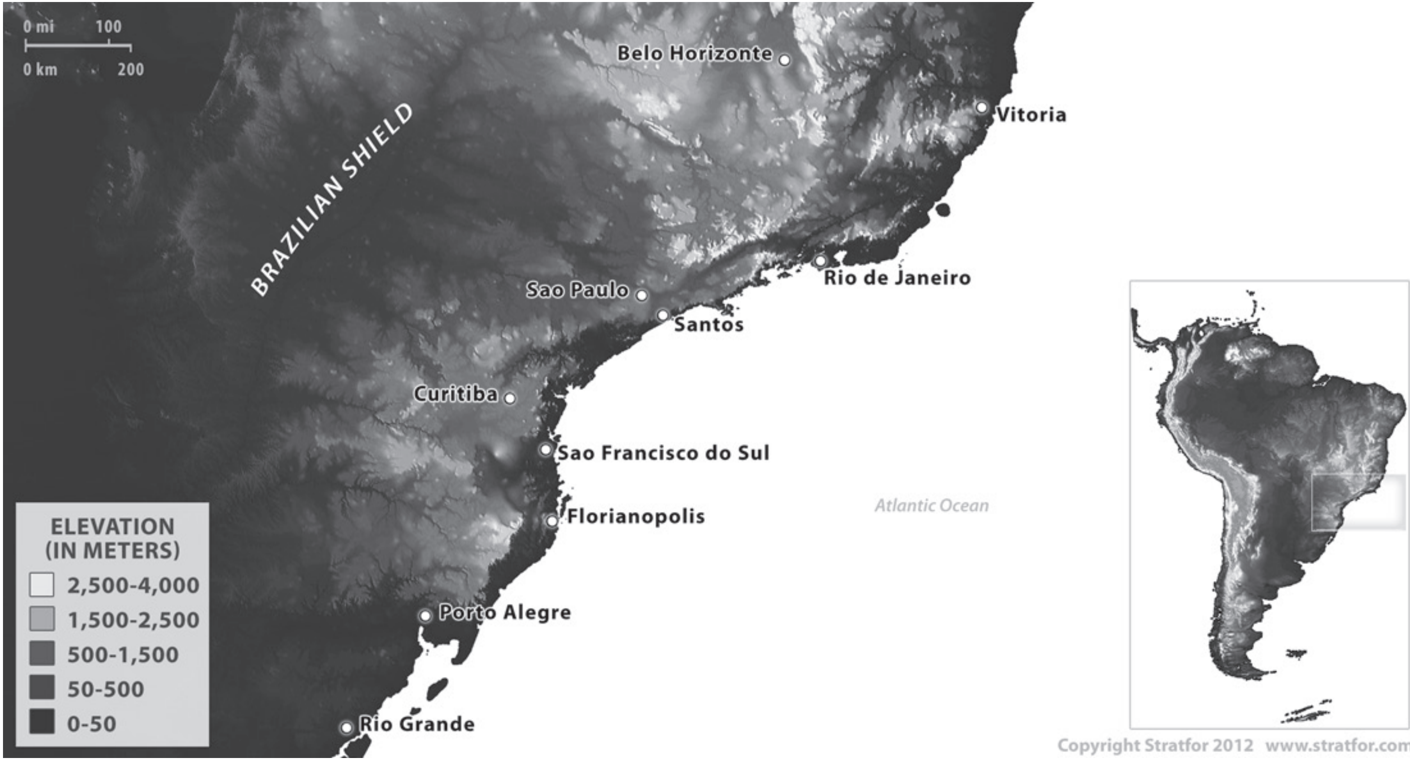
Two obvious characteristics stand out regarding this core Brazilian region. First, it is semi-tropical, so development in the region faces a somewhat less intense version of the challenges described above for fully tropical zones. Second, and more critical, the Brazilian interior is a raised plateau — called the Brazilian Shield — which directly abuts Brazil's Atlantic coast along nearly the entirety of the country's southeastern perimeter. The drop from the shield to the Atlantic is quite steep, with most of the coast appearing as a wall when viewed from the ocean — the source of the dramatic backdrops of most Brazilian coastal cities. This wall is called the Grand Escarpment, and most Brazilian cities in this core region — Rio de Janeiro, Vitoria, Santos and Porto Alegre — are located on small, isolated pockets of relatively flat land where the escarpment falls to the sea.

The primary problem this enclave topography presents is achieving economies of scale. In normal development patterns, cities form around some sort of core economic asset, typically a river's head of navigation (the maximum inland point that a sizable cargo vessel can reach) or a port or nexus of other transport options. The city then spreads out, typically growing along the transport corridors, reflecting that access to those transport corridors provides greater economic opportunities and lower economic costs. So long as somewhat flat land remains available, the city can continue growing at low cost. In time, nearby cities often start merging into each other, allowing them to share labor, capital, infrastructure and services. Economies of scale proliferate and such megacities begin generating massive amounts of capital and skilled labor from the synergies.

Megacities — such as New York City, Los Angeles, London, Paris, Tokyo, Buenos Aires, Istanbul and Shanghai — form the core of the global economic system. This "standard" development pattern has been repeated the world over. The premier American example is the "megalopolis" region of cities on the American Eastern Seaboard stretching from Washington to Boston, encompassing such major locations as Baltimore, Philadelphia, New York, Hartford and Providence. In Europe, a similar conglomeration contains the many cities of the German Rhine Valley. In both cases, major and minor cities alike merge into an urban/suburban conglomeration where the resources of each location are shared with and bolstered by the others. In all such cases, the common characteristic is the existence of land upon which to expand.

That land is precisely what Brazil's core territory lacks. The Grand Escarpment comes right down to the ocean throughout the Brazilian southern coast. Brazil's cities, therefore, are forced to develop on small enclaves of relatively flat land in the few areas where the escarpment has not pushed all the way to the sea. The lack of a coastal plain means no small cities can form between the major cities. Any infrastructure built by one city never serves another city, and linking the cities requires climbing up the escarpment onto the shield itself, traversing the shield and then going back down the escarpment to

COASTAL URBAN AREAS AND THE GRAND ESCARPMENT



MAJOR ECONOMIC CENTERS BY TOTAL AREA

URBAN AREA	COUNTRY	SQUARE KM	POPULATION (2008)	POPULATION/ SQUARE KM
Salvador	Brazil	389	2,980,000	7,661
Recife	Brazil	414	3,490,000	8,430
Fortaleza	Brazil	725	3,160,000	4,359
Porto Alegre	Brazil	777	3,440,000	4,427
Curitiba	Brazil	842	2,900,000	3,444
Belo Horizonte	Brazil	1,010	4,640,000	4,594
Rio de Janeiro	Brazil	1,580	11,160,000	7,063
London	U.K.	1,623	8,320,000	5,126
Montreal	Canada	1,676	3,360,000	2,005
Sydney	Australia	1,788	3,680,000	2,058
Toronto-Hamilton	Canada	2,279	5,790,000	2,541
Milan	Italy	2,370	4,190,000	1,768
Buenos Aires	Argentina	2,590	12,390,000	4,784
Beijing	China	2,616	12,770,000	4,881
Amsterdam-Hague-Rotterdam	Netherlands	2,657	4,248,592	1,599
Osaka-Kobe-Kyoto	Japan	2,720	17,270,000	6,349
Washington DC	U.S.	2,996	4,260,000	1,422
Paris	France	3,043	10,430,000	3,428
Houston	U.S.	3,463	4,550,000	1,314
Sao Paulo-Campinas	Brazil	3,548	21,540,000	6,071
Essen-Dusseldorf-Cologne-Bonn	Germany	3,574	9,260,000	2,591
Dallas-Fort Worth	U.S.	3,959	5,160,000	1,303
Moscow	Russia	4,533	13,260,000	2,925
Philadelphia	U.S.	4,661	5,270,000	1,131
Los Angeles	U.S.	5,812	14,730,000	2,534
Chicago	U.S.	5,952	9,030,000	1,517
Tokyo-Yokohama	Japan	7,835	34,400,000	4,391
New York	U.S.	11,264	20,090,000	1,784

Source: Wendell Cox Consultancy (Demographia) the other cities, a difficult and costly endeavor in terms of both time and engineering. Because Brazil does not have direct access to the navigable rivers of the Rio de la Plata region, it has to scrounge for capital to apply to this capital-intensive project. Absolute limitations on land area also drive up the cost of that land, injecting strong inflation into the mix right at the beginning and raising development costs. Enclavic geography is not something that can be "grown out of" or "developed around." The topography is constant, and these cities simply cannot synergize each other — a modern, low capital-cost city cannot be built on the side of a cliff. Moreover, since these enclaves are Brazil's primary points of interaction with the outside world, they represent a constant, permanent restriction on Brazil's ability to grow.

To this day, Brazil has very few major highways and railways because even where the topography does allow for the possibility, the costs still are much higher than in flatter lands farther south. The country lacks a major coastal road system, as the escarpment is simply too steep and too close to the coast. Following the Brazilian coastline makes clear how Brazil's coastal roads are almost exclusively two-lane, and the coastal cities — while dramatic — are tiny and crammed into whatever pockets of land they can find. And most of the country is still without a rail network; much of that soy, corn and rice that the country has become famous for exporting reaches the country's ports by truck, the most expensive way to transport bulk goods.

The one exception to the rule is Sao Paulo state, centered on the city of the same name. Only Sao Paulo has sufficient flat lands to follow a more standard development pattern and thus achieve any economies of scale. It is also the only portion of Brazil that possesses anything resembling the modern, integrated infrastructure that follows more traditional development patterns. Unsurprisingly, this single state accounts for more than one-third of Brazil's gross domestic product (GDP) despite only serving as home to one-fifth of the country's population. As recently as 1950, Sao Paulo state produced more than one-half Brazil's economic output.

Unfortunately, Sao Paulo is not a coastal city. The escarpment at Sao Paulo is too steep and the coastal enclave — the port of Santos

MAJOR BRAZILIAN INFRASTRUCTURE

— is too small to take full advantage of Sao Paulo's potential. Sao Paulo sits at an elevation of about 800 meters atop the Brazilian Shield, some 70 kilometers inland. (In comparison, the U.S. city at the Mississippi River's head of navigation, Minneapolis, Minn., sits at less than 200 meters elevation despite being 3,000 kilometers inland.) This sharp elevation change helps mitigate the climatic impact of the region's near-tropical conditions that predominate on the coast, but comes at the dauntingly high capital and engineering costs required to link the city and state to the coast. So while Sao Paulo is indeed a major economic center, it is not one deeply hardwired into Brazil's coastal cities or to the world at large.

The lack of economies of scale and the difficulty of integrating local infrastructure forces bottlenecks. The worst of those bottlenecks occur where the coastal enclaves interact with the outside world — in Brazil's ports — and it is here that Brazil faces the biggest limiting factor in achieving economic breakout. Brazil is correctly thought of as a major exporter of any number of raw commodities, but the hostility of its geography to shipping and the inability of its cities to integrate have curtailed port development drastically. The top seven Brazilian ports combined have less loading capacity than the top U.S. port, New Orleans, and all Brazilian ports combined have considerably less loading capacity than the top two U.S. ports, New Orleans and Houston.

Building a more sustainable Brazil cannot be done on the coast; there simply is not enough land there to feed a growing nation. But climbing up the Grand Escarpment to develop the interior introduces a new problem.

The coastal ridge at the top of the Grand Escarpment also divides drainage basins. Within a few dozen kilometers of the southeastern coast, South American rivers flow west, not east, ultimately emptying into the Rio de la Plata network. As the early Brazilian cities attempted to develop interior hinterlands, those hinterlands found themselves more economically intertwined with Argentine and Paraguayan lands to the south than with their parent communities to the east. For many in the interior it was cheaper, easier and faster to float products down the rivers to the megaport of Buenos Aires than to lug them by land up and over the Brazilian coastal mountain ranges and down the Grand Escarpment to the middling disconnected ports of coastal Brazil. Similarly, it was far easier to sail down the Atlantic coast and up the Rio de la Plata Basin onto the Parana than expend the cost of building on-land infrastructure. Brazil's early efforts to develop integration within its own territories paradoxically led to an economic dependence upon its southern neighbors that weakened intra-Brazilian relationships.

Those southern neighbors took advantage of this situation, leaving Brazil struggling to control its own land. Unlike the U.S. independence experience, in which all of the colonies were part of the same administration and battled as one against their colonial overlord, South America was a patchwork of different entities, all of which fought for their independence in the same 15-year period. Paraguay achieved independence in 1811, Argentina in 1818 and Brazil in 1823. Immediately upon independence, the region's new states struggled for control of the waterways that held the key to being the dominant, integrated economic power of the Southern Cone. Since Brazil was the last of the region's states to break away from its former colonial master, it had the least time to consolidate in preparation for post-independence wars, and its enclave nature made such consolidation far more challenging than that of other Southern Cone states. Brazil accordingly did very badly in the ensuing conflicts.

Those early wars resulted in Uruguay's separation from Brazil and the removal of Brazilian authority to above the heads-of-navigation on all of the Rio de la Plata region's rivers. All of the rivers' navigable lengths were now shared between Argentina, Paraguay and Uruguay, leaving capital-poor Brazil sequestered in its highland semi-tropical territories. Argentina and Paraguay rose rapidly in economic and military might, while Brazil languished with little more than plantation agriculture for more than a century.

The next two generations of regional competition focused on Argentina and Paraguay, which struggled for control of the Rio de la Plata maritime system. That competition came to a head in the

1864-1870 War of the Triple Alliance in which Argentina, Brazil and Uruguay eventually won after a brutal struggle with Paraguay. Fully 90 percent of the male Paraguayan population died in the conflict, nearly destroying Paraguay as a country; its demography did not finally rebalance until the 1990s. With Brazil's wings clipped and its more serious regional rival all but destroyed, Argentina fashioned Paraguay and Uruguay into economic satellites, leveraging the region's river systems to become a global economic power. By 1929 it had the world's fourth-highest per capita GDP. Brazil, in contrast, remained impoverished and relatively isolated for decades.

Nor was Brazil united. Between the economic pull of Argentina and its rivers and the disconnected nature of the enclavic coast, regionalism became a major feature of Brazilian politics. Contact between the various pieces of Brazil was difficult, while contact with the outside world was relatively easy, making integration of all kinds — political, economic, and cultural — often elusive.

Regionalism remains a major issue in Brazilian politics, with strong rivalries triggering divisions among states and between states and the federal government. The preponderance of power at the beginning of the 20th century lay in the hands of the wealthier states, Minas Gerais and Sao Paulo. For many years, control of the central government alternated between the two states. This left Brazil's remaining states isolated politically, prodding them to seek economic opportunities globally while defining their identities locally. For the better part of a century, "Brazil" was less a national concept as much as it was a geographic concept. Rio de Janeiro and Rio Grande do Sul states, for example, in many ways started acting like independent countries. This state of affairs lasted until very recently.

Brazil's Inflation Trap

Brazil's biggest problem — which began with the colonial settlement process and continues to the current day — is that it is simply not capable of growth that is both sustained and stable. Economic growth anywhere in the world is inflationary: Demand for arable land, labor, transport, capital and resources pushes the prices of all of these inputs up. Growth in most places can continue until those inflationary pressures build and eventually overtake any potential benefit of that growth. At that point, growth collapses due to higher costs and a recession sets in. Brazil's burden to bear is that land, labor, transport infrastructure and capital exist in such extreme scarcity in Brazil that any economic growth almost instantly turns inflationary. Arable land, transport infrastructure and capital have already been discussed, but labor requires a more thorough examination, particularly given contemporary Brazil's population of 194 million.

The labor issue is rooted in Brazil's oligarchic economic system, something that also has a geographic origin. Brazil suffers from low capital generation and high capital costs — the opposite of most of the world's economic power centers. In those power centers, the relative omnipresence of capital allows a democratization of economic power.

In the American experience, anyone could easily venture out of the cities into the lands of the Greater Mississippi Basin and, within a year or two, be exporting agricultural produce to both American and European cities. In Brazil, by contrast, massive amounts of capital were needed simply to build roads up the Grand Escarpment. The prospect of a common citizen establishing an independent economic existence in that sort of environment was unrealistic, as the only people who had the capacity to "build" Brazil were those who entered the country with their own pre-existing fortunes. So while the early American experience — and the industrialization that followed — was defined by immigrants from Europe's rural poor seeking land, Brazil was started on its path by rich Portuguese settlers who brought a portion of their fortunes with them.

The American culture of small businesses long predates independence, whereas its Brazilian equivalent did not take root until the immigration waves of the late 19th century. As could be expected in a location where capital was rare but the needs for capital were high, these oligarchs saw no reason to share what infrastructure they built with anyone — not even with each other.

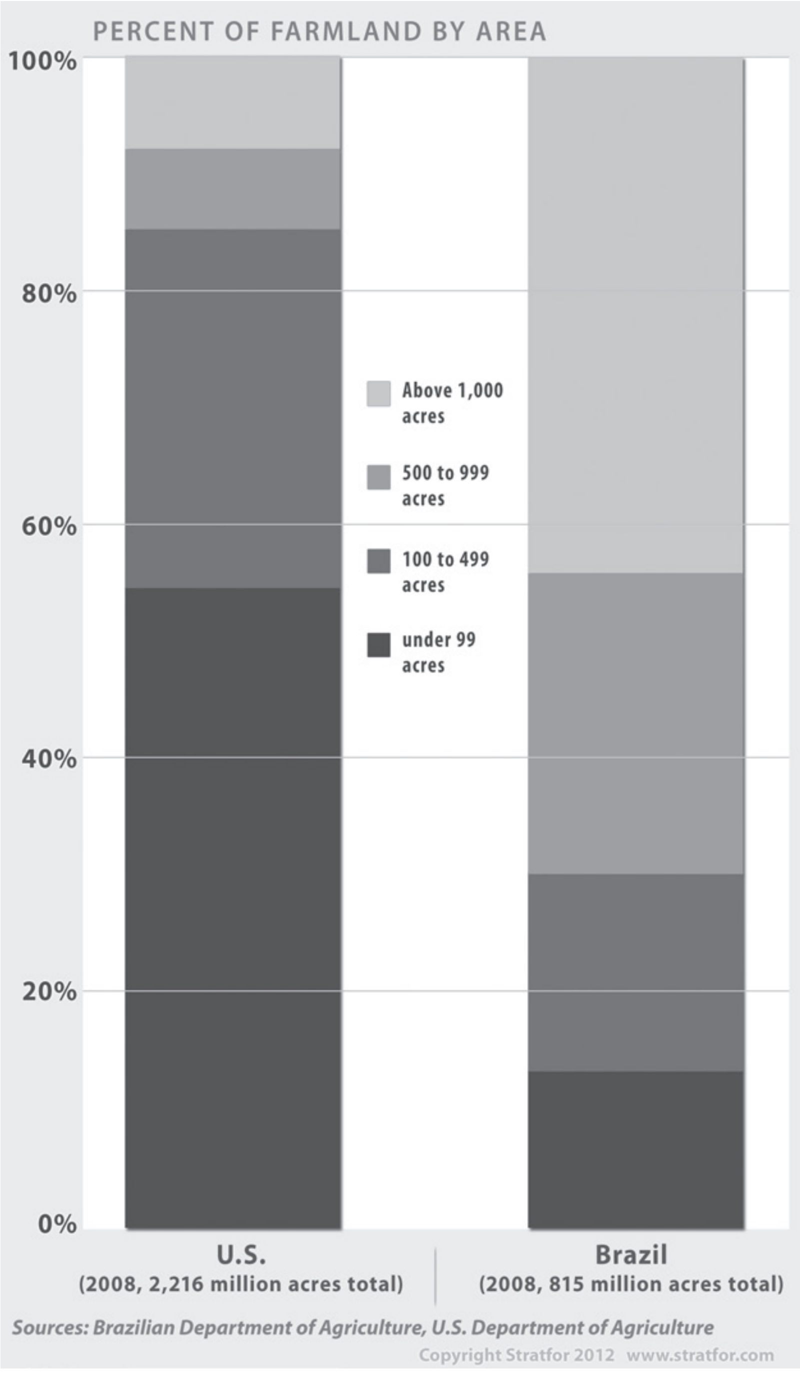
Complicating matters was that early Brazil did not have full access to that France-sized piece of arable land — most of it lay in the interior on the wrong side of the Grand Escarpment. The tropical climate drastically limited agricultural options. Until the mid-20th century, the only crops that could be grown en masse were plantation crops, first and most famously sugar, but in time coffee, citrus, bananas and tobacco. But unlike more traditional cereal crops that only require a few weeks of attention per year, such tropical crops are far more labor intensive in their planting, tending, harvesting and transport. Tobacco had to be cut and dried; sugar had to be cut, cooked and refined. Whereas a grain field can be quickly harvested and dumped into a truck, harvesting and transporting bananas, for example, takes much longer.

These characteristics impacted Brazil in two critical ways.

First, the capital required for these plantations was so great that smallholders of the American model were largely shut out. No smallholders meant no small towns that could form kernels of education and industrialization. Instead, plantations meant company towns where economic oligarchies gave birth to political oligarchies. In time, the political and economic power imbalance would provide the foundation for the Brazilian military governments of the 20th century. Even in modern times, Brazil's geography continues to favor oligarchic plantation farming to family farming. At present, 85 percent of farms in the United States — a country with a reputation for factory farming — are 500 acres or fewer, whereas 70 percent of Brazilian farms are 500 acres or more.

Time has not moderated this trend, but rather deepened it. In the latter half of the 20th century, Brazil launched a massive agricultural diversification effort that included the clearing of vast swaths of land in the interior, some of it in the cerrado and some as far inland as the Bolivian border. Among other agricultural products, some of these new lands were appropriate for corn and soybeans, crops normally quite amenable to farmers of a more modest capital base. But the cerrado requires massive inputs before agriculture can be attempted, and the interior lands are often in excess of 1,000 kilometers from Brazil's

U.S. AND BRAZILIAN FARM SIZES



perennially overworked ports. The twin development and infrastructure costs wound up reinforcing the oligarchic nature of the Brazilian agricultural system to the point that the average "new" Brazilian farm is six times the size of the farms of "old" Brazil.

Second, plantation agriculture calls for unskilled labor, a pattern that continues into the modern day. Unlike the more advanced New World colonies — which enjoyed access to easier transport and thus more capital, yielding the kernels of urbanization, an educational system and labor differentiation — Brazil relied on slave labor. It was the last country in the Western Hemisphere to outlaw slavery, a step it took in 1888.

A lack of skilled labor means, among other things, a smaller middle class and lower internal consumption than other states at a similar level of development. Consequently, Brazil has a small number of landed elite and a large majority of poor. As of 2011, fully one in four Brazilians eke out a living in Brazil's infamous slums, the favelas. According to the Gini coefficient, a sociological measure of income inequality, Brazil has been the most unequal of the world's major states for decades.

Taken together, Brazil faces inflationary barriers at every stage of the growth cycle. Starting a business requires capital, which is in short supply and held by a privileged class. Shipping goods requires scarce infrastructure, which is insufficient to needs, expensive and often owned by a privileged class. Any increase in demand for either of these inputs puts upward pressure on the associated costs. Expanding a business requires skilled labor, but there is not a deep skilled labor pool, so any hiring quickly results in wage spirals. And holding everything back is the still-disconnected nature of the Brazilian cities, so there are few economies of scale. More than anywhere else in the world, growth triggers inflation — which kills growth.

Consequently, Brazil has been characterized by below-average growth and above-average inflation for centuries and thus has traditionally been underindustrialized compared to most other developing states. Even before the oligarchs' interests are factored in, any infrastructure projects that make sense will be linked to projects with good foreign cash-generating potential, which quickly narrows the list of likely projects to agriculture and mining (all commodities are U.S.-dollar denominated).

As such, Brazil has had little choice but to focus on the production or extraction of primary commodities such as sugar and iron ore. Such capital-intensive industries not only reinforce the oligarchic system but also skew the economy's output. As of 2010, fully 70 percent of Brazil's exports are dollar-denominated, with 45 percent of exports by value consisting of raw commodities. This may help Brazil's (dollar-denominated) bottom line, but it does nothing to address its chronic infrastructure, labor, inequality or inflationary restraints.

It is thus unsurprising that Brazil has not yet emerged as a major global power. It cannot economically expand without killing itself with inflation. Its skilled labor pool and capital markets are woefully insufficient for its needs, and the oligarchs have a vested interest in keeping things that way. Even efforts to expand out of the country's various traps have in many ways only entrenched the system. Moreover, what growth Brazil has enjoyed in recent years has been because of the combination of a broad rise in commodity prices and heavy foreign investment into Brazilian infrastructure to get at those commodities, not because of anything Brazil has done.

This hardly means that Brazil is either a failed state or that its past is condemned to be its future. What this does mean is that if Brazil is to rise as a major power something has to change. And two things have changed, in fact: Argentina, and the way Brazilians view their country.

Modern Argentina's Decline

Argentina has everything necessary to become a major global power. Its lands are flat and temperate, its rivers are navigable and interconnected, and it enjoys the buffer of distance from major competitors and ample resources to fuel a rise to greatness. Indeed, throughout its first century of independence, Argentina moved from victory to victory — first over Brazil, then Paraguay, and then into the ranks of the world's richest states. Standing in Argentina's shadow, it is no surprise that Brazilians developed the tendency to be humble and passive, unwilling to challenge their rich and dynamic southern neighbor.

In the aftermath of the War of the Triple Alliance, Argentina enjoyed a historic boom. European immigrants arrived en masse, and the opportunities of the Rio de la Plata allowed for the creation and metabolization of massive amounts of capital. Alone among the Latin American states, Argentina generated a substantial middle class. But Argentina had two weaknesses, and from roughly 1930 on, Argentina's trajectory has been downward.

First, unlike in Anglo America, land in Argentina was not widely distributed to individual landholders. Like elsewhere in Latin America, Argentina began with an oligarchic landholder system that left most of the population economically dependent on a small, wealthy elite. A successful backlash to this autocratic structure came in the form of labor unrest that propelled the populist Peron regime to power.

The legacy of Peronism is the enhancement of autocratic power by political mobilization of the lower and middle classes. This power has remained consolidated under the control of a leader whose authority is unquestioned and whose influence over the institutions of the state is near total. Other institutions are much weaker than the presidency, and as a result, policymaking in Argentina is highly dependent on the individual in power at any given time. Populist demands have overpowered more conventional policies for decades on end, resulting in Argentina's slow and irregular decline for nearly a century.

Second, the vast distance of Argentina from the rest of the world greatly shaped Argentine perceptions. Tucked away at the bottom of the Atlantic, Argentina is one of the world's most sequestered states. Once Brazil and Paraguay had been contained as local threats, the next closest threat to Argentina was the United Kingdom, some 12,000 kilometers away. As in the United States, such large distances allowed a large degree of cultural insulation and national savings. (There was no need to maintain a large standing military.)

But there is a critical difference between the two experiences. The Americans were some 7,000 kilometers closer to potential rivals and thus on occasion were reminded that they are not, in fact, alone. Events such as the 1814 burning of Washington, the European willingness to ignore the Union blockade during the Civil War, the 1941 bombing of Pearl Harbor and, most recently, 9/11 unsurprisingly have had a major impact on the American psyche. Each shocked the Americans out of complacency and spurred them to overreact to the sudden "surprise" that the rest of the world exists. In those subsequent spasms of activity, the Americans remake themselves. This process entails a great deal of disruption in the United States and abroad, but it keeps the Americans adaptable.

Argentina's greater distance from world affairs means that they have suffered no such revivals following intrusions into their geographic utopia. The War of the Triple Alliance is now 140 years past. The war over the Falklands Islands, known to Argentines as the Malvinas, was the one notable instance in which Argentina sought interaction with the outside world. Buenos Aires initiated conflict with a far superior military power — the United Kingdom — and the resulting political and military defeat crushed the standing of the Argentine military, heavily contributing to the decline and fall of the military government. Although the Falklands War had a huge political impact, it did not pose the kind of challenge to Argentine core elements of prosperity that would require a concerted effort at reform and self-renewal. As a result, Argentina has neglected to address national problems that have crept up on it over the decades.

Recent developments underline this tendency. An economic crisis in 2001-2002 placed a new populist government in power that defaulted on the country's debt, which freed Buenos Aires of the need to make interest payments. Rather than seize the opportunity to rebalance the Argentine economic and political system onto a sounder footing that leveraged the country's geographic blessings, the state instead spent the savings on mass subsidies to bolster its populist credentials. High growth resulted, but the policies were only paid for by hollowing out the country's capital stock and distorting the economy to the point where fundamental industries — from cattle farming to wheat growing to energy production — have now begun to fail. High taxes combined with high consumption encouraged by large subsidies and price controls have crippled business owners and agriculturalists alike. The subsidies have proved particularly problematic, as they have locked the government into ever-increasing expenditures expressly linked to the populist patronage the people demand as their right. Consequently, Buenos Aires only wields limited influence in South America and little to none beyond the continent.

With all that said, Argentina is still the power in South America with the clearest, most likely growth path. It still holds the Rio de la Plata's river network and it still holds the Pampas, the best farmland in the Southern Hemisphere. What it cannot seem to figure out is how to make use of its favorable position. So long as that remains the case — so long as the natural dominant power of the Southern Cone remains in decline — other powers have at least a chance to emerge. Which brings us back to Brazil.

Modern Brazil's Success

Brazil's challenges are legion, but at core they are as simple as these two issues: Brazil's geography works against it, and its economy is trapped by inflation. The Brazilians have spent decades struggling against these two facts, and in the past generation they have finally achieved significant progress.

Brazil's Struggle With Geography

As discussed, Brazil's core coastal territories present the country with a variety of difficulties that no amount of local development can overcome. Yet Brazil does sport a broad swath of arable land in its interior which is flatter, more temperate and largely unified topographically — the trick is uniting the coastal territories on the east side of the Grand Escarpment with the interior in a way that does not undermine the authority of the state. From the 1870s until the 1980s

Brazilian development strategy therefore was relatively straightforward: expand the country's infrastructure, kilometer by painstaking kilometer, into those interior arable zones. The sheer size of the territories that could be put under plow partially overcame the inflationary and transport bottlenecks that limited Brazil's core coastal regions.

While early expansion certainly weakened central authority by encouraging economic links to Argentina, as that expansion built upon itself and developed economies of scale, interior Brazil became a formidable economic engine in and of itself. And while Brazil's gaze still lingered on the attractiveness of the Rio de la Plata's transport network, Brazil was sizable enough to have independent economic heft. Under those circumstances, association with coastal Brazil was an economic complication rather than an economic catastrophe.

By the 1970s several interlocking factors started solidifying the many interior success stories:

- Argentina's deepening malaise lessened the attractiveness of the Rio de la Plata's rivers.
- Brazil finally cleared enough interior lands so that more easily shippable conventional cereals were starting to be produced in large quantities, producing a more positive value-bulk ratio in the transport of Brazilian agricultural produce that somewhat eased its transport problem.
- Brazil's interior expansion took it right up to the borders of Bolivia, Paraguay and Uruguay, and after some tentative moments, Brazilian infrastructure and capital started moving across the borders and integrating the agricultural lands of the border states into the broader Brazilian economy. Argentina did little to resist. Bit by bit Argentina lost influence in the three states and by 2011 all three have become de facto Brazilian economic satellites.
- Foreign investors saw sufficient potential in the Brazilian interior that they were willing to invest increasing sums of their own capital in underwriting both the country's interior

development projects and its efforts to assimilate the three border states.

Surprisingly, the clear-cutting of the interior provided the basis of Brazilian political liberalization. One of the many downsides of an oligarchic economic system is that politics tend to become as concentrated as wealth. Yet in clearing the land Brazil created artificial trade ways — roads — that allowed some Brazilians to strike out on their own (though they were not as efficient as rivers). Currently there are some 2.6 million landholders with farms of between 5 and 100 acres (anything less is a subsistence farm, while anything more verges into the category of high-capital factory farms). That is 2.6 million families who have a somewhat independent economic — and political — existence. Elsewhere in the world, that is known as a middle class. The environmental price was steep, but without this very new class of landholder, Brazilian democracy would be on fairly shaky ground.

The interior expansion effort solved none of the coastal bottleneck issues, but the constellation of forces certainly conspired to ease Brazil's path. But perhaps the most important aspect of this interior push was that Brazil ceased to be simply a geographic concept. The rising importance of the interior — best symbolized by the relocation of the political capital to the interior city of Brasilia in 1960 — diluted the regional leanings of the coastal cities. The lands of the interior saw themselves first and foremost as Brazilian, and as that identity slowly gained credence, the government finally achieved sufficient gravitas and respect to begin addressing the country's other major challenge.

Inflation

No economic strategy can allow Brazil to achieve the magic mix of locally determined, strong growth with low inflation. At most, Brazil can have two of the three. For most of the 20th century, Brazilian governments tended to favor growth as a means of containing social unrest and mustering resources for the government, even at the cost of inflation. But since inflation tends disproportionately to harm the poor, the already-wide income gap between the oligarchs and the rest of the population only widened. Since 2006, strong global commodity prices have allowed the Brazilian economy to grow fairly rapidly, but those commodity prices are based on factors wholly beyond Brazil's control. As with every other commodity cycle, this one, too, will come to an end, triggering all the economic dislocation with which Brazilians are all too familiar.

Unless of course, the government changes the game — which it has done.

The macroeconomic strategy of the current regime, along with that of a string of governments going back to the early 1990s, is known colloquially as the "real plan" (after Brazil's currency, the real). In essence, the strategy turned Brazil's traditional strategy of growth at any cost on its head, seeking instead low inflation at any cost. Subsidies were eliminated wholesale across the economy, working from the understanding that consumption triggered inflation. Credit — whether government or private, domestic or foreign — was greatly restricted, working from the assumption that the Brazilian system could not handle the subsequent growth without stoking inflation. Government spending was greatly reduced and deficit spending largely phased out on the understanding that all forms of stimulus should be minimized to avoid inflation.

In practice, this led to a series of policies that most economists interpreted as rather orthodox, consisting of extremely low government debt; extremely restrained government activity; and extremely well capitalized, heavily regulated and conservative banks. These strict inflation control policies have achieved a high degree of economic stability. Inflation plunged from more than 2,000 percent a year to the single digits. But those gains came at a cost: Between 1980 and 2005, Brazil has shifted from one of the world's fastest growing economies with one of the highest inflation rates to one of the lowest inflation economies with one of the lowest (if somewhat irregular) growth rates.

But the real plan is not an orthodox economic policy. Economic orthodoxy stems from the belief that constrained credit, limited government and low inflation are policy tools designed to maximize growth. Orthodox policies are means to an end. The real plan approaches the question from the other side, in which strong growth is the enemy because it causes runaway inflation that destroys economic, political and social stability. As such, constrained credit, limited government and low inflation are the goals of the real plan, not the means. The distinction is sufficiently critical to bear repeating: Growth is the enemy of the real plan, not its goal.

What results is not so much a difference between perception and reality but between what the Brazilian government intended and what the international markets perceive those intentions to be. Investors across the world believe the real plan's ends are in actuality its means — and they interpret those ends as being in perfect sync with their interests. Thus, foreign investors have been voting for Brazil and the real plan with their money. Inward investment to Brazil is at historical highs, with the Brazilian Central Bank projecting the country's 2011 foreign direct investment take at a stunning $60 billion.

All this money is working against the real plan's goals: introducing credit where the government seeks to constrain credit, overfunding banks that the government wants to keep tightly regulated, encouraging spending that the government deems dangerous. Brazilians may be feeling richer because of the cheap, imported credit, but for government planners the environment is becoming ever more dangerous, threatening the hard-won stability that the real plan seeks to sustain. At the time of this writing, annualized inflation has edged up to 6 percent, right at the government's redline.

The true success of the real plan lies in achieving economic stability and, most of all, control. Brazil's geographic and social challenges are daunting, and no government could hope to address them competently if it could not first master local macroeconomic forces. In this, the real plan has performed to design. While hardly dead, inflation is restrained — and that has given the government space to start addressing the myriad other issues the country faces.

As with the interior expansion plan, the success of the real plan has changed how Brazilians feel about their country. When inflation burned through poor citizens' savings, when it destroyed livelihoods and condemned tens of millions to lives of poverty, faith in central institutions was lacking. The real plan may not promise great growth or even great wealth, but it has delivered price stability — and with price stability people can lay at least a limited groundwork for their own futures. Savings holds value from year to year. Purchasing power is constant. These are basic economic factors that most of the developed world takes for granted but which are relatively new to the current generation of Brazilians — and Brazilians rightly credit their central government with achieving them.

Just as the interior expansion effort provided all of the Brazilian states with a vested political interest in the Brazil project, the real plan has provided all of the Brazilian states with a vested economic interest in the central government. It is not so much that the real plan removed the structural and geographic causes of Brazil's inflation problem — which is impossible to do — but it proved to Brazilians that their country could be economically stable and that their government could act in the interests of Brazil in its totality rather than simply for whichever state happened to hold the presidency at the time.

Brazil's Geopolitical Imperatives

Geopolitical imperatives are broad, strategic goals a country must pursue if it is to achieve security and success. These are non-ideological paths determined by the geography of a given country and by the geography of its neighbors. Geopolitical imperatives typically nest: The second imperative is dependent upon the first imperative, the third upon the second, and so on. This is not the case for Brazil, however.

Since Brazil occupies such a difficult geography, it has traditionally been a weak state that has lacked the resources and institutional capacity to greatly impact the world around it. Its first three imperatives reflect this. As such, the order in which those imperatives might be attained is largely determined by the constellation of forces in Brazil's near abroad — factors for the most part beyond the Brazilians' ability to manipulate — rather than any decision-making process in Brasilia. Brazil can only push to achieve these imperatives as circumstances beyond its control allow.

Imperative One: Protect the Coast

The Brazilian southern coast contains the country's core territories. However, the ruggedness of that coast and the disconnected enclave nature of the core territories mean that infrastructure linking the coastal territories will not ensure mutual defense. The only way Brazil can protect its core itself is to cultivate a naval force of sufficient strength to deter would-be predatory powers. Without such a navy, Brazil would shatter into a series of (most likely mutually hostile) city-states. And without a navy any Brazilian exports are utterly at the mercy of more maritime-oriented entities.

But Brazil is capital poor and cannot afford such a navy. Historically, this has led Brasilia to seek alliances with whatever the dominant Atlantic power has happened to be in order to hold the traditionally more powerful Argentina in check. In the first half of the 19th century, the Brazilians sought out a favorable relationship with the British. But the deeper expression of this imperative came from Brazil's enthusiastic embracing of the United States' Monroe Doctrine. Nearly alone among Western Hemispheric powers, Brazil expressed enthusiasm for the American neo-colonial policy of barring European states from the Western Hemisphere, largely because it could not stand up to those powers without assistance.

Even today, Brazil's navy is unable to patrol the Brazilian coastline reliably beyond the Brazilian core territories. Thus, Brazil maintains close — if not exactly friendly — relations with the United States both to ensure that America never views Brazil as a state of concern and as a hedge against other potential threats.

Imperative Two: Selectively Expand into the Interior

Developing (or outsourcing) a navy is one means of protecting Brazil's core. Another is to expand that core into new areas not so exposed to a hostile navy. In this, Brazil faces several challenges. The coastal enclaves are not large enough to generate their own economies of scale, so reaching inland requires the expenditure of massive resources Brazil simply does not have. As such, Brazil's inland expansion has been halting, slow and piecemeal and driven by an often badly coordinated mix of government, oligarchic and foreign interests. The obvious target for this expansion is into the subtropical and temperate regions of the country's south, not the tropical zone of the north.

However, the farther these new territories are from the coast, the more integrated they will naturally become into the capital-rich lands of the Rio de la Plata region to the south. Ironically, in achieving strategic depth and a better economic position, Brazil risks its territory becoming more fully integrated into its neighbors, as opposed to the Brazilian core.

In this challenge, however, also lies an opportunity. When the economies and populations of Brazil's interior regions are small, they naturally gravitate toward Argentina's sphere of influence. But as they grow they eventually reach a critical mass in terms of influence, which brings us to the third imperative.

Imperative Three: Expand into the Rio de la Plata Region

The solution lies in increasing Brazilian influence to the south so that those territories ultimately answer to Brazilian economic and political decision-making. Like the first two imperatives, this requires decades of slow efforts to make any progress. It has only been in the past generation that Brazil has created enough capital to encroach into the Argentine-Brazilian buffer states of Bolivia, Paraguay and Uruguay. Brazil has invested heavily into Bolivian energy and agriculture. Most Bolivian foodstuffs are now sold to or through Brazil to the outside world. Natural gas — responsible for by far the largest component of Bolivian state income — is under the direct management of Brazilian state-owned energy company Petroleos Brasileiros (Petrobras). In Paraguay, Brazilians have migrated in significant numbers and are the dominant investors in the economy — particularly in electricity, as the two are partners in the Itaipu Dam. Brazilian (and Argentine) cash fuels Uruguay's vibrant financial sector, and Brazilian-born Uruguayan citizens now own a majority of Uruguay's farmland.

The next logical question — something the normally nonconfrontational Brazilians are currently struggling with — is what to do once economic control has been seized but political control is not yet in place. Here the Brazilians come up against an odd cultural barrier: Nonconfrontation is hardwired into the Brazilian psyche. Even today, with the Brazilian economy growing and Argentina continuing to struggle, there exists a belief in government circles that Brazil needs to concentrate on striking an equilibrium with Argentina, with perhaps the inclusion of even Chile in a trilateral balance of power in the region (the Chileans for their part want little to do with the Southern Cone and even less to do with the Argentine-Brazilian balance of power).

For all practical purposes, Brazil has already secured dominance in the three buffer states — Uruguay, Bolivia and Paraguay are all but economic satellites of Brazil — but in light of Brazil's historically passive foreign policy these states rarely shirk from demanding better terms out of Brasilia. Uruguay charges steep fees on Brazilian cargo. Paraguay recently was able to triple the cost of electricity produced by the Itaipu Dam, Brazil's single-largest source of electricity, and routinely receives financial aid from Brazil and Mercosur. The Bolivian government regularly confronts Medialuna landowners who for all intents and purposes are fully integrated into the Brazilian economy, and it has not been shy about its attempts to nationalize energy assets owned by Brazilian interests. If Brazil is going to make its gains stick, at some point it will need to devise a strategy for formalizing its control of the buffer states. That means, among other things, learning to be less accommodating.

There also looms a much more significant — potentially bruising — competition. Brazil cannot be truly secure until at the very least it controls the northern shore of the Rio de la Plata. That requires significant penetration into Paraguay and de facto control of Uruguay and of select pieces of northern Argentina. Were that to happen, Brazil's interior would have direct access to one of the world's most capital-rich regions. The marriage of such capital generation capacity to Brazil's pre-existing bulk will instantly transform Brazil into a power with global potential.

But not before. Without these territories, the Southern Cone balance of power remains in place no matter how weak Argentina becomes. So long as Argentina can exercise functional independence, it persists as a possible direct threat to Brazil, constrains Brazil's ability to generate its own capital and exists as a potential ally of extraregional powers that might seek to limit Brazil's rise.

Imperative Four: Challenge the Dominant Atlantic Power

Should Brazil manage to consolidate control over the Rio de la Plata basin the game changes greatly. At this point Brazil is no longer a vulnerable, enclave-based state facing extreme challenges to its development. Instead, Brazil would control the majority of the continent and command broad swaths of easily developed arable land. Instead of cowering in fear of regional naval powers, it would be the dominant regional naval power. With that transformation, Brazil would not see extraregional navies as friends protecting it from Argentina but as enemies seeking to constrain its rise.

Obviously, this imperative will be well beyond Brazil's reach for many decades. Not only is Brazil's navy far smaller than that of states with one-third its population, it is nowhere close to commanding the Rio de la Plata region. Until that happens, Brazil has no choice but to align with whatever the Atlantic's dominant power happens to be. To do otherwise would risk the country's exports and its overall economic and political coherence.

Contemporary Challenges: Escaping the Trap

Contemporary Brazil faces three interlocking problems that pose severe structural challenges to all of the economic stability it improbably has attained: an overvalued currency, Mercosur and China.

As to currency, investor enthusiasm for Brazil's recent stability and theoretical growth prospects has flooded the country with external funding. In addition to complicating always-critical inflation concerns, all that capital is having a demonstrable impact on the Brazilian currency, pushing the real up by more than 50 percent in just the past two years, and doubling it since 2003.

For Brazil's commodity exports — all of which are dollar-denominated — this has no demonstrable impact, but for the country's industrial exports this currency appreciation is disastrous. Because Brazil's infrastructure is inadequate and the country is capital poor, Brazil produces very little that is high value-added; Such industries are the providence of capital-rich, low-transport-cost economies such as Germany and Japan. Instead, Brazil's predominantly low- and medium-value-added industries compete heavily on price. A 50 percent increase in the currency largely guts any price competitiveness enjoyed by Brazil's sheltered industries. The only Brazilian firms benefiting from the mix of impacts are those few high-skill firms that happen to price their products in U.S. dollars, most notably oil firm Petrobras and aerospace firm Embraer — which, while world class by any definition, are not representative of the broader Brazilian economic structure.

Second, Brazil has limited itself with the highly distorting and damaging trade network known as Mercosur. Recall that an oligarchy has long dominated the Brazilian economy, controlling most of the country's scarce capital and enjoying a privileged economic and political position. Unlike most trade agreements — which are negotiated by governments on behalf of the corporate world — Brazil's oligarchic background meant these oligarchs negotiated Mercosur on behalf of the Brazilian government.

This abnormal process radically changed the end result. A normal trade deal removes barriers to trade and exposes companies in all the affected countries to competition from each other. In Mercosur's case, the various Brazilian industrialists were able to block off entire swaths of the economy for themselves, largely eliminating foreign competition. As such, Brazil's industrial sector is shielded from competition with outside forces — and even from most other forces within Mercosur. Add in a 50 percent currency appreciation and Brazil's industrial base is now one of the world's least competitive.

Third, Brazil has allowed competition from the one power most capable of destroying that sheltered industrial base: China. Throughout the past decade, Brazilian governments have sought Chinese investment largely to help alleviate some of the country's transport bottlenecks. The Chinese, hungry for Brazilian resources, have happily complied. But that infrastructure development has come at the cost of granting Chinese firms Brazilian market access, and that access — and even the investment — is damaging the Brazilian system.

At its core it is a difference in development models. The Chinese system is based on ultraloose capital access aimed at maximizing employment and throughput, regardless of the impact on profitability and inflation — about as far as possible from the real plan. This has had a number of negative side effects on the Chinese system, but as regards Brazil, it has resulted in a flood of subsidized Chinese imports.

The China trap is catching Brazil in three ways. The first is direct competition for market share in Brazil. The Chinese yuan is de facto pegged to the dollar, so Brazilian goods are now even less competitive versus Chinese goods on the domestic market (even before one takes into account that Chinese goods are for all intents and purposes subsidized). Second, China is engaging in indirect competition for market share by shipping goods into Brazil via other Mercosur member states — a fact that has prompted Brazil to raise non-tariff barriers that penalize Mercosur partners in an effort to stem Chinese competition. Third, the Chinese are among those international investors whose cash is pushing the value of the real ever upward. With every dollar the Chinese invest into Brazilian commodity production, the real goes just a bit higher and Chinese goods edge out their Brazilian counterparts just a bit more.

Resisting these trends will require some clever and quick policymaking along with a remarkable amount of political bravery. For example, scrapping Mercosur and adopting free market policies would throw the Brazilian market open to global competition. That would decimate Brazil's inefficient industrial base in the short run with the expected knock-on impact on employment, making it a policy the oligarchic and powerful labor unions alike would oppose. But it is difficult to imagine Brazilian industry progressing past its current stunted level if it is not forced to play on a larger field, and weakening the hold of the oligarchs is now at least a century overdue. Two more years of a rising currency and an enervating Chinese relationship will surely destroy much of the progress the Brazilians have painstakingly made in recent decades.

The current president, Dilma Rousseff, is a non-charismatic, no-nonsense technocrat well known for demanding respect and results, a good person to have in office given the nature of Brazil's contemporary challenges. Success in any free market-oriented reforms would require brutal and rapid changes in Brazil's standard operating procedures — changes that would undoubtedly come with serious political risks. The alternative is to continue to pursue protectionist, defensive policies while allowing international forces to shape Brazil rather than Brazil developing the means to shape international forces. This could well be the path Brazil follows. After all, the damage being inflicted by Mercosur and the China relationship are direct outcomes of policies Brazil chose to follow, rather than anything produced by Brazil's geography.

We do not mean to belittle Brazilians' achievements to date. Taming their lands, taming inflation and crafting a series of economic sectors fully deserving of international acclaim are no small feats. But insufficient infrastructure, an ossified oligarchy, a shallow skilled labor pool and the looming question of Argentina continue to define the Brazilian position. The maintenance of that position remains largely beyond the control of the Brazilian government. The economy remains hooked on commodities whose prices are set far beyond the continent. Their ability to supply those commodities is largely dependent upon infrastructure in turn dependent upon foreign financing. Even Brazilian dominance of their southern tier is as much a result of what Argentina has done wrong as opposed to what Brazil has done right.

For Brazil to emerge as a significant extraregional power, Brazilians must first address a lengthy list of internal and regional issues. These include — but are hardly limited to — moving beyond their oligarchic economic system, ensuring that Argentina will never again threaten it and formalizing their dominant position in the border states of Bolivia, Paraguay, and Uruguay. These cannot be accomplished easily, but doing so is the price Brazilians must pay if they are to be the masters of their own destiny rather than simply accepting an environment crafted by others.

Brazil's Favela Offensive

December 3, 2010

Backed by federal armed forces, local police in Rio de Janeiro have launched an offensive in the city's two most violent and drug-ridden favelas, or shanytowns: Complex do Alemao and Villa Cruzeiro.

The offensive is part of the police force's efforts to pacify the city over the past two years. The government had long avoided deploying the armed forces into the favelas until after recently concluded state and presidential elections. In Rio in particular, Gov. Sergio Cabral, who is closely allied with outgoing President Luiz Inacio Lula da Silva and President-elect Dilma Rousseff, understood the importance of maintaining his popularity among the poor in the favelas to secure re-election. With national elections over, the pacification strategy in Rio was able to recommence.

Pacifying the Favelas

The first phase of the strategy entails a military offensive such as the one now being waged in Alemao and Cruzeiro. On Nov. 21, drug gangs, particularly the Comando Vermelho criminal organization, set fire to some 100 cars and buses across the city, including at tourist hot spots Ipanema and Copacabana, and set off a spate of violence that killed 35 people. The attacks were orchestrated by drug lords who are currently held in federal prison in Parana state. This orchestration allowed government and police units to justify greater reliance on federal assets. The Brazilian government on Nov. 24 authorized the deployment of 800 army and navy troops, supported by helicopters and armored vehicles equipped with machine guns, to reinforce Rio police in flushing out criminals from the targeted favelas.

Once the favelas are pacified, some 2,000 police forces are expected to remain both in barracks and in houses within the favelas to maintain order and keep the drug traffickers at bay. So far, Pacification Police Units have been deployed to 13 favelas in the city; the government aims to increase that number to 40 by 2014. Given the immense size of Complexo do Alemao, where some 60,000 people reside, considerable doubt remains whether the current contingent of police forces, already apparently worn out by the offensive in terms of material and funding, will be able to make a lasting security impact on the favela.

Integrating the Favelas

To complement the security efforts, the government in Rio has allocated $1 billion toward reconstruction projects to gradually integrate the favelas into the formal economy. The word favela means "self-made" and stems from the fact that the slums, clinging to the Rio hillsides, were built illegally on public lands. Within the favelas, there are no banks or formal market mechanisms for people to buy and sell goods. Instead, the favela economy is entirely informal. Considerable portions of the labor pool are absorbed by the drug trade; young boys can make between $800 and $1,000 a month by keeping surveillance and warning their bosses when the police come around, and middle managers can make an average of $3,000 to $5,000 a month.

While the first phase of forcibly rooting out drug traffickers is widely being heralded as a success by the state, the real challenge lies ahead in developing, legalizing and integrating the favela economy into the state. Only then will the government have a decent chance of winning the trust of the favela dwellers, who are currently more likely to put their trust in the drug dealers for protection rather than in the police. Indeed, constituent support within the favelas is precisely what allows the drug traffickers to survive and sustain their businesses. Many of the drug traffickers being pursued in the current crackdowns are laying low and taking cover in homes within the favela and escaping to other favelas, usually through sewer tunnels and then into the dense surrounding forest, where they can rebuild their networks and continue their trade. Similar to combatants in an insurgency, members of criminal organizations will typically avoid combat, lay low and relocate their operations until the situation clears for them to return. The state will meanwhile expend millions of reals on these shifting targets while achieving decisive results in integrating the favelas into the legitimate economy. Winning the trust of the favela dwellers would greatly abet the police operations, but building that trust takes time and dedication to economic development. Since reconstruction within the favelas is hindered by the presence of drug runners and their use of physical force, the government needs a sustained police presence — rather than the quick hit operations that have failed in the past — to achieve its goals.

For the first time, the Brazilian government and security apparatus are devoting significant amounts of federal forces to the pacification campaign and making longer-term plans for police to occupy the favelas for at least two years. By maintaining a security presence within the favelas, the state is imposing considerable costs on the criminal organizations. The police have already seized around $60 million worth of drugs (about 40 tons) and weapons and have arrested around 30 criminals in this latest crackdown. According to Rio state statistics, profits in Rio from drug sales amount to roughly $400 million a year, which means (based on loose estimates) that this operation has cost the drug gangs somewhere around 15 percent of their annual profit so far.

If integration is successful, Brazil could take a major step forward in alleviating the severe socioeconomic inequalities that threaten the country's regional rise. Though Brazil has laid claim to a number of economic accomplishments and is moving aggressively to promote itself on the global stage, those success stories cannot be viewed in a vacuum. With drug traffickers in control of sizable portions of favelas in urban Brazil, where informal economies and slum dwellers are disconnected from the state, organized crime remains one of many critical impediments to the country's growth.

The Operation's Prospects of Success

The greater urgency behind the favela agenda can also be understood in the context of Brazil's plans to host the World Cup in 2014 and the Olympics in 2016. It is no coincidence that this combined military and police offensive is taking place in Rio de Janeiro, the site of these two sporting events. Rio, more so than other Brazilian urban areas, poses a considerable security challenge for the government. Whereas in Sao Paulo, a single criminal group, the First Command of the Capital, monopolizes the drug-trafficking scene, Rio is home to multiple criminal enterprises. The fluidity of the Rio drug networks and rivalry among the factions makes the city more prone to sporadic violence. It is therefore all the more imperative for the government to find a way to contain them. Organized crime elements would like to remind the state of their ability to paralyze Brazil's urban hot spots, as they demonstrated in the car and bus torchings in recent days. The Brazilian government understandably wants to deny them that opportunity as it looks to use these high-profile events as an opportunity to showcase Brazil as a major power.

But it is still too early to speculate on the success of the current operation. Many of the most wanted drug traffickers have been able to escape to other favelas, particularly to Vidigal and Rocinha. Rocinha is the largest and most developed favela in Brazil and has large areas that are still dominated by drug dealers, which are likely safe havens for those on the run from Alemao and Cruzeiro.

Beyond the resilience of the drug trade, another critical factor hampering this offensive is the fact that the Rio police force is underpaid and often outgunned by criminal organizations. Considering the average salary of a Rio police officer operating in Alemao is about $1,000 a month — roughly the same as the young boys on the bottom of the drug supply chain — there is a major threat of corruption marring the pacification campaign. Already there are reports of militias led by corrupt local police filling the power vacuum created in the favelas by the recent military offensives. These corrupt officers are taking advantage of the situation by collecting and pocketing informal taxes from the favela dwellers for their illegal cable television, electricity and other services. There is a rumor now that corrupt policemen are also collecting taxes from small businesses in the favelas that are unregistered with the state. Without adequate oversight, it will become more and more difficult for the favela inhabitants to discern the lesser of two evils: corrupt cops or criminals in the drug trade. And as long as trust remains elusive, the criminals will have a home to return to and set up shop, constraining Brazil's rise.

Brazil's Battle Against Drug Traffickers

February 8, 2011

Backed by tanks and helicopters, nearly 700 police forces (380 military police, 189 civilian police, 103 federal police and 24 federal highway police) along with 150 marines and an unspecified number of officers from Brazil's elite Special Operations Battalion (BOPE) launched a massive operation Feb. 6 to occupy the favelas of Sao Carlos, Zinco, Querosene, Mineira, Coroa, Fallet, Fogueteiro, Escondidinho and Prazeres in the northern Rio hills of Estacio, Catumbi and Santa Teresa. The operation was swift and effective and was curiously met with virtually no resistance from the drug trafficking groups that had been operating in the area.

The UPP Model

The crackdown is part of a Pacification Police Unit (UPP) campaign that began in Rio in 2008 to flush out long-entrenched drug trafficking groups and bring the city's lawless hillsides under state control. The UPP plan involves special operations by BOPE forces, followed by a heavy-handed offensive involving police and military units, flushing drug traffickers out from the territory, the installation of a UPP command post at the top of the main favela hillsides and finally a long-term police occupation. During the police occupation phase, which could last for up to 25 years according to some Rio police sources, social workers are brought in to work alongside the police occupants to help build trust between the state and favela dwellers and integrate the territory with the state by providing business licenses, home addresses, electricity and water services, satellite dish installations, and schooling.

The UPP model has worked remarkably well in smaller favelas, such as Santa Marta, which has evolved into a tourist attraction for the state to show off its success to skeptical Rio inhabitants and curious outsiders. But critical challenges to the UPP effort remain, and the risks to the state are intensifying the more this campaign spreads.

Challenges Ahead

The most immediate issue is a lack of resources, specifically police resources, for a long-term occupation of Rio's sprawling favelas. The

Santa Teresa area targeted Feb. 6 has 12 favelas and houses around 560,000 people. Some 630 police are expected to comprise the occupying force for this area. Morro Sao Joao, where the 14th UPP was installed Jan. 31, has 6,000 inhabitants, but that one UPP will also be responsible for the pacification and security of about 12,000 inhabitants living in the surrounding communities of Morro da Matriz, Morro do Quieto Abolicao, Agua Santa, Cachambi , Encantado, Engenho de Dentro, Engenho Novo, Jacare, Lins de Vasconcelos, Riachuelo, Rocha, Sampaio, Sao Francisco Xavier and Todos os Santos. Another UPP is likely to be installed in the Engenhao area, where a stadium that was built for the Pan American Games and that likely will be used for the 2016 Olympics is located. Maracana stadium, near Morro do Borel in the Tijuca area of Rio where UPPs have already been installed, will be the main stadium used for the 2014 World Cup.

Salaries for Rio police are notoriously low and have a difficult time competing with those offered to people working for drug trafficking groups, from the young kite flyers who alert their bosses when the police approach to the middle men to the chief dealers. This, in turn, makes the police a major part of the problem as well. Police militias have sprung up in various occupied favelas, where they take a handsome cut of the profits from the drug trade and other basic services in the favelas in exchange for weapons, forewarning of police operations and general immunity. Comando Vermelho (CV) and Amigos dos Amigos (ADA), the two chief drug trafficking groups of Rio, are consequently well armed, often with AK-47s and military explosives trafficked by police allies as well as arms dealers from Angola who benefit from the vibrant arms market in Rio.

According to Stratfor sources in the Rio security apparatus, ADA is most closely tied to the police militias, which may explain why most of the favelas that were first targeted in northern Rio (Complexo Alemao, Villa Cruzeiro, Santa Marta, Zinco, Querosene, Mineira, Coroa, Fallet, Fogueteiro, Escondidinho and Prazeres) have been CV strongholds. Notably, however, the more recent crackdowns in and around the Santa Teresa area and Morro Sao Joao have been

ADA strongholds. As the UPP campaigns have spread, CV and ADA appear to have united against the common enemy of the state and are reportedly cooperating to provide each other with refuge and supplies. Moreover, it appears that the drug trafficking groups are often given ample lead time ahead of major police offensives. For example, in the latest offensive targeting the Santa Teresa favelas, which are concentrated in a major tourist area of the city where many wealthy Rio inhabitants also live, Rio state Gov. Sergio Cabral announced the impending operation Feb. 1, effectively removing the element of strategic surprise from the Feb. 6 operation and allowing drug traffickers plenty of time to flee.

Due to rampant police corruption, Rio has had to depend heavily on military forces to carry out these offensives and make way for UPP occupations. The military is far more immune to the corruption tainting many of Rio's police officers, but Brazil's military leadership is also wary of involving its forces too deeply in these operations for an extended period of time; it fears the military may fall prey to corruption or unsettle Brazil's delicate civil-military relationship, a balance that is still being tested considering Brazil's relatively recent transformation from military rule to democracy.

Moreover, even if a more concerted effort were made to imprison Rio's worst-offending drug traffickers, Rio lacks an effective prison system to house them. Overcrowded prison cells, where isolation barriers are often broken down to make more room, have more often evolved into highly effective command centers for the leadership of these groups to coordinate the activities of their drug cartels. Indeed, a memory often invoked in the minds of many Brazilian officials is the violent 2006 campaign ordered by a handful of imprisoned crime bosses belonging to Sao Paulo's most powerful drug trafficking group, First Capital Command, against police and security officials when the state went too far in isolating the leaders of the group in maximum security prisons.

Similarly, when Rio police officials began impinging on the CV's money laundering operations in 2009, attacks were ordered on police and public transportation to pressure the police and state officials into backing off their investigations. According to a Stratfor source, many of the police involved in those money laundering investigations used the operation to bribe jailed crime bosses into keeping their names off the guilty list, but when they went too far with the bribes, the CV did not hesitate to use violence to retaliate. When Brazil entered its election year in 2010, the confrontation between the police and the jailed drug traffickers over the money laundering investigations subsided. In many cases, the drug trafficking groups are often careful to spare civilians in these violent campaigns, and the state authorities are usually quick to reach an accommodation with the crime bosses to contain the unrest.

Eyeing the Threat of Backlash

The main challenge that lies ahead for not only Rio but for the political authorities in Brasilia is how to recognize and pre-empt a major backlash by Rio's chief drug trafficking groups. The Brazilian state has a more immediate interest in demonstrating to the world that it is making a concerted effort to combat well-entrenched organized crime in the country, as well as a broader geopolitical interest to bring significant swathes of territory under state control — a goal in line with Brazil's growing reputation as an emerging power.

However, the UPP occupations thus far have been far more effective at displacing the drug traffickers than in removing them altogether. The market for marijuana, crack and cocaine appears to be just as large as it was prior to the UPP initiative, thereby providing an incentive for drug traffickers to move more of their business into urban Rio neighborhoods — a trend already developing, according to several Stratfor sources in Rio. Critically, the bulk of drug traffickers have reportedly relocated to Rocinha as well as the nearby city of Niteroi. Rumors of an impending Rocinha operation have been circulating for some time, but Rocinha is a massive cluster of favelas housing roughly 120,000 people, where Rio's most wanted drug traffickers are now most heavily entrenched.

Already the CV has been issuing warnings to Rio authorities that their pacification campaign is going too far and that there will be consequences. Working in favor of the drug traffickers are the 2014 World Cup and 2016 Olympics to be hosted by Rio. The preference of these groups is to reach an accommodation with the state and go on with business as usual, but the potential marring of these two high-profile events in the midst of Brazil's rise to global prominence is a powerful threat to Brazilian state authorities, who are not interested in having international media fixate on images of burning buses, police fatalities and shootouts in favelas in the lead-up to the events. The more the UPP campaign spreads, the more the risk of backlash to the state increases. And with time, resources and money in short supply for the state, the drug traffickers are not as pinched as many may have been led to think. In Stratfor's view, an expansion of the UPP campaign into Rocinha likely constitutes a redline for Rio's chief drug trafficking groups. Whether the state chooses to cross that line arguably remains the single-most important factor in assessing Rio's stability in the months ahead.

Creating Opportunities in Obama's Visit To Brazil

March 19, 2011

U.S. President Barack Obama will arrive in Brasilia on March 19 to meet with his Brazilian counterpart, Dilma Rousseff, on a trip that will also take him to El Salvador and Chile. While the visit comes at a troubled time in global politics, it presents an opportunity for Brazil and the United States to confer on a number of important bilateral issues as Brazil's new presidential administration is setting its agenda on economics, defense and international relations.

Latin America has thus far been low on the priority list for U.S. foreign policy under the Obama administration, and that is unlikely to change any time soon. However, Brazil's increasing prosperity and its international profile necessitate that the United States maintain cordial relations. Further, there is enormous potential for economic cooperation between the two western powers.

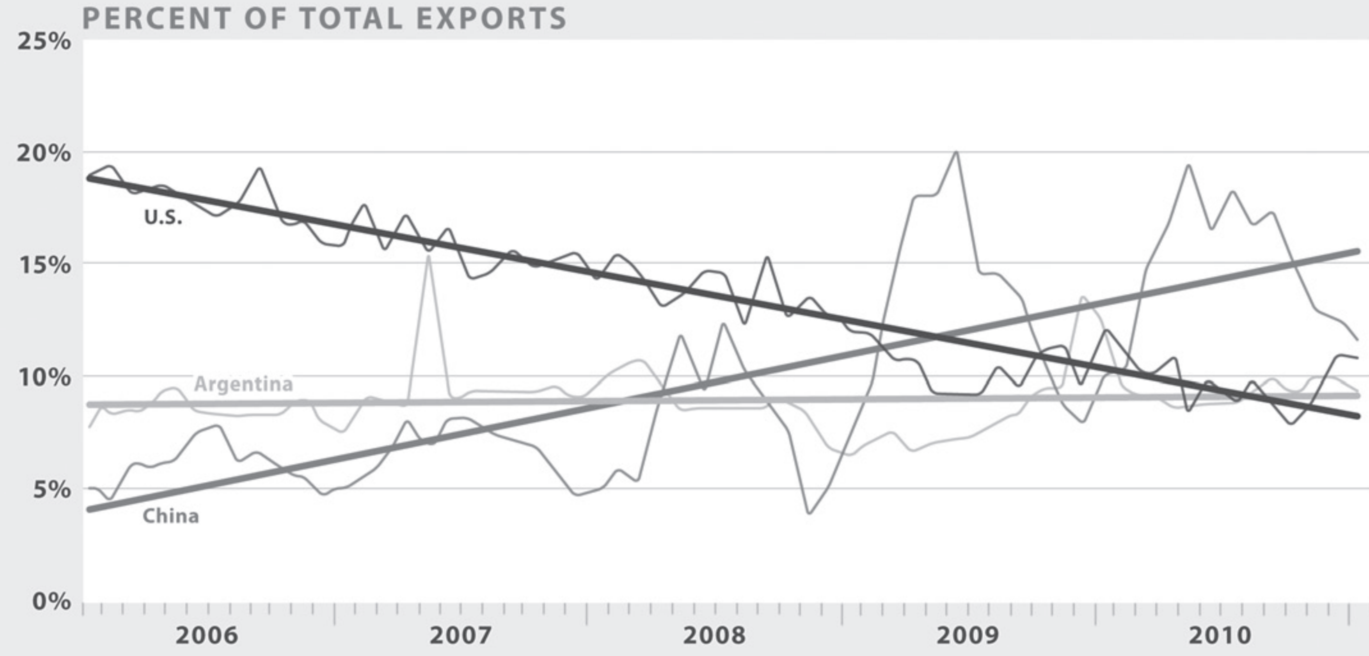
Toward the end of the administration of former Brazilian President Luiz Inacio Lula da Silva, Brazil began to enter the international stage, attempting to participate in the Middle East peace talks and strengthening its relationship with Iran, to the displeasure of the United States. The Rousseff administration, however, appears to be re-evaluating a number of Brazil's policies, taking care to keep more distance from thornier issues in which the United States is engaged, thereby creating an opportunity for Washington to reset relations.

On the security front, Obama will likely use the visit to urge Brazil to cooperate more closely on counterterrorism issues. Brazil has thus far dodged the issue to avoid being a target of terrorist organizations. Brazil's security concerns lie in domestic issues, with the government intensely focused on rooting out drug trafficking organizations from the favelas of Rio de Janeiro ahead of the 2014 World Cup and the 2016 Olympics.

Economic cooperation is even higher on Obama's agenda. Obama is traveling with a business delegation comprising more than 300 high-profile business leaders from a number of industries, ranging from energy to telecommunications. U.S. companies are increasingly interested in the possibilities presented by Brazil's large and increasingly wealthy consumer market as well as in the opportunities presented by Brazil's natural resources.

Brazil's pre-salt oil deposits off its eastern shores will require significant external technological and financial investments once Brazil begins to license out production contracts. It will also require the further development of a sophisticated support industry. With companies from all over the world seeking to enter this market, Obama's visit creates the opportunity for the United States to lend institutional support to U.S. companies interested in investing. Support could include direct financing of energy industry projects through the U.S. Export-Import Bank.

BRAZIL'S TOP THREE EXPORT MARKETS



Source: Brazilian Ministry of Development, Industry and Foreign Trade

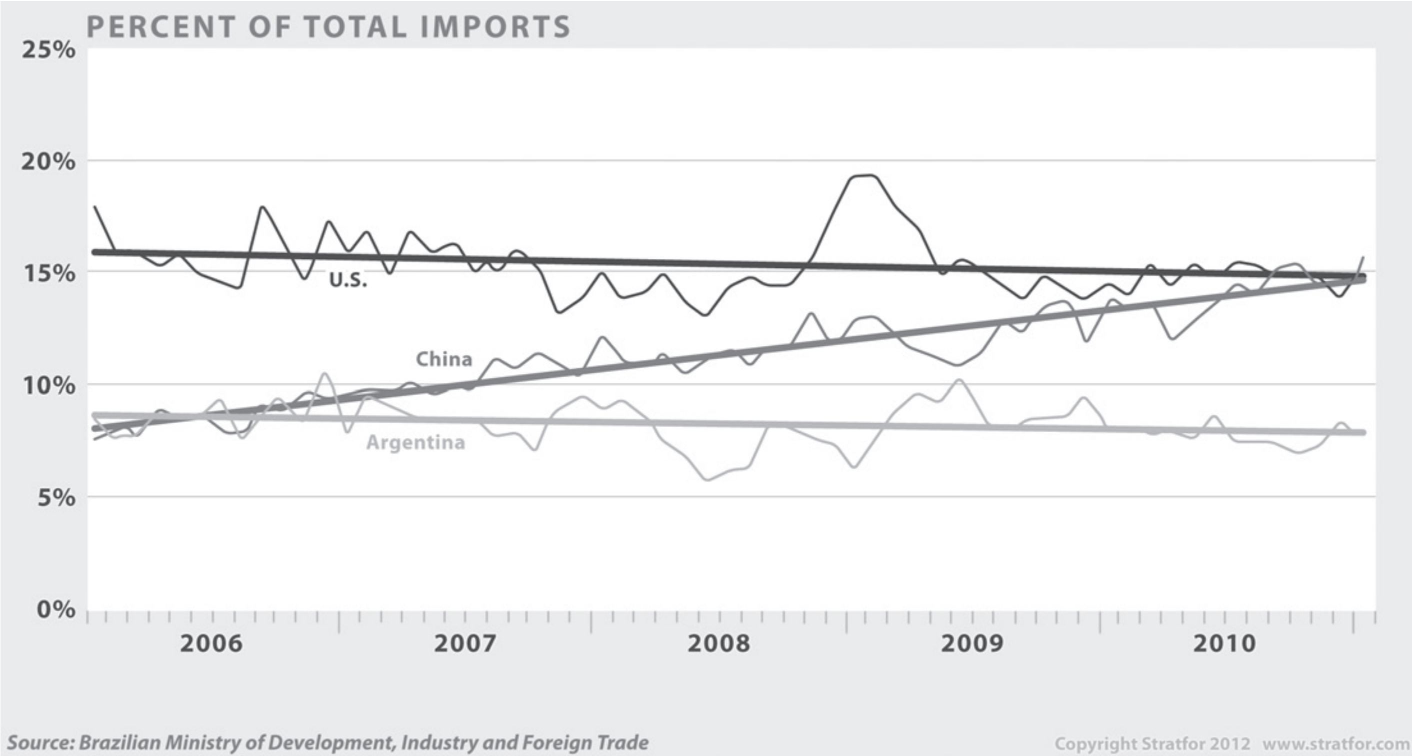
Internationally, Brazil and the United States are increasingly in line in their concerns about the constant flow of cheap Chinese goods supported by an undervalued yuan. Brazil's trade patterns with China have shifted dramatically in the wake of the international financial crisis. As exports to Argentina and the United States — previously Brazil's top two export markets — fell because of the crisis, demand in China for Brazilian commodities skyrocketed. With demand falling in other markets, China's rising interest in Brazilian goods has benefited overall trade, but it has privileged commodity exports, particularly minerals, at the expense of manufactured goods. At the same time, China's low-cost manufactured goods have entered the Brazilian consumer market, competing with Brazil's domestic manufacturers.

The Chinese share of Brazilian imports and exports has markedly changed the composition of Brazil's trade, much to the alarm of Brazil. Brazil has imposed anti-dumping tariffs on Chinese shoes and toys in an attempt to protect domestic manufacturers and has formed a commission to study the impact of China's activities. The commission is expected to formulate a set of recommendations for Brazil's strategy toward China. Given similar U.S. concerns about the challenges posed to domestic firms by competing with Chinese goods subsidized by a low-value currency, this visit is an opportunity for the United States and Brazil to present a united front on an international policy dilemma.

Despite many overlapping interests, Brazil will likely avoid tying itself too closely to U.S. policies — or the policies of any other country. As a rising power, Brazil has made it clear that it intends to conduct itself independently of the United States, despite the northern country's enormous power. To this end, Brazil will receive Venezuelan President Hugo Chavez in Brasilia shortly after Obama departs, emphasizing that Brazil keeps close relations with a diverse array of partners.

This strategy of independence is evident in the competition to sell fighter jets to Brazil. U.S. airplane manufacturer Boeing is hoping to beat out France's Dassault and Sweden's Saab to sell F-18s to Brazil. Brazil, however, has serious concerns about the U.S. congressional

BRAZIL'S TOP THREE IMPORT MARKETS



constraints that would be placed on any defense deal and is not in a hurry to be tied that closely to the U.S. defense industry. Under the da Silva administration, Brazil appeared to be leaning toward a partnership with France for fighter aircraft. With Rousseff in power, Obama will have a chance to plead Boeing's case once more.

For Brazil, the visit is an opportunity to show that it brings the United States to the table on these important issues while emphasizing its continued independent foreign policy. For the United States, it demonstrates the importance of conferring with Brazil as the country's new administration sets a new agenda, despite the ongoing pressing international crises in the Middle East and Japan.

Brazil and China Find Space for Economic Cooperation

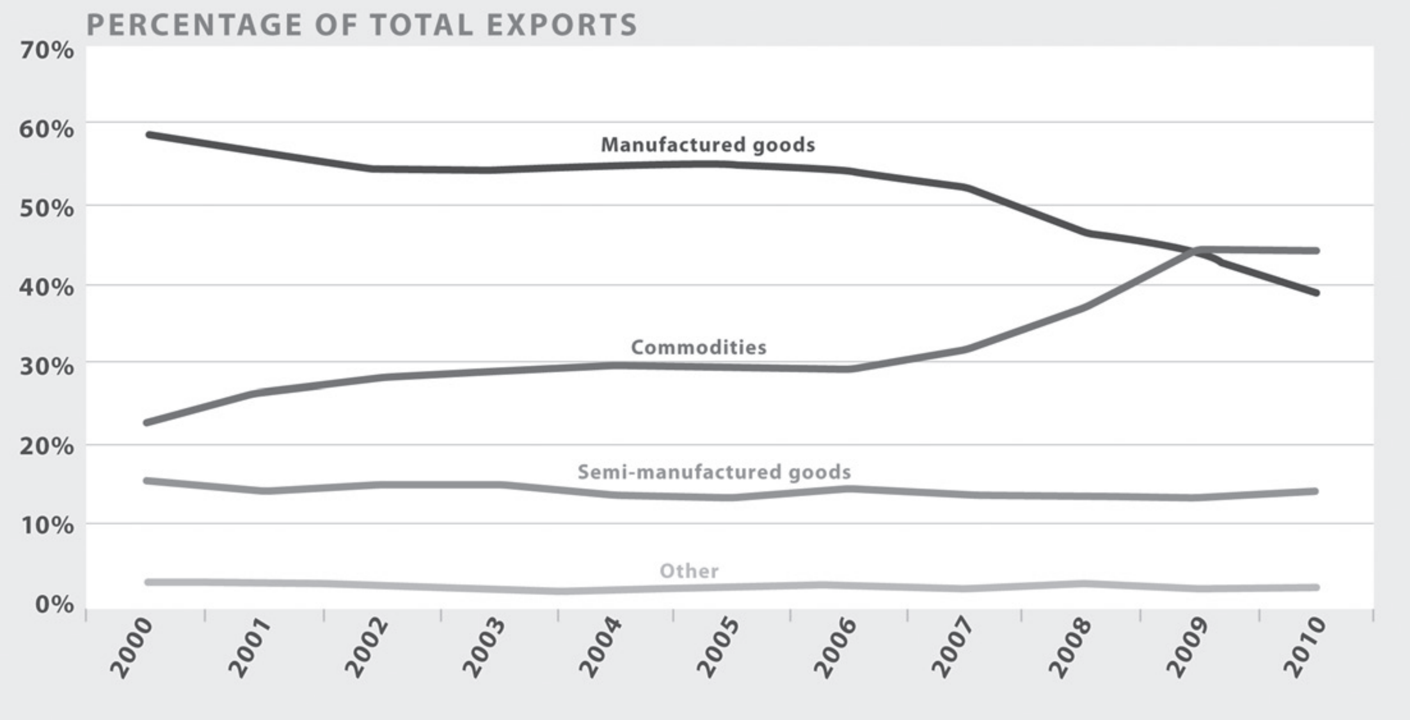
April 13, 2011

Brazilian President Dilma Rousseff and Chinese President Hu Jintao signed more than 20 bilateral agreements — along with 13 agreements between Chinese and Brazilian companies — April 12 during Rousseff's ongoing five-day trip to the Asian nation, her first outside of the Western Hemisphere since her inauguration in January. The visit and deals come as Brazil is re-evaluating its strategy toward China, which has skyrocketed in importance for Brasilia. The deals included infrastructure development, defense, finance, energy extraction, aviation and trade.

As two major global economies struggling to achieve industrialization, China and Brazil make better rivals than partners, and this can be seen in Brazil's cautious approach to relations with China. However, despite challenges, there are a number of ways the two can benefit from cooperation.

Rousseff's visit to China comes after a change of administrations in Brazil and during a complete reassessment of the country's

BRAZIL EXPORT COMPOSITION

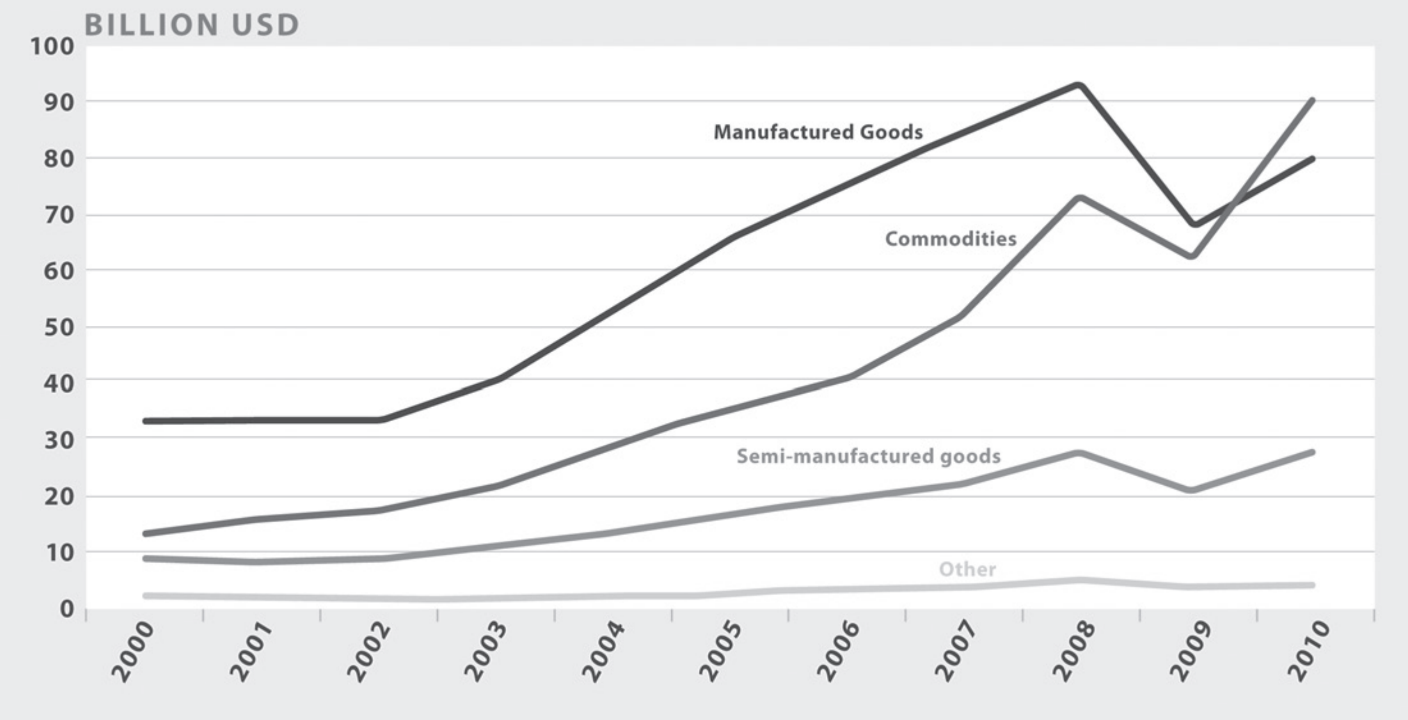


Source: Ministerio de Desenvolvimento, Industria e Comercio Exterior policies. But more important, it follows on the heels of a rapid change in Brazil's trade patterns. In the wake of the 2008 financial crisis, China's interest in Brazilian natural resource exports rose dramatically. Chinese imports from Brazil jumped from \$8.4 billion in 2006 to \$30.8 billion in 2010, mostly consisting of iron ore, soybeans and crude oil. Soaring Chinese interest coincided with a decline in Brazilian exports to the United States and Argentina, countries that had generally sought higher value-added products from Brazil. As a result, China has become Brazil's largest trading partner and has caused a significant shift in Brazilian exports toward natural resources and away from manufactured goods.

Brazil's manufacturing sector has been hurt by this shift, and that damage has been compounded by competition from Chinese manufactured goods on the domestic market. The common complaint about Beijing's monetary and trade policies designed to maintain employment levels — and thus social stability — is that its undervalued currency contributes to an unfair competitive advantage for Chinese exporters, and Brazil is no exception. Cheap Chinese goods have flooded Brazil's market, eliciting protests from domestic producers and prompting Brazil to levy tariffs on some Chinese goods, such as shoes. As a rule, Brasilia is just as protective of its developing domestic industries as Beijing is of its own exporters. This is particularly important given that many Brazilian companies have not yet reached efficiency levels that would allow them to be competitive on the international market. The influx of Chinese goods has threatened Brazil's industrial development and domestic jobs, challenging the heart of Brazil's economic management strategy and emphasizing the degree to which their similar strategies actually detract from beneficial cooperation.

This clash has forced Brazil to re-evaluate its relationship with China. Brasilia recently established the China Group, a commission formed to recommend a strategic policy for the government. Additionally, Brazilian businesses have been given until the end of April to submit lists of foreign goods that they deem to be competing

BRAZILIAN EXPORTS



Source: *Ministerio de Desenvolvimento, Industria e Comercio Exterior* unfairly with Brazilian goods on the domestic market, an indicator that additional tariffs may be forthcoming.

Despite these challenges for Brazil, there are a number of arenas in which there are very lucrative partnership opportunities between the two industrializing nations.

Part of China's foreign policy revolves around the promotion of Chinese companies and their access to natural resources and general investment opportunities. After the financial crisis, China became the only major investor on the international scene — and thus saw competition plummet — and its investments in the former Soviet Union, Latin America and Africa surged. This global policy, which allows China to diversify its investments away from U.S. Treasury bills toward hard assets and helps it manage its monetary policy, has played a key role in China's approach to Brazil. In addition to importing an increasing amount of resources, China has invested $30 billion in Brazil in the past year, with more envisioned in the April 12 deals.

China's investment carries considerable benefits for Brazil, which is facing a number of extremely capital-intensive projects. Not only will Brazil need financial commitments from serious partners to develop its pre-salt oil reserves, but it will also have to significantly upgrade its national infrastructure if it seeks to enter the global market on competitive footing with advanced industrial economies. For Brazil, the deals signed and discussed this week — including an estimated $1.4 billion worth of deals for Brazilian aviation champion Embraer and a potential $12 billion manufacturing investment by Taiwanese tech company Foxconn — meet this strategic need for investments in industrial sectors affected by deteriorating trade conditions.

Fundamentally, neither China nor Brazil has any interest in seriously disrupting this newly important relationship. Despite Brazil's concerns about commodity exports outpacing the manufacturing export sector, it can hardly turn down China's large and growing demand for these resources. Brasilia also does not want to lose market share to Argentina, another large commodity exporter to China. For its part, China has almost too much capital on hand, so if offering billions of dollars worth of deals to Brazil assuages the bilateral relationship, it is a very small price to pay.

It is unclear how long this dynamic can persist. Although Rousseff refrained from denouncing China's undervalued currency on this visit, the issue that has not gone away, and Brazil has any number of allies if it chooses to pressure China more heavily on the matter, not least of which is the United States. Furthermore, as the United States recovers from the financial crisis and imports rebound further, Brazil may find Chinese demand for natural resources counterbalanced by a return of the U.S. consumer's demand for higher value-added goods. And in the end, there are serious concerns for the sustainability of China's growth and the policies that drive its export-intensive and outward direct investment-oriented economic strategy. For the moment, however, Brasilia and Beijing have found a mutually beneficial middle ground.

Brazil Responds to an Economic Slowdown

September 8, 2011

Recent economic policy shifts in Brazil indicate that the country is prioritizing the need for growth over the fear of inflation. These include a proposal to reduce general interest rates, the potential approval of a plan to increase the country's minimum wage and a robust microcredit program.

Brazil is preparing not only for a projected global economic slowdown but also for balancing the needs of its declining manufacturing sector with its booming primary commodity export sector. The change increases the danger of inflation — a particularly contentious issue in Brazil politically — and the Rousseff administration will have to calibrate its approach carefully to maintain political popularity.

Factors Affecting Brazil's Economy

In the wake of the global financial crisis that began in 2009, Brazil experienced a significant boom in both exports and investment. Trade with China is the main driver of Brazil's export growth. China has become Brazil's largest export destination, primarily importing raw commodities — soybeans, iron ore and crude oil — and their byproducts. Brazil's exports to China in the first seven months of 2011 totaled $24.4 billion, or 17 percent of total exports (an increase from the same period last year, during which Brazil's exports to China totaled $16.7 billion and 15.7 percent of total exports). Brazil's relatively positive economic outlook and stable political system made it one of the most popular destinations for foreign portfolio and direct investment. Foreign direct investment alone amounted to $48.5 billion in 2010, an increase of more than 480 percent from 2003.

The huge influx of foreign capital and large trade surpluses has driven up the value of the real. From mid-May 2010 to late July 2011, the real increased by 18.6 percent against the dollar and currently hovers at $1.65 per real. Though the strengthening of the real has a limited effect on producers of commodities (which are traded in dollars), it has directly and negatively affected the competitiveness of Brazil's value-added manufacturing sector, particularly in combination with lowered global demand for manufactured goods.

Strict government controls on Brazil's economy have included high interest rates and capital controls, reducing incentives for investment. Furthermore, competition with Chinese products both at home and abroad has hurt Brazilian industry; 57 percent of all exporting companies have reported facing competition with the Chinese, and 67 percent of those have already lost clientele to that competition. Shoe, textile and machinery equipment companies have been hit particularly hard: Some 80 percent of Brazil's machinery and textile industry lost clients to Chinese competition, and 21 percent of the country's shoe manufacturing industry stopped exporting due to the competition. On the domestic front, 12.6 percent of Brazilian companies have reported losing business to Chinese competition.

The Brazilian manufacturing sector's troubles remained largely isolated as overall growth rose. Now, however, Brazil is seeing the beginning of a general slowdown that is projected to continue in the near future. A lower-than-predicted job creation index (a registered 140,563 newly created jobs in July, as opposed to 215,393 in June), a plummeting stock market index (currently at around 55,000, down from roughly 71,000 in January) and gross domestic product growth of only 0.8 percent through August indicate a slowdown. These domestic indexes, coupled with the ongoing economic crisis and the fact that Brazilian government analysts are predicting a downturn in the global economy, have sparked a fear that Brazil's cooldown could become a recession.

Balancing Growth and Inflation Concerns

In order to counter this possibility, the government announced several measures meant to stimulate growth and lending. Among these is a measure offered for the National Congress' approval to increase the minimum wage by 13.6 percent to a total of 619.21 reals per month in 2012 in a regularly scheduled revision of the wage. The government has also said it wants to reduce the general interest rate to 12 percent from 12.75 percent and increase the number of government investment and social spending programs, including the implementation of one of the largest microcredit programs ever seen in the country for small businesses.

These policies could increase Brazil's inflation rate, which is already stimulated by foreign capital and the booming commodities sector; inflation is currently just more than 4 percent for the accumulated yearly index. Brazil is no stranger to inflation: Structural constraints on Brazil's economy and occasional economic mismanagement have caused inflation rates to fluctuate throughout the country's history, pushing it to quadruple digits in the late 1980s and early 1990s, which in turn leads to daily price increases. After a handful of currency exchanges and other measures repeatedly failed to resolve the issue, the Real Plan implemented in 1994 by then-Finance Minister (and later President) Fernando Henrique Cardoso finally ended the period of hyperinflation and stabilized the economy. Since then, inflation has remained an exceptionally dangerous subject in Brazilian politics and economic policy.

Because of this, a rise in inflation much beyond the current target of just under 7 percent would be problematic for Rousseff in two ways. First, it would seriously undermine her personal political credibility, since she ran for office on the promise of keeping inflation under control. Second, and more important, any sharp rise in inflation would affect the lower class — the power base of Rousseff's Labor Party — more than another segment of society. It would also hurt Brazil's burgeoning middle class (although the measures to increase minimum wage and microcredit can be seen as a way to offset the financial difficulties these groups could face). Though inflation seems highly unlikely to reach the heights of the late 1980s, even an increase to double-digit inflation will be a political problem for the administration and could inspire more incidents like the Sept. 1 student demonstration against increased bus fares in the city of Piaui — that demonstration ended with a bus being lit on fire.

It is vitally important, for political and economic reasons, that Brazil's inflation be curtailed as much as possible, as the government had been doing until recently (for instance, by cutting the federal budget by $36 billion), lest the memory of hyperinflation undermine the government. However, it is equally important that the Rousseff administration protect its own popularity by safeguarding jobs, which requires stimulus- and inflation-inducing policies. With its current policies, the government is indicating that it is choosing growth over inflation control, but the balance it must maintain between the two is very delicate.

China's Entry into a Venezuelan-Brazilian Oil Deal

October 21, 2011

The China Development Bank has agreed to provide loan guarantees for Venezuelan state-run oil company Petroleos de Venezuela (PDVSA) to back 75 percent of PDVSA's 10 billion real ($5.7 billion) commitment to the Abreu e Lima refinery, under construction by Brazilian energy company Petroleos Brasileiros (Petrobras), according to an Oct. 14 report by Veja. According to the report, Portuguese bank Espirito Santo will finance the remaining 25 percent of PDVSA's commitment. The terms of the loan guarantees have not yet been made public, but it appears that the Brazilian Development Bank's concerns about the financial stability of Espirito Santo pushed PDVSA to look for alternative means of financing.

Stratfor does not have direct knowledge of why China decided to enter into the PDVSA-Petrobras deal. However, China's loan guarantees are consistent with its expanding ties to Venezuela, and it could stand to heavily profit from the deal. However, given China's competition with Brazil, it is possible that the Chinese loan guarantees are motivated as much by a desire to hamper Brazil by tying this refining project to the unstable PDVSA.

The deal for a joint PDVSA-Petrobras refinery was originally finalized in October 2009. Petrobras is committed to owning a 60 percent stake, leaving the remaining 40 percent with PDVSA. The refinery is expected to process 230,000 barrels per day (bpd) of oil to supply Brazil's domestic market with diesel and liquefied petroleum gas to northeastern Brazil. Approximately half the oil to be processed by the refinery is expected to come from the Carabobo bloc of Venezuela's Orinoco Belt, an area jointly explored by PDVSA and Petrobras. The oil from this area of Venezuela is some of the heaviest, sourest crude in the world; combined with similar crude from Brazil, this will give the refinery a focus on heavy crude markets.

Though Petrobras has already begun construction on the project, the financing for the deal has been pending for two years in the face of PDVSA delays. The offer from the China Development Bank is the firmest backing so far in the negotiations, and it comes just in time for the Nov. 30 deadline for PDVSA to find the cash or back out of the project. Still, the deal is not yet assured. There is pressure from within Petrobras to walk away from partnering with PDVSA. One concern for Petrobras is that by committing to import oil from Carabobo, the refinery will be more costly. Furthermore, as the financing drama (among other ongoing issues) demonstrates, PDVSA can hardly be considered a reliable business partner.

The Complexities of the China-Venezuela Relationship

This deal fits into the framework of China's growing relationship with Venezuela. The two have signed deals worth more than $30 billion in recent years. This loan would be worth an additional $4.2 billion. Although details of the China Development Bank's agreement with Venezuela are unavailable, it is likely that Venezuela plans to pay China back in crude oil. According to PDVSA, total exports of crude and refined petroleum products fell 11.6 percent to 2.41 million bpd in 2010 from 2.73 million bpd in 2009. Total exports to North America and the Caribbean also fell in 2010. On the other hand, exports to Asia (dominated by China) rose 154 percent to 341,000 bpd in 2010.

Diversifying oil away from the United States is a strategic goal for the Venezuelan government and has been the explicit policy of the Chavez administration since the failed coup attempt of April 2002 that Chavez blamed in large part on the influence of the United States. However, there are reasons to believe that while the reported volume of shipments to China has gone up dramatically, much — if not most — of that oil is actually turned around and sold to U.S. refineries.

China has limited ability to process the heavy, sour crude Venezuela sells. The refineries best equipped to handle Venezuelan crude are in the Caribbean and along the Gulf coast of the United States. For China, it is four to six times cheaper — a difference of hundreds of thousands of dollars per shipment — to ship oil into the North American market than it is to ship it some 15,000 kilometers (9,321 miles) to the Chinese mainland. A U.S. diplomatic cable from 2010 released by Wikileaks reported that an internal PDVSA audit indicated that Venezuelan-Chinese oil-for-loan deals had resulted in oil sales to China for as little as $5 per barrel. Even if the average sale value is much higher, at just under $100 per barrel on the open market, China stands to profit heavily from resale of this oil to local markets.

The reality of the matter is that for all the talk about having diversified away from the North American market through this relationship with Venezuela, the actual dependence on the U.S. market remains very high. The significance of a real deal on Abreu e Lima would be in the actual commitment of a substantial portion of Venezuelan crude to a non-Asian, non-North American market. This would represent a real step toward diversification for Venezuela in a way it has not yet been able to achieve.

The Geopolitics of Oil Refining

The Abreu e Lima deal is motivated in part by politics and in part by technical needs. PDVSA signed the deal with Petrobras under the administration of Brazilian President Luiz Inacio Lula da Silva and at a time of high optimism for Venezuela's prospects for diversification and regional cooperation. However, PDVSA's repeated delays have turned the agreement into a source of tension for the two neighbors.

Venezuelan President Hugo Chavez stated in a recent news conference that there is pressure from within Petrobras to back out of the deal and build the refinery on its own. It would in many ways make sense for Petrobras to do so. Having access to PDVSA's stream of heavy, sour crude — some of the world's most technically difficult to refine — would give it solid footing in the heavy crude market. In the long term, the global crude mix is expected to get increasingly heavy, and this would be a step toward preparing for that eventuality. However, such a move would tie Petrobras to the politically volatile Venezuela. A deal with PDVSA is also not entirely necessary. Petrobras could source heavy crude from the open market on its own or even scrap the idea of a focus on heavy crude altogether, turning to other key oil producers such as Angola for partnerships.

Stratfor does not have direct visibility into the Chinese decision-making on this deal, and the factors at play are exceedingly diverse. What we do know is that in most ways, Brazil and China are competitors. Nowhere is China more competitive than when it comes to securing access to resource deposits around the world. It is therefore logical that China would facilitate the completion of this deal between Petrobras and PDVSA as a way to lock the two together, thereby forestalling additional competition with Brazil for global oil supplies.

Managing Bolivian Opposition to a Brazilian Road

October 28, 2011

Brazilian officials indicated that the Brazilian Development Bank will agree to negotiate an increase in funding for a controversial road project through the Isiboro Secure National Park and Indigenous Territory (TIPNIS) in Bolivia, Brazilian newspaper Valor reported Oct. 27. The move comes in response to the Oct. 21 Bolivian decision to suspend construction of the Brazilian-funded road.

Brazil has now signaled to Bolivia that it will be flexible while Bolivia solves domestic political objections to the project, which Brazil hopes will facilitate transportation of Brazilian goods to the Pacific port of Arica in Chile. In doing so, Brasilia is seeking to avoid exacerbating domestic unrest in Bolivia while guarding its interest in completing the project.

Morales' Dilemma

Intense protests by indigenous people from the TIPNIS area cost Bolivian President Evo Morales public support, forcing him to cancel construction of the road. A violent confrontation Sept. 29 between TIPNIS protesters marching to La Paz from Beni department proved particularly embarrassing to the Morales administration. Though Morales' decision to cancel the road pleased the TIPNIS indigenous protesters, the dispute triggered a re-evaluation of indigenous groups' support for Morales throughout Bolivia.

Leaders of a number of lowland indigenous organizations announced that they will reconsider participating in the so-called "Unity Pact" with Morales' Movimiento al Socialismo party. The 2006 pact is a critical element in Morales' coalition of highly diverse indigenous community under his leadership as the first indigenous president of Bolivia.

Halting the project to shore up support with the TIPNIS group was a disappointment to another key Morales constituency, however: Bolivia's coca growers, known in Spanish as "cocaleros." The cocaleros, with whom Morales got his political start as a cocalero labor organizer, marched in support of Morales and the road project Oct. 25 because it would improve access to potential coca-growing territory. Abandoning the project would thus hamper Morales' relationship with the cocaleros. Despite the cocaleros' interest in the road, Brazil is the key stakeholder that would be disappointed by the decision to cancel the TIPNIS section of the road project.

Brazil's Balancing Act

Despite its size and wealth, Brazil has generally taken a very soft approach to involvement in Latin America. It wants to ensure that its economic and political goals, which include expanding trade and infrastructure throughout the region, are achieved. But it does not want to create perceptions among its neighbors, who had a very different colonial experience from Brazil, that it is an imperialist force.

The road through Bolivia and a similar corridor through southern Peru would greatly improve Brazil's access to Pacific ports at a time of significant economic development in interior states like Rondonia, Goias and Mato Grosso do Sul, directing export traffic away from Brazil's overburdened Atlantic ports. The country has invested, or at least plans to invest, a considerable amount of money into infrastructure in these interior areas, in part through the Growth Acceleration Program initiated in 2007 by former President Luiz Inacio Lula da Silva and now in its second phase under President Dilma Rousseff.

Bolivia figures into Brazil's development as more than just a transit corridor. Brazilian energy firm Petroleos Brasileiros controls the development of Bolivia's most important resource, natural gas. Roughly 70 percent of Bolivia's natural gas output, equivalent to 85 percent of total Bolivian exports, is exported to Brazil.

Stability in Bolivia is thus a foreign policy priority for Brazil. And this means Brazil must decide whether to risk fomenting major domestic disturbances by promoting the port project and threatening its other economic interest in Bolivia or risk losing the transit corridor.

Brazil's task is to somehow ensure Bolivian stability while simultaneously ensuring that the road project proceeds. Brazil has chosen to avoid threatening financial penalties on Bolivia if the project fails in favor of a softer approach in a bid to portray itself as a flexible partner. As an emerging continental power in an unstable region, Brazil will find that such careful management of its neighbors' domestic troubles will become increasingly important.

Risks and Rewards in Brazil's Favela Offensive

November 11, 2011

Antonio "Nem" Bonfim Lopes, Rio de Janeiro's most wanted drug trafficker, was arrested around midnight Nov. 9 after being found in the trunk of a car driven by two men, one of whom claimed to be an honorary consul at the Consulate of the Democratic Republic of the Congo in an effort to evade arrest. Captured just a few kilometers from his home in Rochina favela, or slum, Nem was fleeing in anticipation of a scheduled Nov. 13 sweep of the favela by Brazilian police and military forces of Rocinha and neighboring Vidigal favela. The operation is the latest in a string of favela pacification efforts in Rio de Janeiro that began in 2008 to prepare the city to host the 2014 World Cup and the 2016 Olympics.

While its actual population is unknown, Rocinha is considered the largest favela in Latin America, with somewhere between 60,000 and 100,000 inhabitants. Vidigal is about half the size of Rocinha. Both favelas are controlled by Amigos dos Amigos (ADA), one of Rio's two most powerful criminal organizations. According to Rio de Janeiro police, around 2 million reais ($1 million) worth of drugs, primarily cocaine, pass through Rocinha every week. Rocinha is close to some of Rio's wealthiest neighborhoods and has been steadily expanding outward. Its location raises the risks of spillover violence into Zona Sul neighborhoods such as Sao Conrado, Gavea and Leblon, although the idea that stability in Rocinho and Vidigal would lower crime and boost property values in those areas has created strong local support for the police action.

Tactical Shift on the Horizon

The initial police pacification campaign in Rocinha has gone on for more than a week. Around 50 police have loosely surrounded the favela to check cars, stage raids to break up illegal business operations and make arrests. Police report that exact intelligence about Nem's movements allowed them to track his vehicle as he left the favela and make the arrest. A Nov. 3 raid on the favela yielded 12 arrests, a host of confiscated counterfeit goods and the discovery of what police described as artillery stored next to a pile of tires for use against law enforcement helicopters in the event of a government assault on the favela. Police said the likely strategy was to set the tires on fire and create enough smoke to force the helicopters to fly lower, within range of the weaponry.

On Nov. 13, police will switch from limited searches and seizures to a full occupation of the favela with 2,600 local and federal police agents, including multiple elite strike teams. The Brazilian marines also will assist in the assault by providing armored personnel carriers and infantry fighting vehicles, although the operation remains a police initiative. The standard plan for pacification campaigns is to send a large contingent of police and military personnel into the favelas for 45 to 60 days before turning the favela over to a Pacification Police Unit (UPP) of 200 officers to conduct regular patrols. But police likely expect to leave the initial wave of agents in the favela far longer than the standard plan to ensure security. In a similar ongoing operation launched in November 2010 to occupy interlinked favelas known as Complexo do Alemao, police do not plan to hand control over to the UPPs until July 2012.

The extensive lead-time and public announcement about the actual operation is a calculated strategy on the part of Rio's police. The overarching goal is to give the criminal organizations the opportunity to cede control of the favelas. By conducting limited operations before the full invasion, gang leaders will have a chance to flee the favelas. Often, they will head to neighboring favelas or leave the city altogether. The invasions themselves are not designed to capture and detain gang members due to political concerns. If police attempted to cordon off the favelas in a surprise operation to capture or kill gang leaders, the operation could easily become a pitched battle against heavily armed organizations in a densely populated civilian environment. Considering the generally flimsy nature of construction in the favelas, the collateral damage likely from such a strategy would be difficult to justify politically.

Multiple Risks, Limited Potential

This strategy has multiple long-term drawbacks, however. By allowing the leadership of these drug trafficking organizations to stay largely intact, they can regroup and resume their activities elsewhere or even seek retaliation against the government. When other major favelas have been pacified, many of the traffickers fled to Rocinha and other uncontrolled favelas. Drug kingpins have been known to flee as far as Paraguay while still running their organizations. The general strategy is to push traffickers to the outskirts of the city in order to clear the city center. In this instance, police expect traffickers to flee to the large nearby area of Baixada Fluminense and the city of Niteroi. However, with hundreds of favelas in Rio alone, there are many potential havens for fleeing traffickers. Arresting traffickers has limited effects as well, as detained drug lords like Nem can continue running their organizations from prison due to poor prison security and high corruption levels.

Fleeing leaders also leave behind former employees with no source of income. These "orphans of the favelas" can be expected to resume criminal activities under their own direction and create persistent problems for the UPP. The pressure of corruption on police units stationed in the favelas is an even bigger challenge. Proximity to the drug trade and well-armed trafficking organizations means that Rio police working directly in the favelas are under constant pressure to accept bribes or succumb to extortion. For example, Nem and the other men arrested with him reportedly offered to pay a bribe of 1 million reais to escape capture.

International Games Looming

Despite these challenges visible in some of the pacified favelas, there have been several successful pacification efforts. For example, the small Santa Marta favela has begun to encourage visits from tourists as an alternative economic model.

Ultimately, however, the goal of favela pacification campaigns is primarily to project the appearance of control ahead of the upcoming international games. The need to minimize retaliatory violence means that the government will do what it can to allow the ADA and rival (and occasional partner) drug trafficking organization

Comando Vermelho to cede territory peacefully to avoid an internationally embarrassing flare-up of violence.

U.S. Ethanol Subsidies End as Brazilian Production Shrinks

December 1, 2011

Several U.S. laws that have subsidized the American ethanol industry are set to expire at the end of 2011. In the current political context, it appears likely the laws will in fact be allowed to lapse.

The end of the measures, which comes at a time of increasing ethanol consumption in the United States, will likely have major consequences for smaller U.S. ethanol producers, but it will have positive effects overall on the industry. Unfortunately for Brazil, which has long complained of U.S. ethanol subsidies, the expiration of the measures also comes at a time of decreased Brazilian ethanol production and increased domestic consumption. This paves the way for other foreign producers to step into the U.S. market in the short term while Brazil works to ramp up its ethanol production in the long term.

Ethanol in the United States

The expiring U.S. provisions include:

- The Volumetric Ethanol Excise Tax Credit (VEETC), a $0.45-per-gallon (about $0.12-per-liter) compensation for ethanol producers and blenders.
- The Small Ethanol Producer Credit (SEPTC), an extra $0.10-per-gallon (about $0.03-per-liter) tax return to the first 57 million liters (15 million gallons) produced in a year by distillers with a capacity of less than 227 million liters per year.

- The Import Duty for Fuel and Ethanol, which puts a 2.5 percent value-added tax on ethanol imports and a $0.54-per-gallon (about $0.14-per-liter) nominal tax.

These protectionist measures have been crucial to the expansion of the corn-based ethanol industry, but the U.S. government is now looking to cut spending. Eliminating incentives through the VEETC for E10 blends — which mix ethanol at a 1-to-9 ratio with gasoline — provides a total savings of more than $6 billion per year. Eliminating incentives for E85 blends, used at select pumps by flex-fuel vehicles that can handle the higher ethanol mixture, totals $54 million.

Various U.S. ethanol interest groups are pushing for the laws' extension. Most prominent among these is the Renewable Fuels Association, which has pointed to the cost to the U.S. economy of letting the laws lapse. According to critics' claims, the laws' expiration will lead to the loss of 112,000 jobs, cost $16 billion per year in lost economic activity, and lead to a household income loss of $4.2 billion, spread throughout producing regions like California and the Corn Belt states, particularly Iowa.

While lobbyists can be expected to cite statistics bolstering their case, the loss of the subsidies and tariffs will indeed leave the ethanol industry more exposed to foreign competition, putting less competitive distilleries in jeopardy. The expiration of the SEPTC in particular will eliminate a lifeline to smaller distilleries that produce up to 114 million liters per year. Such distilleries cannot rely on the same economies of scale as distilleries that produce 150 million to 245 million liters per year. Ethanol-producing distilleries in the first category can be expected to close or to be purchased by larger companies. This is not entirely bad news for the U.S. industry, however. Consolidation of ethanol-producing operations will create a more efficient and competitive industry, just as biofuel consumption in the United States is set to increase.

This expected increase in consumption is partly the result of an expansion in U.S. ethanol infrastructure, including fuel pumps and a fleet of flex-fuel cars equipped to handle ethanol's particular chemical nature. More significantly, another law requires increased consumption. The Renewable Fuels Standard (RFS) mandates that the United States use up to 57 million liters per year of renewable biofuels (which, in the United States, will be primarily corn-based) by 2015 and a total of 136 million liters per year of renewable fuels by 2022. The RFS does not mandate the source of the ethanol, however, meaning foreign suppliers can help meet the target.

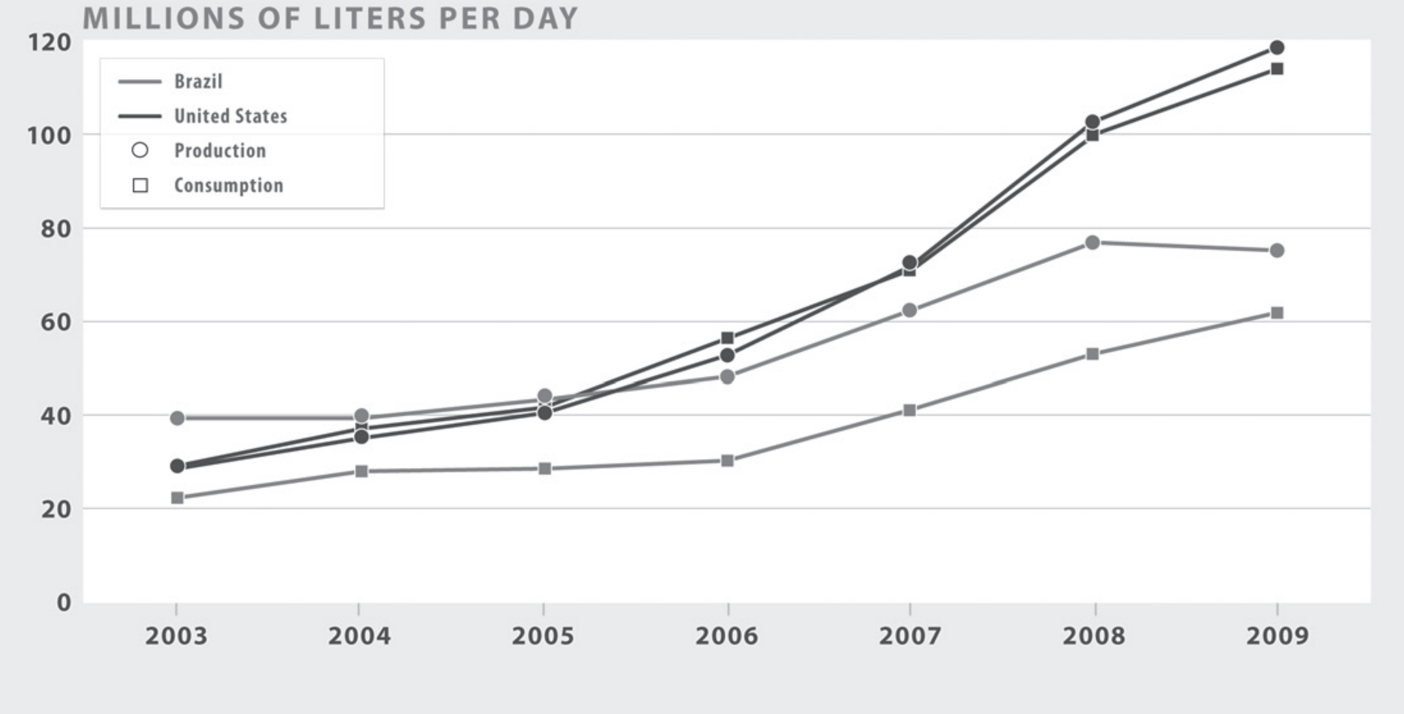
Ethanol in Brazil

Brazil is the biggest competitor of U.S. ethanol producers. Unlike the United States, Brazil's ethanol comes from sugarcane. With a production capacity second only to the United States, Brazil has long had its eye on the U.S. market. Brazil often has complained of U.S. ethanol protectionism. One of its criticisms has focused on the inherent inefficiency of U.S. corn-based ethanol in comparison to Brazilian sugarcane-based ethanol. Despite the barriers, Brazil has exported ethanol to the United States. The end of subsidies and protection is a long-anticipated windfall for Brazil.

But several factors will limit Brazil's ability to take advantage of this opportunity. For one, investment in Brazilian sugarcane production in 2008-09 declined due to the global financial crisis. Since sugarcane takes two years to mature, versus six months for corn, Brazilian industry is only now feeling the impact of the drop in production. Furthermore, bad weather, including summer droughts and winter frosts, has afflicted recent sugarcane crops in Brazil's central-south states, the country's main production area. This has caused declines in harvests over the past few years, prompting industry experts like Datagro and Cosan to issue lackluster short-term forecasts for the cane harvest.

The decline in supply has coincided with a strong increase in domestic demand for ethanol. More flex-fuel cars capable of handling high-ethanol blends are being sold in Brazil than are standard automobiles. These factors have driven the cost of refined sugar upward, tempting growers away from ethanol and further constricting supply.

BIOFUEL CONSUMPTION AND PRODUCTION



Source: U.S. Energy Information Administration

Meanwhile, higher ethanol prices at the pump have limited the fuel's competitive advantage vis-a-vis gasoline. Generally speaking, when ethanol's price surpasses 70 percent of gasoline's price, then gasoline is more economical in terms of the fuel cost per mile.

The Brazilian government has tried many measures to guarantee the supply of ethanol at the pump, including planned billion-dollar investments in the sector and a reduction of the minimum ethanol mandate, from E25 to E20. But Brazil still has had to import gasoline from the Middle East and has even become a net importer of ethanol from the United States.

At present, Brazil imports around 57,000 liters per day of ethanol from the United States, in large part probably due to the April 2010 suspension of Brazilian ethanol import tariffs. The suspension was a Brazilian attempt to induce a similar move by the United States, which has begun to export an increasing volume of biofuels. High foreign demand for U.S. ethanol has driven domestic U.S. prices to around $0.74 per liter, an almost 25 percent increase from the $0.59 per liter of ethanol in 2007.

Brazil's Long-Term Growth Strategy

Despite Brazil's ongoing, albeit decreasing, ethanol exports to the United States, Brazil simply does not have the production capability to cover its own ethanol demand while simultaneously cornering the U.S. market. As Brazil struggles with its shortfall, other ethanol supporters could step in to supply U.S. needs. While foreign penetration into the U.S. market largely will depend on how far U.S. ethanol production capacity recedes, producers like China, Thailand, Europe, Colombia and the countries of the Caribbean Basin Initiative will find the end of U.S. subsidies and tariffs equally enticing.

But Brazil has big plans for its ethanol industry and the government hopes to turn its situation around in the long term. State development bank BNDES plans to invest $19 billion in cane growth by 2014. Federal fiscal incentives for the production of cane ethanol and for ethanol storage will be revealed Dec. 15. And around 63 new distilling plants should be operational by 2018, a year when Brazilian ethanol production is forecast to double its 2009 figure, reaching 46.33 billion liters from 26.08 billion liters.

Still, even more production is arguably needed. Sugarcane industry association UNICA says investments of at least $80 billion are necessary in the next 10 years to meet global demand, while sugar trading group Czarnikow argues that $340 billion of investments are required by 2030. Regardless of medium-term necessities, short-term production forecasts suggest a serious uptick in cane harvests is not likely before 2013-14, when the Brazilian sugarcane expansion strategy should start to pay off.

Brazilian Police Strikes Threaten Rio's Carnival

February 7, 2012

State military police taking refuge in the Salvador Legislative Assembly building clashed Feb. 6 with federal troops surrounding the building. The police are leading a strike that began Feb. 1 by an estimated 10,000 military police in Brazil's Bahia state in demand of higher salaries. The work stoppage has triggered an outburst of crime; 89 people have been murdered in the state capital since the strike began, despite the deployment of 3,500 federal troops to reinforce public safety.

The Bahia strike is just the latest — albeit the most violent — in a series of recent police strikes in states across Brazil, including Ceara and Rondonia. The federal government's inability to arrive at a national policy has led to state-level debates about police reform across Brazil. A possible strike by security personnel in Rio de Janeiro state could pose the biggest test for the country yet. Scheduled to begin just one week before the Feb. 17 start of Carnival, the strike would stretch the state's security capabilities amid a massive influx of visitors to the country. Rio de Janeiro's attempts to settle the dispute will test its ability to meet other significant challenges before hosting the 2014 World Cup and the 2016 Summer Olympic Games.

In Rio de Janeiro state, civil and military police officers have joined demonstrations by firefighters protesting low salaries, dangerous working conditions and poor labor practices. The groups plan to go on strike Feb. 10 if their demands are not met, according to the Union of Civil Police in Rio de Janeiro State. The three groups argue that they earn the lowest wages among security personnel in the country — approximately half the wages of their counterparts in Brasilia. The strike is scheduled despite the fact that Rio de Janeiro Gov. Sergio Cabral announced plans Jan. 27 for a 39.4 percent salary increase over the next two years. According to Cabral, the raise will equal a 100 percent increase from 2007 wage levels by the time it is fully implemented in 2013. In a rejection of the offer, nearly 20,000 people attended a protest Jan. 29 organized by the groups.

Security groups in Rio de Janeiro are hoping to use the Carnival season, as well as the upcoming World Cup and Olympics, to pressure the government into making concessions. Carnival attracted an estimated 4.5 million people to Rio de Janeiro in 2011, including 400,000 foreigners. Rio de Janeiro faces serious security challenges year-round, but such an influx of revelers heightens the threat posed by the city's vibrant criminal underground. Legally, only 70 percent of security forces in Rio de Janeiro can strike at any one time, leaving 30 percent to accomplish basic policing duties. But Carnival is a critical time for the city to increase, not diminish, its security presence. While the federal government might contribute troops to help make up the shortfall, as the situation in Bahia demonstrates, it is not certain that federal troops could handle the situation. However, it is also unclear whether the protesting security forces can successfully leverage the government's concerns and force Cabral into a more favorable compromise.

Beyond the immediate challenge posed by Carnival, officials in Rio de Janeiro are deeply concerned with improving the city's international image ahead of the World Cup and Olympic festivities. Rio de Janeiro state faces major infrastructure challenges, and it needs to cultivate a dependable state security force. The city and the state are also relying heavily on both local and federal security forces to evict sophisticated organized criminal groups from the favelas. The current labor issues will test the state's abilities to face these challenges. And while there is still some time to prepare for the global games, violence during Carnival will be a setback for the state as it seeks to prove its readiness for hosting.

PART 2: RUSSIA

The Geopolitics of Russia: Permanent Struggle

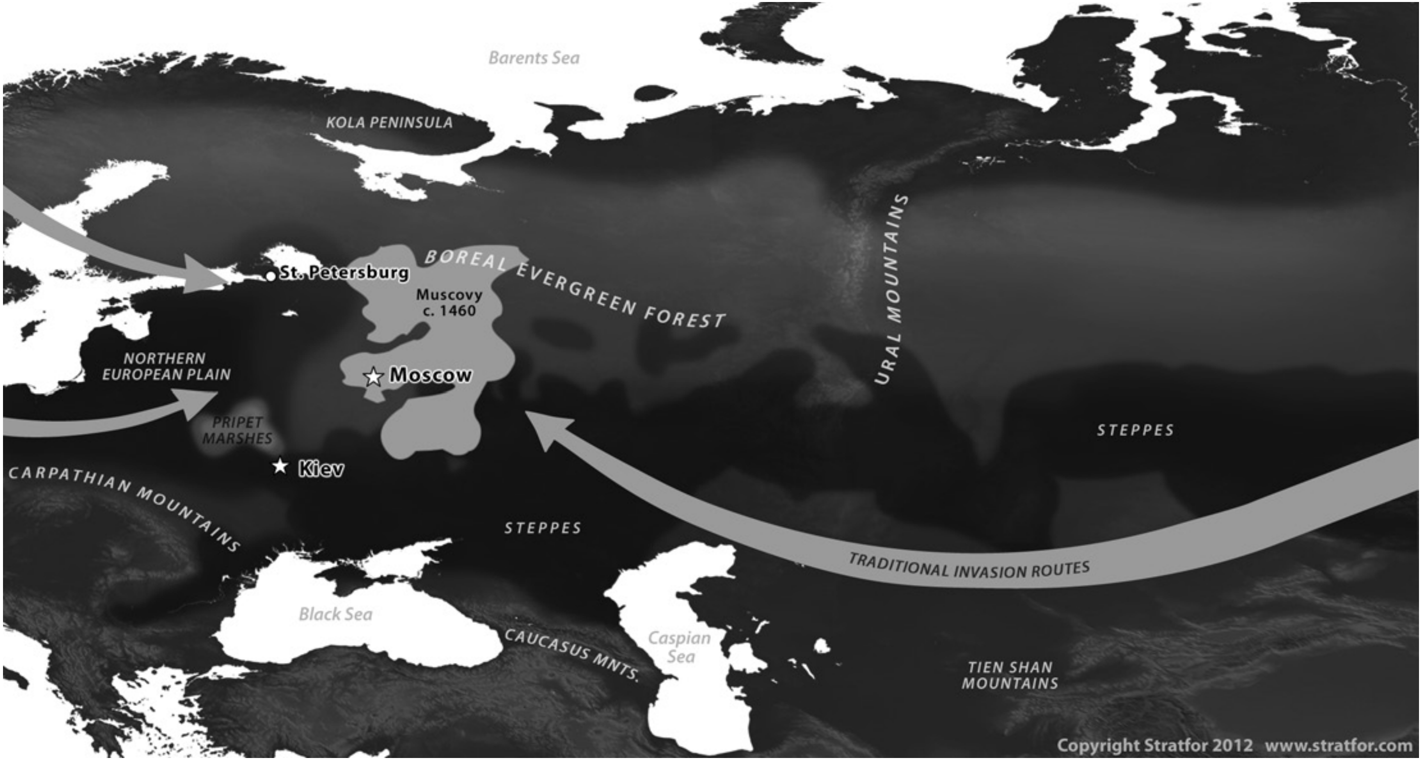
October 2008

Russia's defining characteristic is its indefensibility. Unlike the core of most states that are relatively defensible, core Russia is limited to the region of the medieval Grand Principality of Muscovy. It counts no rivers, oceans, swamps or mountains marking its borders — it relies solely on the relatively inhospitable climate and its forests for defense. Russian history is a chronicle of the agony of surviving invasion after invasion.

Traditionally these invasions have come from two directions. The first is from the steppes — wide open grasslands that connect Russia to Central Asia and beyond — the path that the Mongols used. The second is from the North European Plain, which brought to Russia everything from the Teutonic Knights to the Nazi war machine.

To deal with these vulnerabilities, Russia expanded in three phases. In the first, Russia expanded not toward the invasion corridors to establish buffers but away from them to establish a redoubt. In the late 15th century, under Ivan III, Russia did creep westward somewhat, anchoring itself at the Pripet Marshes, which separated Russia from the Kiev region. But the bulk of Russia's expansion during that period was north to the Arctic and northeast to the Urals. Very little of this territory can be categorized as useful — most was taiga or

MUSCOVY'S GEOGRAPHIC CHALLENGES



actual tundra and only lightly populated — but for Russia it was the only land easily up for grabs. It also marked a natural organic outgrowth of the original Muscovy — all cloaked in forest. It was as defensible a territory as Russia had access to and their only hope against the Mongols.

The Mongols were horsemen who dominated the grasslands with their fast-moving cavalry forces. Their power, although substantial, diminished when they entered the forests and the value of their horses, their force multipliers, declined. The Mongols had to fight infantry forces in the forests, where the advantage was on the defender's side.

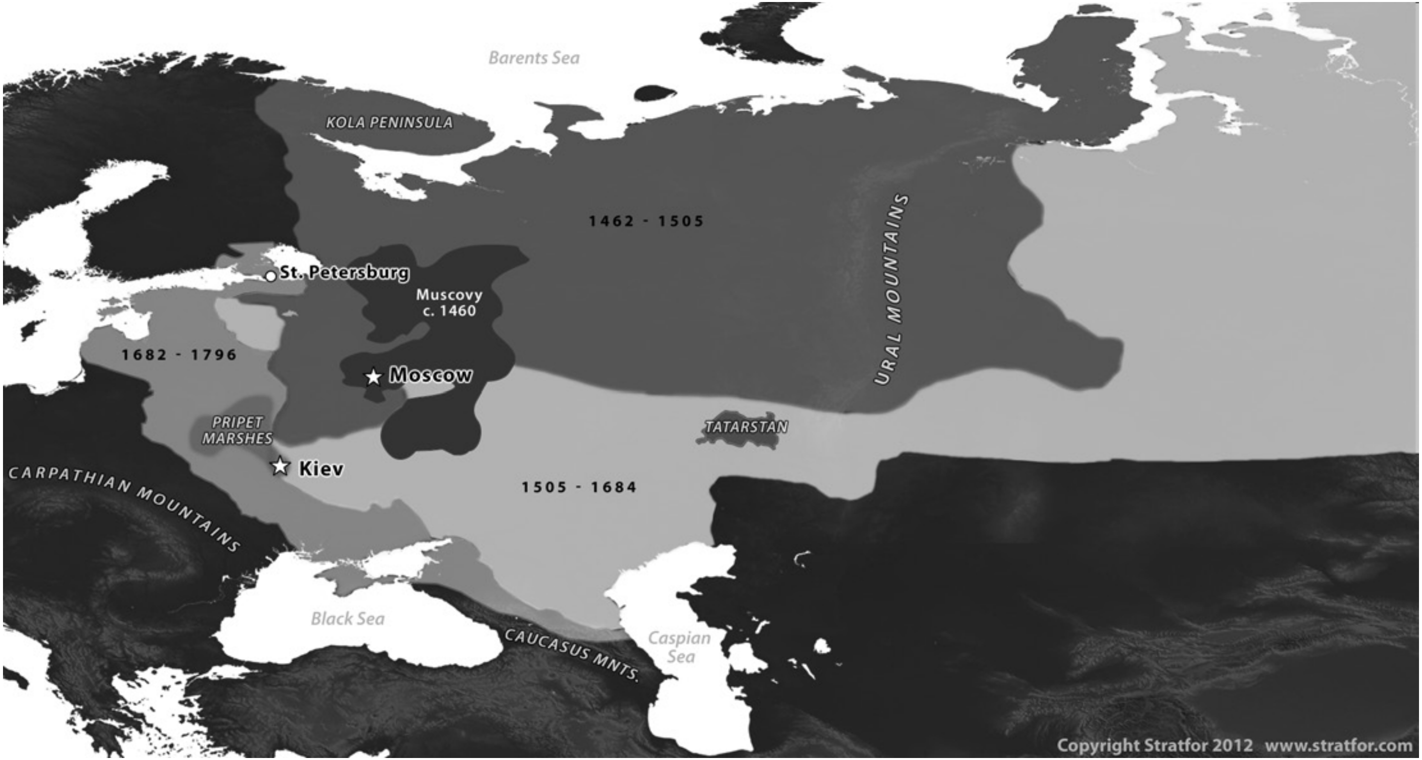
The second phase of expansion was far more aggressive — and risky. In the mid-16th century, Under Ivan IV, Russia finally moved to seal off the Mongol invasion route. Russia pushed south and east, deep into the steppes, and did not stop until it hit the Urals in the east and the Caspian Sea and Caucasus Mountains in the south. As part of this expansion, Russia captured several strategically critical locations, including Astrakhan on the Caspian, the land of the Tatars — a longtime horse-mounted foe — and Grozny, which was soon transformed into a military outpost at the foot of the Caucasus.

Also with this expansion, Ivan IV was transformed from Grand Prince of Moscow to Tsar of All Russia, suggesting the empire to come. Russia had finally achieved a measure of conventional security. Holding the northern slopes of the Caucasus would provide a reasonable defense from Asia Minor and Persia, while the millions of square kilometers of steppes gave birth to another defensive strategy: buffers.

Russia — modern, medieval or otherwise — cannot count on natural features to protect it. The Pripet Marshes were small and could in many cases simply be avoided. There is no one who might wish to attack from the Arctic. Forests slowed the Mongol horsemen, but as Muscovy's predecessor — Kievan Rus — aptly demonstrated, the operative word was "slowed," not "stopped." The Mongols conquered and destroyed Kievan Rus in the 13th century.

That leaves buffers. So long as a country controls territory separating itself from its foes — even if it is territory that is easy for a hostile military to transit — it can bleed out any invasion via attrition

RUSSIAN EXPANSION PHASES



and attacks on supply lines. Such buffers, however, contain a poison pill. They have populations not necessarily willing to serve as buffers. Maintaining control of such buffers requires not only a sizable standing military for defense but also a huge internal security and intelligence network to enforce central control. And any institution so key to the state's survival must be very tightly controlled as well. Establishing and maintaining buffers not only makes Russia seem aggressive to its neighbors but also forces it to conduct purges and terrors against its own institutions in order to maintain the empire.

The third expansion phase dealt with the final invasion route: from the west. In the 18th century, under Peter and Catherine the Great, Russian power pushed westward, conquering Ukraine to the southwest and pushing on to the Carpathian Mountains. It also moved the Russian border to the west, incorporating the Baltic territories and securing a Russian flank on the Baltic Sea. Muscovy and the Tsardom of Russia were now known as the Russian Empire.

Yet aside from the anchor in the Carpathians, Russia did not achieve any truly defensible borders. Expansions to the Baltic and Black Seas did end the external threat from the Cossacks and Balts of ages past, but at the price of turning those external threats into internal ones. Russia also expanded so far and fast that holding the empire together socially and militarily became a monumental and ongoing challenge (today Russia is dealing with the fact that Russians are barely a majority in their own country). All this to achieve some semblance of security by establishing buffer regions.

But that is an issue of empire management. Ultimately the multidirectional threat defined Muscovy's geopolitical problem. There was a constant threat from the steppes, but there was also a constant threat from the west, where the North European Plain allowed for few natural defenses and larger populations could deploy substantial infantry (and could, as the Swedes did, use naval power to land forces against the Muscovites). The forests provided a degree of protection, as did the sheer size of Russia's holdings and its climate, but in the end the Russians faced threats from at least two directions. In managing these threats by establishing buffers, they were caught in a perpetual juggling act: east vs. west, internal vs. external.

The geography of the Russian Empire bequeathed it certain characteristics. Most important, the empire was (and remains) lightly settled. Even today, vast areas of Russia are unpopulated while in the rest of the country the population is widely distributed in small towns and cities and far less concentrated in large urban areas. Russia's European part is the most densely populated, but in its expansion Russia both resettled Russian ethnics and assimilated large minorities along the way. So while Moscow and its surroundings are certainly critical, the predominance of the old Muscovy is not decisively ironclad.

The result is a constant, ingrained clash within the Russian Empire no matter the time frame, driven primarily by its size and the challenges of transport. The Russian empire, even excluding Siberia, is an enormous landmass located far to the north. Moscow is at the same latitude as Newfoundland while the Russian and Ukrainian breadbaskets are at the latitude of Maine, resulting in an extremely short growing season. Apart from limiting the size of the crop, the climate limits the efficiency of transport — getting the crop from farm to distant markets is a difficult matter and so is supporting large urban populations far from the farms. This is the root problem of the Russian economy. Russia can grow enough to feed itself, but it cannot efficiently transport what it grows from the farms to the cities and to the barren reaches of the empire before the food spoils. And even when it can transport it, the costs of transport make the foodstuffs unaffordable.

Population distribution also creates a political problem. One natural result of the transport problem is that the population tends to distribute itself nearer growing areas and in smaller towns so as not to tax the transport system. Yet these populations in Russia's west and south tend to be conquered peoples. So the conquered peoples tend to distribute themselves to reflect economic rationalities, while need for food to be transported to the Russian core goes against such rationalities.

Faced with a choice of accepting urban starvation or the forcing of economic destitution upon the food-producing regions (by ordering the sale of food in urban centers at prices well below market prices), Russian leaders tend to select the latter option. Joseph Stalin certainly did in his efforts to forge and support an urban, industrialized population. Force-feeding such economic hardship to conquered minorities only doubled the need for a tightly controlled security apparatus.

The Russian geography meant that Russia either would have a centralized government — and economic system — or it would fly apart, torn by nationalist movements, peasant uprisings and urban starvation. Urbanization, much less industrialization, would have been impossible without a strong center. Indeed, the Russian Empire or Soviet Union would have been impossible. The natural tendency of the empire and Russia itself is to disintegrate. Therefore, to remain united it had to have a centralized bureaucracy responsive to autocratic rule in the capital and a vast security apparatus that compelled the country and empire to remain united. Russia's history is one of controlling the inherently powerful centrifugal forces tearing at the country's fabric.

Russia, then, has two core geopolitical problems. The first is holding the empire together. But the creation of that empire poses the second problem, maintaining internal security. It must hold together the empire and defend it at the same time, and the achievement of one goal tends to undermine efforts to achieve the other.

Geopolitical Imperatives

To secure the Russian core of Muscovy, Russia must:

- Expand north and east to secure a redoubt in climatically hostile territory that is protected in part by the Urals. This way, even in the worst-case scenario (i.e., Moscow falls), there is still a "Russia" from which to potentially resurge.
- Expand south to the Caucasus and southeast into the steppes in order to hamper invasions of Asian origin. As circumstances

allow, push as deeply into Central Asia and Siberia as possible to deepen this bulwark.

- Expand as far west as possible. Do not stop in the southwest until the Carpathians are reached. On the North European Plain do not stop ever. Deeper penetration increases security not just in terms of buffers; the North European Plain narrows the further west one travels making its defense easier.
- Manage the empire with terror. Since the vast majority of Russian territory is not actually Russian, a very firm hand is required to prevent myriad minorities from asserting regional control or aligning with hostile forces.
- Expand to warm water ports that have open-ocean access so that the empire can begin to counter the economic problems that a purely land empire suffers.

Given the geography of the Russian heartland, we can see why the Russians would attempt to expand as they did. Vulnerable to attack on the North European Plain and from the Central Asian and European steppes simultaneously, Russia could not withstand an attack from one direction — much less two. Apart from the military problem, the ability of the state to retain control of the country under such pressure was dubious, as was the ability to feed the country under normal circumstances — much less during war. Securing the Caucasus, Central Asia and Siberia was the first — and easiest — part of dealing with this geographic imbroglio.

The western expansion was not nearly so "simple." No matter how far west the Russians moved on the European plain, there was no point at which they could effectively anchor themselves. Ultimately, the last effective line of defense is the 400 mile gap (aka Poland) between the Baltic Sea and Carpathian Mountains. Beyond that the plains widen to such a degree that a conventional defense is impossible as there is simply too much open territory to defend. So the Soviet Union pressed on all the way to the Elbe.

At its height, the Soviet Union achieved all but its final imperative of securing ocean access. The USSR was anchored on the Carpathians, the Black Sea, the Caucasus and the Urals, all of which protected its southern and southwestern flanks. Siberia protected its eastern frontier with vast emptiness. Further to the south, Russia was anchored deeply in Central Asia. The Russians had defensible frontiers everywhere except the North European Plain, ergo the need to occupy Germany and Poland.

Strategy of the Russian Empire

The modern Russian empire faces three separate border regions: Asian Siberia, Central Asia and the Caucasus (now mostly independent states), and Western Europe.

First, Siberia. There is only one rail line connecting Siberia to the rest of the empire, and positioning a military force there is difficult if not impossible. In fact, risk in Russia's far east is illusory. The Trans-Siberian Railroad (TSR) runs east-west, with the Baikal Amur Mainline forming a loop. The TSR is Russia's main lifeline to Siberia and is, to some extent, vulnerable. But an attack against Siberia is difficult — there is not much to attack but the weather, while the terrain and sheer size of the region make holding it not only difficult but of questionable relevance. Besides, an attack beyond it is impossible because of the Urals.

East of Kazakhstan, the Russian frontier is mountainous to hilly, and there are almost no north-south roads running deep into Russia; those that do exist can be easily defended, and even then they dead-end in lightly populated regions. The period without mud or snow lasts less than three months out of the year. After that time, overland resupply of an army is impossible. It is impossible for an Asian power to attack Siberia. That is the prime reason the Japanese chose to attack the United States rather than the Soviet Union in 1941. The only way to attack Russia in this region is by sea, as the Japanese did in 1905. It might then be possible to achieve a lodgment in the maritime provinces (such as Primorsky Krai or Vladivostok). But exploiting the resources of deep Siberia, given the requisite infrastructure costs, is prohibitive to the point of being virtually impossible.

We begin with Siberia in order to dispose of it as a major strategic concern. The defense of the Russian Empire involves a different set of issues.

Second, Central Asia. The mature Russian Empire and the Soviet Union were anchored on a series of linked mountain ranges, deserts and bodies of water in this region that gave it a superb defensive position. Beginning on the northwestern Mongolian border and moving southwest on a line through Kyrgyzstan and Tajikistan, the empire was guarded by a north extension of the Himalayas, the Tien Shan Mountains. Swinging west along the Afghan and Iranian borders to the Caspian Sea, the empire occupied the lowlands along a mountainous border. But the lowlands, except for a small region on the frontier with Afghanistan, were harsh desert, impassable for large military forces. A section along the Afghan border was more permeable, leading to a long-term Russian unease with the threat in Afghanistan — foreign or indigenous. The Caspian Sea protected the border with Iran, and on its western shore the Caucasus Mountains began, which the empire shared with Iran and Turkey but which were hard to pass through in either direction. The Caucasus terminated on the Black Sea, totally protecting the empire's southern border. These regions were of far greater utility to Russia than Siberia and so may have been worth taking, but for once geography actually helped Russia instead of working against it.

Finally, there is the western frontier that ran from west of Odessa north to the Baltic. This European frontier was the vulnerable point. Geographically, the southern portion of the border varied from time to time, and where the border was drawn was critical. The Carpathians form an arc from Romania through western Ukraine into Slovakia. Russia controlled the center of the arc in Ukraine. However, its frontier did not extend as far as the Carpathians in Romania, where a plain separated Russia from the mountains. This region is called Moldova or Bessarabia, and when the region belongs to Romania, it represents a threat to Russian national security. When it is in Russian hands, it allows the Russians to anchor on the Carpathians. And when it is independent, as it is today in the form of the state of Moldova, then it can serve either as a buffer or a flash point. During the alliance with the Germans in 1939-1941, the Russians seized this region as they did again after World War II. But there is always a danger of an attack out of Romania.

This is not Russia's greatest danger point. That occurs further north, between the northern edge of the Carpathians and the Baltic Sea. This gap, at its narrowest point, is just under 300 miles, running west of Warsaw from the city of Elblag in northern Poland to Cracow in the south. This is the narrowest point in the North European Plain and roughly the location of the Russian imperial border prior to World War I. Behind this point, the Russians controlled eastern Poland and the three Baltic countries.

The danger to Russia is that the north German plain expands like a triangle east of this point. As the triangle widens, Russian forces get stretched thinner and thinner. So a force attacking from the west through the plain faces an expanding geography that thins out Russian forces. If invaders concentrate their forces, the attackers can break through to Moscow. That is the traditional Russian fear: Lacking natural barriers, the farther east the Russians move the broader the front and the greater the advantage for the attacker. The Russians faced three attackers along this axis following the formation of empire — Napoleon, Wilhelm II and Hitler. Wilhelm was focused on France so he did not drive hard into Russia, but Napoleon and Hitler did, both almost toppling Moscow in the process.

Along the North European Plain, Russia has three strategic options:

1. Use Russia's geographical depth and climate to suck in an enemy force and then defeat it, as it did with Napoleon and Hitler. After the fact this appears the solution, except it is always a close run and the attackers devastate the countryside. It is interesting to speculate what would have happened in 1942 if Hitler had resumed his drive on the North European

Plain toward Moscow, rather than shift to a southern attack toward Stalingrad.

2. Face an attacking force with large, immobile infantry forces at the frontier and bleed them to death, as they tried to do in 1914. On the surface this appears to be an attractive choice because of Russia's greater manpower reserves than those of its European enemies. In practice, however, it is a dangerous choice because of the volatile social conditions of the empire, where the weakening of the security apparatus could cause the collapse of the regime in a soldiers' revolt as happened in 1917.
3. Push the Russian/Soviet border as far west as possible to create yet another buffer against attack, as the Soviets did during the Cold War. This is obviously an attractive choice, since it creates strategic depth and increases economic opportunities. But it also diffuses Russian resources by extending security states into Central Europe and massively increasing defense costs, which ultimately broke the Soviet Union in 1992.

Contemporary Russia

The greatest extension of the Russian Empire occurred under the Soviets from 1945 to 1989. Paradoxically, this expansion preceded the collapse of the Soviet Union and the contraction of Russia to its current borders. When we look at the Russian Federation today, it is important to understand that it has essentially retreated to the borders the Russian Empire had in the 17th century. It holds old Muscovy plus the Tatar lands to the southeast as well as Siberia. It has lost its western buffers in Ukraine and the Baltics and its strong foothold in the Caucasus and in Central Asia.

To understand this spectacular expansion and contraction, we need to focus on Soviet strategy. The Soviet Union was a landlocked entity dominating the Eurasian heartland but without free access to the sea. Neither the Baltic nor Black seas allow Russia free oceangoing transport because they are blocked by the Skagerrak and the Turkish

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straits, respectively. So long as Denmark and Turkey remain in NATO, Russia's positions in St. Petersburg, Kaliningrad, Sevastopol and Novorossiysk are militarily dubious.

There were many causes of the Soviet collapse. Some were:

- Overextending forces into Central Europe, which taxed the ability of the Soviet Union to control the region while economically exploiting it. It became a net loss. This overextension created costly logistical problems on top of the cost of the military establishment. Extension of the traditional Russian administrative structure both diffused Russia's own administrative structure and turned a profitable empire into a massive economic burden.
- Creating an apparent threat to the rest of Europe that compelled the United States to deploy major forces and arm Germany. This in turn forced the Russians into a massive military buildup that undermined its economy, which was less productive than the American economy because of its inherent agricultural problem and because the cost of internal transport combined with the lack of ocean access made Soviet (and Russian) maritime trade impossible. Since maritime trade both is cheaper than land trade and allows access to global markets, the Soviet Union always operated at an extreme economic disadvantage to its Western and Asian competitors.
- Entering an arms race with much richer countries it could compete against only by diverting resources from the civilian economy — material and intellectual. The best minds went into the military-industrial complex, causing the administrative and economic structure of Russia to crumble.

In 1989 the Soviet Union lost control of Eastern Europe and in 1992 the Soviet Union itself collapsed. Russia then retreated essentially to its 17th century borders — except that it retained control of Siberia, which is either geopolitically irrelevant or a liability. Russia has lost all of Central Asia, and its position in the Caucasus has become tenuous. Had Russia lost Chechnya, its eastern flank would have been driven out of the Caucasus completely, leaving it without a geopolitical anchor.

The gap between Kazakhstan in the east and Ukraine in the west, like the narrowest point in the North European Plain, is only 300 miles wide. It also contains Russia's industrial heartland. Russia has lost Ukraine, of course, and Moldova. But Russia's most grievous geopolitical contraction has been on the North European Plain, where it has retreated from the Elbe in Germany to a point less than 100 miles from St. Petersburg. The distance from the border of an independent Belarus to Moscow is about 250 miles.

To understand the Russian situation, it is essential to understand that Russia has in many ways returned to the strategic position of late Muscovy. Its flank to the southeast is relatively secure, since China shows no inclination for adventures into the steppes, and no other power is in a position to challenge Russia from that direction. But in the west, in Ukraine and in the Caucasus, the Russian retreat has been stunning.

We need to remember why Muscovy expanded in the first place. Having dealt with the Mongols, the Russians had two strategic interests. Their most immediate was to secure their western borders by absorbing Lithuania and anchoring Russia as far west on the North European Plain as possible. Their second strategic interest was to secure Russia's southeastern frontier against potential threats from the steppes by absorbing Central Asia as well as Ukraine. Without that, Muscovy could not withstand a thrust from either direction, let alone from both directions at once.

It can be said that no one intends to invade Russia. From the Russian point of view, history is filled with dramatic changes of intention, particularly in the West. The unthinkable occurs to Russia once or twice a century. In its current configuration, Russia cannot hope to survive whatever surprises are coming in the 21st century. Muscovy was offensive because it did not have a good defensive option. The same is true of Russia. Given the fact that a Western alliance, NATO, is speaking seriously of establishing a dominant presence in Ukraine and in the Caucasus — and has already established a presence in the Baltics, forcing Russia far back into the widening triangle, with its southern flank potentially exposed to Ukraine as a NATO member — the Russians must view their position as dire. As with Napoleon, Wilhelm and Hitler, the initiative is in the hands of others. For the Russians, the strategic imperative is to eliminate that initiative or, if that is impossible, anchor Russia as firmly as possible on geographical barriers, concentrating all available force on the North European Plain without overextension.

Unlike countries such as China, Iran and the United States, Russia has not achieved its strategic geopolitical imperatives. On the contrary, it has retreated from them:

- Russia does hold the northern Caucasus, but it no longer boasts a deep penetration of the mountains, including Georgia and Armenia. Without those territories Russia cannot consider this flank secure.
- Russia has lost its anchor in the mountains and deserts of Central Asia and so cannot actively block or disrupt — or even well monitor — any developments to its deep south that could threaten its security.
- Russia retains Siberia, but because of the climatic and geographic hostility of the region it is almost a wash in terms of security (it certainly is economically).
- Russia's loss of Ukraine and Moldova allows both the intrusion of other powers and the potential rise of a Ukrainian rival on its very doorstep. Powers behind the Carpathians are especially positioned to take advantage of this political geography.
- The Baltic states have re-established their independence, and all three are east and north of the Baltic-Carpathian line (the final defensive line on the North European Plain). Their presence in a hostile alliance is unacceptable. Neither is an independent or even neutral Belarus (also on the wrong side of that line).

Broader goals, such as having a port not blocked by straits controlled by other countries, could have been pursued by the Soviets. Today such goals are far out of Russian reach. From the Russian point of view, creating a sphere of influence that would return Russia to its relatively defensible imperial boundaries is imperative.

Obviously, forces in the peripheral countries as well as great powers outside the region will resist. For them, a weak and vulnerable Russia is preferable, since a strong and secure one develops other appetites that could see Russia pushing along vectors such as through the Skagerrak toward the North Sea, through the Turkish Straits toward the Mediterranean and through La Perouse Strait toward Japan and beyond.

Russia's essential strategic problem is this: It is geopolitically unstable. The Russian Empire and Soviet Union were never genuinely secure. One problem was the North European Plain. But another problem, very real and hard to solve, was access to the global trading system via oceans. And behind this was Russia's essential economic weakness due to its size and lack of ability to transport agricultural produce throughout the country. No matter how much national will it has, Russia's inherently insufficient infrastructure constantly weakens its internal cohesion.

Russia must dominate the Eurasian heartland. When it does, it must want more. The more it wants the more it must face its internal economic weakness and social instability, which cannot support its ambitions. Then the Russian Federation must contract. This cycle has nothing to do with Russian ideology or character. It has everything to do with geography, which in turn generates ideologies and shapes character. Russia is Russia and must face its permanent struggle.

The Expanding Role of Russia's Youth Groups

June 8, 2011

Over the past two years, the Kremlin has been steadily shifting its focus from consolidation within Russia and in Moscow's former Soviet territory to planning for Russia's future. Part of that planning involves launching a series of massive economic projects involving modernization and privatization. A more controversial component of Moscow's plans is the use of the government's nationalist youth groups, like Nashi and the Young Guard, to create the next generation of leadership.

Nashi's Inception and Growth

The first step in Russia's becoming a Eurasian power once again was consolidation — years spent pushing Western influence out of Russia and its periphery and regaining control of Russia's society and strategic assets. The success of Moscow's social consolidation efforts became evident in 2005, when the Kremlin created a youth organization called Nashi. The Kremlin realized the Russian youths about to come of age were born after the Soviet era, when nationalism and the primacy of the state were intrinsic, and were more familiar with the Russian decline and the proliferation of foreign influence. Nashi was created to instill a sense of nationalism in the new generation and to counter any attempt the West might make at starting a pro-Western "color revolution" like those seen in Georgia and Ukraine.

The creation of Nashi — "Ours," in Russian — was spurred by then-Russian President Vladimir Putin and his loyalists. The group appealed mainly to lower-class ethnic Russians, who found a sense of community and purpose in the organization. Nashi also gave them an opportunity to network with a higher class and gain advantages for education and work.

The concept of Nashi is nothing new. Aspects of it have been widely compared to the Soviet Komsomol and even the Hitler Youth. Throughout the years, Nashi inspired and incorporated many other groups (both officially and unofficially). Among them are Nashi's official children's group, Teddy Bears, and the group Stahl, which calls itself "a weapon for Russia" and takes a more aggressive approach to anti-Kremlin elements. The Young Guard, which is an unofficial brother group of Nashi, is the most important youth group outside of Nashi. Officially, it is affiliated with Russia's ruling political party, United Russia. With an estimated membership of 150,000, the Young Guard started off differently from Nashi in that its members, previously nicknamed "golden youth," come from families already in power in the government or in state businesses. The Young Guard prepares its members to be active in the government.

Although these pro-Kremlin groups are not officially part of the government, they all receive a great deal of funding from the government. According to Stratfor sources, the Russian government spent approximately $250 million on Nashi in the organization's first year. Most large businesses in Russia are encouraged to donate to the youth programs, which means such donations help a business stay in the Kremlin's good graces. Members of eight different youth organizations — mostly Nashi, the Young Guard and Stahl — sit on the council of the Russian Federal Agency for Youth Affairs. Nashi's founder, Vasily Yakemenko, previously ran the government's Federal Youth Agency, and the two organizations share a press secretary.

As Nashi spread nationalism among Russia's up-and-coming generation, racism and xenophobia — particularly anti-Western and anti-Muslim sentiment — escalated among Russian youths. The major racist groups in Russia are the highly controversial Slavic Union, the People's National-Patriotic Orthodox Christian Movement and the banned Movement Against Illegal Immigration. Many Nashi members also belonged to these extremist groups because the organizations share a goal: a strong and nationalist Russia. This meant foreigners and non-Slavic or non-Orthodox populations were subject to intimidation and attack. As such, an uptick in radical xenophobic attacks has coincided with the burgeoning nationalist youth movements in Russia.

By 2007, Nashi had become a major movement in Russia, with more than 170,000 members. (Some estimates put its current membership near 600,000.) The group began to organize further, holding an annual summer camp attended by thousands of members. Putin and Russian President Dmitri Medvedev, along with other influential government members, visit the camps, which include seminars on Russian culture, business, politics and sports.

Also in 2007, the Kremlin began using Nashi as a tool not just to unite Russian youth in nationalism but also to act against many anti-Kremlin elements in Russia and beyond. Nashi organized activities targeting embassies, diplomats and international organization offices. Nashi's activities typically are nonviolent, but the group does have a government-trained paramilitary branch that has been used to ensure security and to incite riots. Nashi also took part in protests in Finland and riots in Estonia and is thought to have been responsible for the 2007 cyberattacks against Estonia.

Nashi's New Role

The purpose of Nashi and the other youth movements has changed from simply consolidating Russia's youth under the Kremlin to implementing social programs and preparing the next generation to lead the country. Nashi and the other youth organizations have taken on a large social role in the country by organizing large programs with goals ranging from promoting education to discouraging drinking. These programs, plus the unifying element of the youth groups, are preparing the new generation for leadership roles in the government, business and civil society. This is meant to keep Russia strong, nationalistic and united.

Seeing the success of the youth groups in Russia, the Kremlin has begun spreading the groups' influence. This summer, Nashi will hold a different summer camp comprising several thousand Nashi members and nearly a thousand Dagestanis in the Caucasus. Nashi has started a related youth movement in Chechnya called Ramzan, whose members call themselves "Putin's foot soldiers." The goal of these activities is to start spreading pro-Kremlin sentiment beyond ethnic Slavs and to consolidate the next generation in Russia's Muslim Caucasus republics under the Kremlin as a way of combating Islamist extremism after two decades of wars.

Russia has been spreading its youth groups into Europe as well, with both Nashi and Stahl forming partnerships in Serbia with various national parties' youth wings. The Russian youth groups have also expanded their social programs like the Orthodox Project, Project Steel and the Voluntary Youth Militia (also known as the DMD Brigade) to Serbia. The Russian groups hope to continue this expansion as part of Russia's overall foreign policy. Thus the Kremlin could use Russian youth groups to cooperate with other countries, and it would also have a presence in these other countries if Moscow believes aggression, rather than cooperation, is needed.

With the role of Nashi and the other Russian youth groups evolving and expanding in recent years, nationalism and consolidation in Russia appears to be steadfast. The youths involved in these organizations have been educated in the primacy of the Kremlin and the power of the Russian state and will become the next generation of Russian leaders, continuing on the path set by those who came before them.

Russia, Belarus, Kazakhstan: The Customs Union Agreement Deepens

July 1, 2011

On July 1, custom controls between Russia, Belarus and Kazakhstan will be lifted. This is the last official step toward implementing the customs union agreement the countries entered into Jan. 1, 2010, with the goal of creating a common economic space by January 2012. Control of customs will be transferred formally from the Russian-Kazakh and Russian-Belarusian borders to the union members' external borders, establishing a unified regulatory system and in theory eliminating internal trade boundaries.

With this change, the duties Belarus and Kazakhstan levy on goods imported from outside the customs union will be synchronized with the much higher duties Russia currently charges. This will significantly raise the cost of importing goods to Belarus and Kazakhstan and consequently increase both countries' dependence on the one trade partner unaffected by a tariff hike: Russia. In other words, while the official purpose of the move is to promote two-way trade within the union, in practice it will pull Kazakhstan and Belarus away from the global market and further into Russia's sphere of influence.

The Belarusian economy is based on heavy industry and manufacturing, and Minsk has generally aligned its tariffs more closely with Moscow's import duties to protect its domestic industry. Kazakhstan, however, depends heavily on oil revenues and, with little industrial production of its own, imposes far lower tariffs. Thus, the move to unify customs duties and the resulting rise in the price of imports from countries outside the customs union will be felt much more acutely in Kazakhstan than in Belarus.

That Minsk and Astana are willingly raising the price of their imports indicates just how powerful Russia has become. In fact, the basic structure of the customs agreement has always held clear economic disadvantages for Kazakhstan and Belarus. Prior to the customs union, shared Soviet-era infrastructure and design, not to mention geography, bound the economies of Russia, Belarus and Kazakhstan, so formalizing economic union was not difficult. When the union came into effect, both Belarus and Kazakhstan had been hit hard by the global recession of 2008-2009 and were seeking economic stability. Russia's ascendance in the region made it clear that Moscow alone could offer such stability. Initially, Minsk and Astana hoped that membership in the customs union would soon lead to better energy arrangements with Russia. However, Moscow has not agreed to any such concession.

As Belarus' and Kazakhstan's financial situations deteriorate, Russia's economic clout within the grouping continues to grow.

Belarus is facing a financial crisis. Minsk's continued political and economic isolation from the West leaves Russia as Belarus' only real option for a financial lifeline, which Moscow is more than happy to extend — in exchange for control of some of the country's key strategic assets. Kazakhstan has not fully recovered from the global recession. The country's much-indebted banking sector remains particularly vulnerable to a major crisis. If a worst-case scenario forced Astana to consider default, the likely cutoff from international credit markets would leave Kazakhstan with few if any financial options outside the customs union.

Full implementation of the customs-control change will take quite some time, but it is already having some effects. The anticipated increase in the cost of imports from the West is leading thousands of Belarusians to try to clear customs at checkpoints on the Belarusian-Polish border with expensive imports like cars before the new tariffs take effect. Belarusians in general believe this move toward reintegration will not have positive implications for the country's economy. However, such changes are also seen as necessary, and there has been no resistance from the general population.

There are also political and security-related implications to increasing economic integration with Russia, as evidenced by the reactions of the countries Moscow hopes will join the customs union: Kyrgyzstan, Tajikistan and Ukraine.

Russia's stated intention to help Kyrgyzstan and Tajikistan join shows that Moscow's strategic interests in the union are not solely — or even predominantly — financial. Kyrgyzstan and Tajikistan, likely the next two countries to acquire membership, have almost no economic relevance; neither country would be a net contributor to the union or a particularly lucrative market for Russian products. However, both states hold essential transit routes for illicit drugs coming from Central Asia into Russia. Under the aegis of the customs union, Moscow would have a formal structure and authority to impose far stricter regulatory controls upon the countries' extremely porous borders and root out institutional corruption. Ukraine, meanwhile, has a more viable economy than Kyrgyzstan or Tajikistan do.

Its strategic position and importance to Russia place it at the center of growing economic competition between Russia and the European Union. Moscow would like to increase its influence over Ukraine by having it join the customs union. Whether or not that happens, it is clear every step forward taken by the customs union strengthens Russia's position in the region.

Russia Rebuilding an Empire While It Can

October 31, 2011

U.S.-Russian relations seem to have been relatively quiet recently, as there are numerous contradictory views in Washington about the true nature of Russia's current foreign policy. Doubts remain about the sincerity of the U.S. State Department's so-called "reset" of relations with Russia — the term used in 2009 when U.S. Secretary of State Hillary Clinton handed a reset button to her Russian counterpart as a symbol of a freeze on escalating tensions between Moscow and Washington. The concern is whether the "reset" is truly a shift in relations between the two former adversaries or simply a respite before relations deteriorate again.

The reset actually had little to do with the United States wanting Russia as a friend and ally. Rather, Washington wanted to create room to handle other situations — mainly Afghanistan and Iran — and ask Russia for help. (Russia is aiding in moving supplies into Afghanistan and withholding critical support from Iran.) Meanwhile, Russia also wanted more room to set up a system that would help it create a new version of its old empire.

Russia's ultimate plan is to re-establish control over much of its former territories. This inevitably will lead Moscow and Washington back into a confrontation, negating any so-called reset, as Russian power throughout Eurasia is a direct threat to the U.S. ability to maintain its global influence. This is how Russia has acted throughout history in order to survive. The Soviet Union did not act differently from most of the Russian empires before it, and Russia today is following the same behavioral pattern.

Geography and Empire-Building

Russia's defining geographic characteristic is its indefensibility, which means its main strategy is to secure itself. Unlike most powerful countries, Russia's core region, Muscovy, has no barriers to protect it and thus has been invaded several times. Because of this, throughout history Russia has expanded its geographic barriers in order to establish a redoubt and create strategic depth between the Russian core and the myriad enemies surrounding it. This means expanding to the natural barriers of the Carpathian Mountains (across Ukraine and Moldova), the Caucasus Mountains (particularly to the Lesser Caucasus, past Georgia and into Armenia) and the Tian Shan on the far side of Central Asia. The one geographic hole is the North European Plain, where Russia historically has claimed as much territory as possible (such as the Baltics, Belarus, Poland and even parts of Germany). In short, for Russia to be secure it must create some kind of empire.

There are two problems with creating an empire: the people and the economy. Because they absorb so many lands, Russian empires have faced difficulties providing for vast numbers of people and suppressing those who did not conform (especially those who were not ethnic Russians). This leads to an inherently weak economy that can never overcome the infrastructural challenges of providing for the population of a vast empire. However, this has never stopped Russia from being a major force for long periods of time, despite its economic drawbacks, because Russia often emphasizes its strong military and security apparatus more than (and sometimes at the expense of) economic development.

Maintaining a Strong State

Russian power must be measured in terms of the strength of the state and its ability to rule the people. This is not the same as the Russian government's popularity (though former president and current Prime Minister Vladimir Putin's popularity is undeniable); it is the ability of the Russian leadership, whether czar, Communist Party or prime minister, to maintain a tight grip on society and security. This allows Moscow to divert resources from popular consumption to state security and to suppress resistance. If the government has firm control over the people, popular discontent over politics, social policies or the economy do not pose a threat to the state — certainly not in the short term.

It is when the Russian leadership loses control over the security apparatus that Russian regimes collapse. For example, when the czar lost control of the army during World War I, he lost power and the Russian empire fell apart. Under Josef Stalin, there was massive economic dysfunction and widespread discontent, but Stalin maintained firm control over both the security apparatuses and the army, which he used to deal with any hint of dissent. Economic weakness and a brutal regime eventually were accepted as the inevitable price of security and of being a strategic power.

Moscow is using the same logic and strategies today. When Putin came to power in 1999, the Russian state was broken and vulnerable to other global powers. In order to regain Russia's stability — and eventually its place on the global stage — Putin first had to consolidate the Kremlin's power within the country, which meant consolidating the country economically, politically and socially. This occurred after Putin reorganized and strengthened the security apparatuses, giving him greater ability to dominate the people under one political party, purge foreign influence from the economy and build a cult of personality among the people.

Putin then set his sights on a Russian empire of sorts in order to secure the country's future. This was not a matter of ego for Putin but a national security concern derived from centuries of historic precedent.

Putin had just seen the United States encroach on the territory Russia deemed imperative to its survival: Washington helped usher most Central European states and the former Soviet Baltic states into NATO and the European Union; supported pro-Western "color revolutions" in Ukraine, Georgia and Kyrgyzstan; set up military bases in Central Asia; and announced plans to place ballistic missile defense installations in Central Europe. To Russia, it seemed the United States was devouring its periphery to ensure that Moscow would forever remain vulnerable.

Over the past six years, Russia has pushed back to some degree against Western influence in most of its former Soviet states. One reason for this success is that the United States has been preoccupied with other issues, mostly in the Middle East and South Asia. Moreover, Washington has held the misconception that Russia will not formally attempt to re-create a kind of empire. But, as has been seen throughout history, it must.

Putin's Plans

Putin announced in September that he would seek to return to the Russian presidency in 2012, and he has started laying out his goals for his new reign. He said Russia would formalize its relationship with former Soviet states by creating a Eurasia Union (EuU); other former Soviet states proposed the concept nearly a decade ago, but Russia is now in a position in which it can begin implementing it. Russia will begin this new iteration of a Russian empire by creating a union with former Soviet states based on Moscow's current associations, such as the Customs Union, the Union State and the Collective Security Treaty Organization. This will allow the EuU to strategically encompass both the economic and security spheres.

The forthcoming EuU is not a re-creation of the Soviet Union. Putin understands the inherent vulnerabilities Russia would face in bearing the economic and strategic burden of taking care of so many people across nearly 9 million square miles. This was one of the Soviet Union's greatest weaknesses: trying to control so much directly. Instead, Putin is creating a union in which Moscow would influence foreign policy and security but would not be responsible for most of the inner workings of each country. Russia simply does not have the means to support such an intensive strategy. Moscow does not feel the need to sort through Kyrgyz political theater or support Ukraine's economy to control those countries.

The Kremlin intends to have the EuU fully formed by 2015, when Russia believes the United States will return its focus to Eurasia. Washington is wrapping up its commitments to Iraq this year and intends to end combat operations and greatly reduce forces in Afghanistan, so by 2015, the United States will have military and diplomatic attention to spare. This is also the same time period in which the U.S. ballistic missile defense installations in Central Europe will break ground. To Russia, this amounts to a U.S. and pro-U.S. front in Central Europe forming on the former Soviet (and future EuU) borders. It is the creation of a new version of the Russian empire, combined with the U.S. consolidation of influence on that empire's periphery, that most likely will spark new hostilities between Moscow and Washington.

This could set the stage for a new version of the Cold War, though it would not be as long-lived as the previous one. Putin's other reason for re-establishing some kind of Russian empire is that he knows the next crisis to affect Russia most likely will keep the country from ever resurging again: Russia is dying. The country's demographics are among some of the world's worst, having declined steadily since World War I. Its birth rates are well below death rates, and it already has more citizens in their 50s than in their teens. Russia could be a major power without a solid economy, but no country can be a global power without people. This is why Putin is attempting to strengthen and secure Russia now, before demographics weaken it. However, even taking its demographics into account, Russia will be able to sustain its current growth in power for at least another generation. This means that the next few years likely are Russia's last great moment — one that will be marked by the country's return as a regional empire and a new confrontation with its previous adversary, the United States.

Russia's Shifting Political Landscape

February 1, 2012

Russia's political landscape has been relatively calm and consolidated for the past decade under former President and current Russian Prime Minister Vladimir Putin. However, recent months have seen instability rise sharply, with a purge in the government, a shift in parliamentary election results and large protests in the streets. None of these is new to Russia, but these and other factors are converging and creating changes in Russia's political landscape.

When Putin came to power in 1999, he ruled a country that was in utter political disarray, economically broken and threatened by internal and external forces. He aggressively consolidated the country politically, economically and socially and quashed the security threats. The country rallied around him as Russia's "savior," a sentiment that in recent years evolved into a cult based on the belief that Putin is the sole heartbeat of the country.

But Russia cannot survive indefinitely under one ruler; historically, internal dissent has risen and fallen inside the inherently unstable country. Such dissent had been under control for the last decade, allowing the country to strengthen. But now dissent is on the rise again, both outside the Kremlin and within Putin's circles of power. All of this comes as Russia is facing economic instability and national security concerns, and Russia's next presidential election — in which Putin is running — is a mere month away.

Kremlin Turmoil and Outside Pressure

The first shift in Russia's political landscape occurred because Putin's complex network of clans inside the Kremlin has utterly collapsed. When he came to power, Putin understood that he needed to set up a group of powerful loyalists to help with the aggressive consolidation needed to rebuild a strong Russia while planning a strategy for the future that involved many more liberal policies — two seemingly contradictory goals. This led to the creation of two clans: the security hawks of the siloviki and the more liberal-minded civiliki. The clan-based system in the Kremlin was also meant to keep the two groups in competition with each other so neither would directly challenge Putin's authority. But the pressures related to a shift in economic policies, economic volatility, a failure in social policy regarding new political groups and personality conflicts all contributed to a massive breakdown in both clans. Putin had to scramble to keep his government functional as his loyalists pursued their own agendas, joined opposition groups or left the government altogether.

This breakdown has left Putin without a strong and focused team to help him handle the other shift in Russia's political scene: the rise of anti-Kremlin groups. The first real hint that these groups were gaining significance was the December 2011 parliamentary elections, in which Putin's United Russia party lost its supermajority in the Duma and opposition parties, particularly the Communist Party, nearly doubled their presence. The week after the elections, protests against alleged election fraud began stirring, culminating in a demonstration Dec. 24 that drew 80,000 participants — one of the largest protests Russia has seen since Putin took power. The anti-Kremlin protest movements are not linked in their ideologies, roots, strategies or goals, but they have come together in mass demonstrations against the Kremlin, catching the attention of both Putin and the outside world.

Anti-Kremlin sentiment stems from many issues. Years of relative stability have led to a sense of political, social and economic security, which has fostered a belief among some Russians that the country no longer needs a "savior" like Putin. Prolonged periods of high energy prices and a strengthening Russian economy have created a new growing middle class, something not really seen in Russia before. Furthermore, much of the generation now coming of age was not raised under the Soviet Union or during the chaotic years immediately following its collapse. An extremist brand of nationalism has also risen across the country, leading more Russians to have no interest in a balanced government. Putin's government did not anticipate these shifts in recent years, and that failure has fed into dissent from within United Russia and the further rise of anti-Kremlin sentiment.

When all of these crises seemed to erupt within a few months, Putin's reaction was uncharacteristically slow. But now he is beginning to form a strategy to deal with the crises in the short term and formulate long-term political and social policies to take into account the shifts in Russia. This kind of adjustment has occurred cyclically throughout Russian history as the country has shifted between stability and chaos.

Putin's Perception Issue

However, these crises are creating problems of perception for Putin and Russia, and the longer Putin takes to resolve these crises, the weaker he will appear to the rest of the world. Putin needs to be seen as a strong and stable leader in order to effectively reorganize his loyalists and manage the strengthening anti-Kremlin groups.

The perception of a weaker Putin — and a weaker Russia — could also affect how well Russia handles other large challenges in the areas of economics and security. Political volatility and the perception that Putin is weakening is discouraging investors in Russia, which was depending on outside investment in order to launch its massive modernization and privatization programs. The perception of a weaker Kremlin will also affect Russia's resurgence in its former Soviet states and attempts to increase pressure in its near abroad, particularly Central Europe. Other countries, especially the United States, have taken advantage of the instability inside Russia and are attempting to exploit the image that Moscow is not as strong or powerful as it claims to be. As Russia continues to pressure Central Europe and Washington's interests in the region, Moscow cannot allow internal issues to erode its position.

Ultimately, the question is not whether Putin can handle the domestic instability and shifting political landscape inside the country, but how long it will take him to rein it in. With elections on the horizon, and the perception of Russia's — and Putin's — power eroding, the Russian leader will have to get his house in order before he can tend to grander schemes for the country.

A Breakdown of the Kremlin Clans

One of the issues causing — and prolonging — Russia's current political instability is the complete breakdown of the Kremlin's power clans.

When Prime Minister Vladimir Putin came to power in 1999, he began creating a complex organization comprising many ambitious and powerful people to help him rule the country. Putin understood that he would need a mix of people who could handle Russia's need for tight security and control in the short term but strategize for a more modern and liberal economy in the future — seemingly conflicting aims, but Putin saw both as necessary to address the problems facing the country.

Though there are countless small groups and loyalties among those in the Kremlin, Putin's system can be divided essentially into two clans — the siloviki and the civiliki. Two very ambitious (and at times ruthless) men ran these clans: Deputy Prime Minister Igor Sechin, who ran the siloviki, and Vladislav Surkov, who ran the civiliki and was recently demoted from first deputy chief of staff. Each man controlled large portions of government bureaucracy, state companies and critical instruments of control throughout Russia. It was an arrangement in which two groups with starkly different backgrounds, ideologies and strategies would be played off each other, and Putin's personal ties to both groups would put him in a position of ultimate power. This allowed him to select which policies to put forward that might not be too appealing to certain elements within the Kremlin. It also kept these ambitious politicians concentrated on each other and not on Putin, who was seen as the great stabilizer.

The Clans

The siloviki clan primarily consists of security hawks and former operatives with the KGB (now known as the Federal Security Service, or FSB) — like Putin. The siloviki primarily fall under the control of Sechin, who played a major role in centralizing the Russian economy and ousting foreign influence over the past decade. Political power brokers like National Security Chief Nikolai Patrushev, Duma Speaker Boris Gryzlov (who has since been removed from his position) and NATO envoy Dmitri Rogozin bolstered Sechin's strength. The siloviki's goal has been to create a tightly controlled, globally strong Russia at the expense of individual rights and democracy. Over the past decade, the siloviki arguably have been the stronger of the two clans, implementing policies of consolidation in Russian business, uniting politically under one party (United Russia) and aggressively pushing Russian influence into Moscow's former Soviet sphere.

The siloviki's rival clan, the loosely organized civiliki, comprises liberal-minded economists, social strategists and non-KGB-linked politicians who worked with Putin in St. Petersburg in the 1990s. The civiliki are not as consolidated in their views as the siloviki; essentially, the factor uniting them is that they are not siloviki. Though the civiliki clan has evolved during the past decade, Vladislav Surkov — who exerts most of his power behind the scenes and who has worked closely with Sechin in the past — has run it recently. Although their agendas vary, the civiliki primarily want to create more liberal and complex financial, economic and social policies for Russia — not really pro-Western policies, but policies that are more focused on social and economic needs than security. Though sidelined for most of the 2000s, at the end of the previous decade the civiliki's plans started to gain prominence.

The Shift and Breakdown of the Clans

Although the clans' conflict has been contained over the last decade, the struggle to maintain a balance between them has always been an issue. Though the siloviki's policies for Russia mostly dominated the 2000s, it was a civiliki that Putin chose to succeed him as president in 2008 in an attempt to maintain the balance. And as Russia grew stronger and more stable both internally and in its near abroad, the Kremlin was able to shift its focus from Russia's security to its future — meaning that a few more liberal social and economic policies could be considered. The problem was that this political shift threw the Kremlin clans off balance. It came as Russia was about to face ripple effects from the European financial crises, and as a change in political sentiment in Russia — the rise of the Communists and protest movements — began. The problem with the Kremlin clans' balance might have been handled more easily if not for these other factors, but the timing of these events led to a complete breakdown of the clan system.

Although numerous political moments over the past two years can be said to have led to the Kremlin crisis, a few crucial events were the major contributors to the imbalance:

- When the civiliki's policy suggestions began taking precedence, the Kremlin had to rein in the siloviki's ideology of economic centralization and their control over major businesses. This threw the siloviki into disarray and displaced most of their power base. It was during this time that Sechin reportedly became ill and stepped out of the spotlight, leaving numerous political heavyweights to struggle for dominance.
- The civiliki were put in charge of economic projects (like the modernization and privatization programs) and social programs (such as the All-Russia People's Front and "managed democracy") to prepare the country socially and politically for the future. But the civiliki — who never were really united — began fighting among themselves about how to implement

these changes. As the financial and social crises began erupting in Russia, the civiliki's plans started to show cracks. This is where public disagreements between the civiliki chief, Surkov, and Russian President Dmitri Medvedev started (as well as the very public row between Medvedev and then-Finance Minister Alexei Kudrin).

- The Kremlin's social and political policies engineered by Surkov failed to take into account the growing anti-Kremlin sentiment among the population. Putin had put an exorbitant amount of trust in Surkov's schemes to win over the people, contain dissent and maneuver through the Kremlin clan politics throughout the years. The most recent plan, "managed democracy," was meant to smooth Putin's transition back into the presidency by creating smaller "independent' political parties that the Kremlin controlled behind the scenes, giving the appearance of a more democratic Russia. The scheme failed, as it was obvious to those outside and inside the Kremlin that this did nothing to make room for actual independent sentiment. This was one of the many failures that prompted dissent within Putin's political party, United Russia, and helped spark the rise of the Communists and the various protest movements.

With the siloviki already struggling, the civiliki collapsed. Surkov was demoted, Kudrin left the government to work with the protesters, and the civiliki were left without a leader or organization or much power. Both clans broke down completely at a time when the anti-Kremlin movements started to rise and elections were on the horizon.

Putin Reacts

Putin's reaction to these circumstances was slower than his responses to similar incidents in the past. Previously, when there was dissidence in the streets, Putin had a loyal team that would respond, and when there were problems within the Kremlin typically he had one clan organized to make up for the other's shortfalls. In this instance, Putin seems to have used a twofold response: He used short reactionary fixes to quell the instability to a degree while he began designing new economic and social policies and rebuilding the Kremlin clans. The quick fixes he employed were as follows:

- Putin reacted to the decline of his party — and rise of the Communist Party — in the recent Duma elections by sacking one of his party's senior members, Gryzlov, as speaker of the Duma. Putin replaced Gryzlov with another, more moderate member of the siloviki who is technically adept at handling a parliament in which United Russia lost the supermajority: Sergei Naryshkin.
- In response to the mass protests, Putin drastically demoted his social and political strategist, Surkov, for the failure of the "'managed democracy'" plan among others. Surkov publicly acknowledged his own failures. However, Putin cannot get rid of the former civiliki leader altogether because, although he might have been abandoned by most of his clan, the one portfolio he holds could be dangerous to all of Russia if left unmanaged: Chechnya. Surkov is the handler for Chechen President Ramzan Kadyrov, who is keeping the instability in the Caucasus at a low simmer for the time being.
- Putin has also answered the rise of anti-Putin and anti-Kremlin sentiment in the country by allowing some political and social reforms to take place. He has also reined in many of the siloviki who would prefer to respond to dissent by violently cracking down and arresting the protesters en masse and clamping down on the Communists by arranging a "change in management" for the party.

Putin is buying time to start grappling with the much deeper issues of forming new social, political and economic policies and rebuilding a network among his loyalists and Kremlin elites. His previous plan took a decade to reach fruition, but he does not have that long this time, as Russia's presidential election will be held March 4.

Putin is starting with a new social and political policy being designed by Surkov's replacement, Vyacheslav Volodin. Surkov's strategy had always been extremely complex, with a great deal of emphasis on appearance, but Volodin seems much more straightforward in how to handle the rise of anti-Kremlin groups in the country. Stratfor sources in Moscow have said that Volodin has been given until mid-February — just weeks before the election — to formulate a plan.

A new economic policy to accommodate the anti-Kremlin movements' demands for a policy change and the rippling crises from Europe being felt in Russia appears to be on hold. The reason for this is that during the clans' breakdown, the Kremlin's chief financial mind — Kudrin — defected from Putin's side. There are other economists in the government, but Kudrin orchestrated Russia's growth and stability over the past decade. He also understands the need to balance liberal economics with Russia's national security. Stratfor sources have indicated that Putin wants Kudrin back in the government. Kudrin has named his price to return: the premiership, so that he does not have to answer to anyone but Putin. It is not clear how this would be received, since Kudrin has been flirting with anti-Kremlin movements and the premiership had long been promised to Medvedev.

Rebuilding a clan system in the Kremlin is more problematic, as there are many powerful personalities with different agendas to consider. The civiliki have shattered into countless factions with no uniting figurehead. Should Kudrin come back to the fold, he could be savvy enough to lead a new version of the civiliki, though it is too soon to tell. Just recently, the siloviki seem to be reconsolidating. Sechin is working again, and the clan has no real opposition to its agenda. In order to ensure that the siloviki do not make too many opportunistic moves, Putin has brought back an older senior leader of the siloviki who understands that a balance in the Kremlin is needed: Sergei Ivanov.

Putin is rebuilding his clan system as well as he can while juggling Russia's other problems. On Jan. 23, Putin vowed that once the presidential election had passed, he would make far-reaching personnel changes. He said this does not mean everyone will be fired, but there would be some major reshuffles. In the past, Putin has not been squeamish about sacking some of the country's most powerful figures, and he could consider this the best time to set up a system around him to help him lead an increasingly complex Russia for years to come.

Rising Anti-Kremlin Movements

The second large trend reshaping Russia's political landscape is the strengthening of numerous movements opposed to Russian Prime Minister Vladimir Putin or the Kremlin. The periodic rise and fall of political dissidence is a Russian tradition. In the past decade, political sentiment has focused on Putin as Russia's "savior," a phenomenon that grew into something like a cult of personality centered on Putin. Now that Russia does not need saving anymore, though, the narrative has changed. Increasing dissent has garnered international media attention and prompted the Kremlin to take another look at politics on the other side of its high red brick walls.

Opposition political groups have strengthened and become important for numerous reasons. First, Russia no longer faces the threats of imminent economic collapse or major security issues. Second, Russia is undergoing a generational shift; the Soviet Union fell more than 20 years ago, which means the generation of Russians coming into their 20s now have a vastly different worldview from that of their predecessors. Furthermore, the increasing use of social media in Russia could be facilitating more efficient communication between and within dissenting groups.

Contributing to the dissent is a sharp increase in nationalism. Generally, over the past decade nationalist groups like the Kremlin-created Nashi youth group and Young Guard political group were considered favorable for Putin. However, in recent years, more extreme breeds of nationalists have re-emerged — some who long for more traditional Russian values instead of the balance of policies

Putin recently implemented. Ultranationalists wanting policies that limit immigration and Islam, the so-called Russia for Russians movement and others, are also growing.

The proliferation of groups that do not share the Kremlin's view has translated into large protests in the streets and losses for Putin's ruling party, United Russia, in recent parliamentary elections. Putin has begun taking these groups into account after largely ignoring them for the past decade and is shifting his policies to accommodate them. However, these anti-Kremlin groups must be examined individually to determine whether they can actually threaten Putin's hold on power.

The Communists' Re-Emergence

The anti-Kremlin groups' rise became noticeable in Russia's Dec. 4, 2011, parliamentary elections, when Putin's United Russia party won just under 50 percent. The other three political parties in the Duma — the Communists, Just Russia and the Liberal Democrats — all benefited from United Russia's decline, but the Communist Party made the most important gain. The successor to the Communist Party of the Soviet Union, the current Communist Party has always been a factor in post-Soviet Russian politics. The Communists share their Soviet-era parent party's ideology of nationalism. The party was fairly prominent in the 1990s, but its popularity dwindled during Putin's rule. For most of the past decade, the Communists held 11-12 percent of the seats in the Duma, but in the 2011 parliamentary elections they nearly doubled their representation, winning 20 percent of the parliamentary seats.

The more traditional and security-oriented voters who had become disenchanted with United Russia and Putin's policies looked to the Communist Party as one of their chief alternatives. This led to the party's rise in the Duma and made the Communists' leader, Gennady Zyuganov, second in the polls for the upcoming presidential election behind Putin (though it is not a close second).

The Communist Party has tried to differentiate itself from the more liberal groups and the ultranationalists in the protest movements and from other political parties in the Duma. However, the Communists can work with those groups, such as the ultranationalist Liberal Democratic Party, in the Duma when it benefits the Communists. The Communist Party and Zyuganov have been communicating with the protest movements in recent weeks, though the Communists' and protesters' ideologies are nearly polar opposites and thus a grand alliance against Putin would be unstable at best.

The Protesters

Protest movements, which have been seen in Russia only in isolated incidents or, in those cases of regular protests, with small numbers of supporters during Putin's rule are also on the rise. The current movements and personalities involved in protests are not united in their roots, goals or activities. The various groups have risen up for different reasons: corruption, growing anti-Kremlin sentiment, changes in wealth distribution, a generational shift, the proliferation of social media and increasing ultranationalism.

Protests have become more common since the end of 2010, and most have been ultranationalist demonstrations. There have been many ultranationalist movements in Russia, though one of the largest is the Russia for Russians movement, which was created at the end of the 19th century. The movement gained momentum at the end of 2010, and the Levada Center polling agency recently reported that 60 percent of Russians agree with the movement's sentiments, which are hostile to Muslims and minorities as well as the government's role in supporting them. As Russia for Russians marches increased in 2010 and 2011, the movement gained support from more extreme groups. In October 2011, on Russia's National Unity Day, the Nashi youth movement publicly separated itself from the Russia for Russians group, breaking many of the Kremlin's links to the movement. During a march in November, representatives of the ultranationalists declared that they were shifting their focus to electoral corruption and political matters and would start protesting to demand political reforms after the parliamentary elections.

Of course, the ultranationalists are not the only protesters. However, there is a large overlap between the new protest movements and the old ones, and the lines separating the protest movements are not clear. The ultranationalists have been joined by large groups of liberals, communists, anarchists and others, all bound by an overall anger toward Russia's current political situation.

Though the protest movements are many in number, they are still a relatively small segment of the population — 80,000 participated in the latest organized protest on Dec. 24, 2011, and some Stratfor sources project that 100,000 could attend the Feb. 4 protest in Moscow. Stratfor has attempted to categorize the various protest movements into four loosely defined groups based more on ideology and roots than on goals and activities (and there is much overlap among these categories):

- Alexei Navalny's followers: The largest of the protest movements began as an indefinable mass but recently rallied behind a lawyer and blogger named Alexei Navalny. Navalny gained popularity in recent years as a whistleblower on government corruption but has become the face of the protest movement (although he does not officially lead these groups). His followers come from various segments of society — the young generation, liberals, the emerging middle class and the ultranationalists (Navalny has been accused of ultranationalism). His followers' diverse goals include ending corruption, ousting Putin's regime, creating political reform and ending government subsidization of the Muslim Caucasus. Navalny's beliefs do not diverge far from Putin's in the area of foreign policy, as he wants Russia to be the center of the region.
- The professional activists: Smaller factions with a great deal of overlap with Navalny's supporters seem to protest almost as a profession. Made up of intellectuals like Boris Akunin and Kseniya Sobchak and revolutionaries like Sergei Udaltsov and

Evgenia Chirikova, these groups have not formulated a political agenda. They demonstrate against the Kremlin rather than making specific demands. In recent weeks, these groups have become more organized, forming into political groups like the League of Voters (designed to monitor election fraud) and Left Front (an anti-capitalism and anti-Kremlin group).

- Established opposition groups: Quite a few opposition groups and their leaders have been working against Putin for years (and some have been protesting the Kremlin since former President Boris Yeltsin was in power). They have arranged protests and formed political parties and coalitions during much of Putin's rule. Notable leaders among these factions are Boris Nemtsov (Union of Right Forces), Mikhail Kasyanov (People's Democratic Union), Garry Kasparov (Other Russia coalition) and Vladimir Ryzhkov (Republican Party of Russia). Their names were associated with anti-Putin sentiment long before the current protest movements started. However, many of these individuals are not trusted among the other groups — and much of the Russian population — because they were either associated with Yeltsin's disastrous economic plans (like Nemtsov) or once worked for Putin (like Kasyanov).
- Dissenters from Putin's camp: A few personalities in the protest movement either came from Putin's inner circle or went along with his policies until recently. Former Finance Minister Alexei Kudrin and oligarch Mikhail Prokhorov both joined the anti-Kremlin movements, though their motives are unclear. After a very public break with the Kremlin, Kudrin is attempting to position himself as the broker between the protesters and the Kremlin and has met with various protest factions already. Prokhorov wants to become the protesters' candidate in the upcoming presidential election. However, both are viewed with suspicion among various segments of the protest movement who believe they have not truly broken away from the Kremlin's political machine.

Crossover Between the Communists and Protesters

Until recently, the Communist Party and the protest movements had little crossover. There is a vast difference between the groups' ideologies. The Communists are mostly from an older rural population and want the economy's strategic sectors nationalized; as Communist leader Zyuganov said, he wanted a re-Stalinization of Russia. The protesters are not as uniform demographically, but most are from a younger, Internet-savvy urban cohort that believes in liberal economic policies. Some of the protest movements, like some ultranationalists, Left Front and Other Russia, do have links to the Communist Party, though most protesters are on the other end of the political spectrum from the vestigial Soviet party.

However, on Jan. 17, the Communist Party and the Left Front created a pact to work together to defeat Putin in the upcoming election. This kind of crossover is important because the protest movement has no strong political or policy machine or representation in government — something it could find via cooperation with the Communists. Stratfor sources say Zyuganov does not want to shift the Communist position but hopes to access the protesters' venues — and votes — in the future. This is not likely to be an easy alliance; Zyuganov will have to be careful not to alienate his own base by supporting unrest and violence in the country, and the Left Front's leader has said he would only support Zyuganov as a "short-term transitional president," which does not mesh with Zyuganov's long-term plans if he should gain power.

The Kremlin's Response

The Russian government is not ignoring the situation as it did in the past when protests were smaller. Moreover, there have been relatively few crackdowns on the protests; the government has given permits and deployed security for the demonstrations. The Kremlin has reacted to the dissidence rapidly within its own walls with a series of sackings and reshuffles among the government elite. The Kremlin also has dealt with the Communists in the Duma, giving the party chairs of some coveted legislative portfolios, like defense.

In order to try to neutralize the anti-Kremlin sentiment, the government is accepting quite a few of the reforms the protesters and Communists have demanded — or at least it appears that the government is acquiescing to those demands. Some of the reforms being enacted only partially meet the protesters' demands, and some do not take effect for another year. Furthermore, each of the reforms had already been under discussion since summer 2011 but received approval right after the protesters called for them. Timing aside, these reforms represent a major concession to the protesters and Communists. The three main reforms are as follows:

- Direct voting for regional governors: Russian President Dmitri Medvedev sent a bill to the Duma on Jan. 16 to reintroduce elections for local governments. Since 2004, the Russian president selected local governors under the guise of protecting national security after the Beslan school siege. The new bill will allow registered political parties to nominate candidates for regional governors for five-year terms after "voluntary consultations" with the president (there has not been an explanation of how voluntary consultations will be carried out). Candidates who are not nominated by a party or who have not met with the president will have to collect signatures in order to run, and the president retains the ability to fire governors for corruption, failure to perform duties or conflicts of interest. The bill could take effect as early as May.
- Restructuring the mandates for certain constituencies in the Duma: A measure introducing proportional representation from 225 constituencies that elect Duma deputies from parties that have cleared the 7 percent threshold is under discussion. The other 225 deputies are elected from single-mandate constituencies. This could mean that all 450 deputies will be elected by single-mandate, or another plan could be introduced. Talks on this issue are still in the early stages.

- Simplifying the registration of parties: Starting in 2013, the threshold for registering to become a political party has been drastically lowered. Currently, a party must have 45,000 members, 50 percent of Russia's regions must have at least 450 members in them and the other 50 percent of the regions must have no fewer than 200 members. It is a list of rules that is extremely convoluted and has prevented most aspiring political parties from registering. The new law is that a political party must have at least 500 members and represent no less than 50 percent of the regions (in theory, 10 members per region). Also, the bill abolishes the rule that to participate in the Duma elections non-parliamentary parties are to collect at least 150,000 signatures in their support. This could create a rapid upsurge in political activity in Russia, though also possibly a more chaotic and confusing opposition.

As the demonstrations continue, the protesters will present new demands to the Kremlin, and the government may answer some and ignore others. The Kremlin is also trying to keep the protest groups from uniting and would like to see them co-opted by Kremlin-friendly personalities like Kudrin. At the same time, the Kremlin wants to prevent certain personalities with a great deal of support from the protesters, such as Navalny, from moving beyond protests and forming their own political platforms.

Next Steps for Anti-Kremlin Groups

Major protests have been announced for Feb. 4 (one month before Russia's presidential election) and March 11 (one week after the election), with a few more demonstrations possible in between. As time goes on, the Communists and protesters have four options:

- Dissolve: The Communist Party could return to its comfortable place as the second-largest party in the Duma and not alienate the Kremlin further, while the protests fade.

- Become co-opted: The Kremlin could ease or manipulate pro-government individuals into position among the protesters and Communists.
- Strengthen: Communist leader Zyuganov could gain momentum ahead of presidential elections while the number of protesters grows into the millions, challenging the security of the state.
- Evolve: The Communists could continue working with the protest movement and the Kremlin without bending to either, while the protesters form small political parties that eventually gain some seats in the government.

Barring an unprecedented consolidation among the anti-Kremlin movements, the factions likely will evolve. The planned protests on Feb. 4 and March 11 will attract large numbers of demonstrators, but after that the numbers could begin dwindling. Then the Communists could return to their opposition role in government and the protesters could start organizing into smaller parties for future elections but not unite into a large opposition movement. This would not be a complete victory for Putin and the Kremlin (though the current regime would remain in power), as Putin has already had to change his policies to account for the shifting political landscape.

Putin's Challenges

Although Russian leader Vladimir Putin likely will retain control after the March presidential election, he has recognized that the Russian political landscape has shifted since the beginning of his more than decadelong rule. Putin has acknowledged that the time when he was needed to consolidate or "save" the country from instability and insecurity has passed. However, he also understands that Russia is under constant threat because of its fractious nature and incessant pressure from abroad.

Therefore, Putin will seek to strike a balance between accepting a less consolidated state — allowing the Communists and the protest movements to have some sort of say — and keeping the Kremlin united under himself and populated with strong minds capable of weathering the challenges ahead. It will not be an easy task, and transitions such as this never go smoothly, so Russia's political landscape will remain volatile in the near term.

The real issue is not whether Putin can handle the struggles, but how long it takes him to sort through them and how much damage his image will sustain in the meantime. This is important because Putin is dealing with numerous issues other than domestic politics. When political instability struck Russia in the past, Putin tackled each problem in order; this time, several problems are occurring all at once, and in the lead-up to a presidential election. Putin needs a strong, united and focused team to tackle the numerous challenges facing Russia, but the anti-Kremlin movements are preventing the formation of a united group that can create effective solutions for the country. In the coming months, as Russia's political volatility continues and Putin examines his strategy, the perception that he is becoming less powerful will continue both inside and outside Russia. The perception of Putin as weak is important, as it could complicate some issues Moscow is dealing with this year and in years to come.

Russia's Economic Challenge

First, Russia is reassessing its economic situation. The country's economy has recovered since the 2008 financial crisis, and Moscow had started implementing some expansive plans for the future. The modernization and privatization 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 and modernize the Russian economy. But these plans depended on European investment, and Europe's various financial and economic crises have forced many to backtrack on their commitments to Russia's programs. Furthermore, the perception that Putin is weakening and that Russia is politically unstable has discouraged many investors.

The Kremlin now faces the possibility of scrapping the programs. The Russian government might be able to fund pieces of the programs, but it would drain much of the Kremlin's savings. The Kremlin's budget is based mostly on oil and natural gas revenue. While prices for both are at record highs, the government is unsure whether oil will remain at about $100 per barrel and is already restructuring its pricing for natural gas with European customers at a much lower rate. Overall, the government wants to make sure it has a sufficient financial cushion if energy revenues fall precipitously.

These economic uncertainties are feeding the country's political problems. The Kremlin clans, Communists and protest movements are divided on how to handle the economic problems in the future; the siloviki and Communists want a more nationalist and consolidated approach, and the civiliki and many of the protest groups want a more liberal and free-market strategy. In recent years, Putin left such decisions to Alexei Kudrin, who was finance minister, but with his defection and possible alignment with the protesters it is unclear if anyone can sort out the economic challenges until the political crises are resolved.

Perceptions of Russian Power

Russia's other main challenge is the next stage of rebuilding its influence in its former Soviet periphery. Russia plans to further institutionalize its relationships with many former Soviet states and anticipates the formation of a Eurasian Union by 2015. Russia also had started to consider taking advantage of the European financial and economic crises by purchasing assets and forming new ventures with many European states. But this was all based on the assumption that Russia would be strong and steady. The political uncertainty has eroded the perception that Russia (and Putin in particular) is strong.

Moreover, some countries, especially the United States, have started taking advantage of the volatility inside Russia to play up the perception that the country is unstable. The U.S. State Department and new U.S. Ambassador to Russia Michael McFaul have not hidden their support for the anti-Kremlin movements; the State Department revealed its funding for some groups, and McFaul met with protesters the week he arrived in Moscow as ambassador. The United States is trying to use the instability to shape the view of Russia abroad and to keep the Kremlin focused on internal matters rather than its resurgence.

This comes as the United States and Russia are locked in a standoff over missile defense and Washington's support for Central Europe. Russia has grown more aggressive over the issue in recent months, with Moscow planning to increase security pressure on Europe, while the United States wanted to avoid talks on the situation, as it is preoccupied with other issues such as Afghanistan and Iran. The United States is using Russia's internal political volatility both to wear away the perception that Russia is as strong as it claims and to buy time.

Putin will need to resolve the instability in Russia's political scene as soon as possible so that he can turn to the other large concerns facing the country. The longer he is focused on domestic politics, the more the country's economic challenges are exacerbated and the perception of his power is weakened. Putin is quite likely to resolve Russia's political problems, though he will have to restructure his inner circle and account for groups that are not under his control (but do not seriously threaten his power).

However, the longer it takes Putin to do all this, the weaker the rest of the world will believe he is. Of course, perception is not necessarily reality, and this is particularly true of Russia — as Winston Churchill famously said, "I cannot forecast you the action of Russia. It is a riddle wrapped in a mystery inside an enigma." Russia is still a relatively powerful country, and its perceived weakness will not keep it from continuing to act assertively as it reclaims its place as a strong and steady country overseeing its former Soviet sphere.

The Next Stage of Russia's Resurgence

February 7, 2012

Stratfor has long followed and chronicled Russia's resurgence, which has included bolder foreign policy moves and resuming the role of regional power. In particular, Moscow has focused its energy in its former Soviet periphery: the Eastern European states of Ukraine, Belarus and Moldova; the Baltic states of Estonia, Latvia and Lithuania; the Caucasus states of Georgia, Armenia and Azerbaijan; and the Central Asian states of Kazakhstan, Uzbekistan, Turkmenistan, Kyrgyzstan and Tajikistan.

In recent years, Russia has increased its influence in many of these states politically, economically, militarily and in the area of security, with the most obvious sign of its return to power coming in the August 2008 war with Georgia. Now, Moscow is preparing for the next stage of its resurgence. This new phase will include the institutionalization of Russia's position as the regional hub, but it will also include the use of more subtle levers and influence in areas Moscow wants to bring into its fold — though not all of these efforts will go unchallenged.

The Geopolitics of the Russian Resurgence

In many ways, Russia's geopolitical strength is derived from its inherent geographic weaknesses. There are few natural barriers protecting Russia's core, and this requires Russia to expand into and consolidate territories around its core to acquire buffers from external powers. With the Arctic Ocean serving as the only natural barrier for Russia to the north, this expansion historically has required Russia to push to the west toward Europe (consolidating Eastern Europe and the Baltics), to the south toward the Islamic world (consolidating the Caucasus), and to the east toward Asia (consolidating Central Asia and Siberia). As Russia absorbed peoples and resources, it grew from a small Eastern European principality in the 13th century to the Grand Duchy of Moscow, which became the Russian Empire and then grew to become the Soviet Union, one of the largest contiguous states in history.

However, this expansion created two fundamental problems for any Russian state: It brought Moscow into conflict with numerous external powers and gave it the difficult task of ruling over conquered peoples (who were not necessarily happy to be ruled by Russia). Russia's geography requires it to expand to stay strong, but paradoxically, the more Russia pushes outward the more difficult and costly it becomes to rule its immense territory. Meanwhile, Russia's lack of access to the wider oceans has cemented its position as a land power but doomed it economically and weakened its position compared to other powers that have ready access to the world's oceans. Such factors have created a cycle in which Russia's power rises and collapses. When Russia is on the rise, it becomes a major regional if not global player, and when it falls it is only a matter of time before it rises again.

So when the Soviet Union collapsed in 1991 at the end of the Cold War and Moscow lost control of its constituent republics and fell into internal chaos, those circumstances did not guarantee that Russia was permanently removed from the international scene and that a unipolar world dominated by the United States would last forever. Certainly by the end of the 1990s, Russia was severely weakened as a geopolitical power; its economy was in chaos and it faced a military defeat in Chechnya, which gained de facto independence and threatened to spur similar movements within Russia proper.

But things began to change with the beginning of the new millennium. Starting with Vladimir Putin's presidency in 2000, Russia was able to reverse its losses in another more successful war in Chechnya, and Russia's position in its former Soviet periphery began to rise steadily. Numerous factors play into this, including the internal consolidation led by Putin to overcome the chaos of the 1990s, high global energy prices and the U.S. involvement in the Islamic world. In the past few years, most of the pro-Western color revolutions that swept the former Soviet Union in the early 2000s have been reversed. Russia has increased its military footprint in many of these states and is in the process of creating economic institutions to match (most notably its customs union with Belarus and Kazakhstan that is set to become the Eurasian Union). In short, Russia has returned to its traditional status of legitimate regional power, and its influence is increasing in its historical geographic buffer zones, which are currently made up of more than a dozen independent states.

Gauging Russia's Resurgence and Looking Ahead

In the context of its resurgence, Russia's broad imperative has been to prevent foreign influence while building and ingraining its own. Of course, Russia's plans for carrying out this imperative differ in each subregion of the former Soviet Union — Eastern Europe, the Baltics, the Caucasus and Central Asia — and in each state.

Russia's resurgence has not been seamless. Since gaining independence, each former Soviet state has developed its own imperatives: consolidating power internally and maintaining some sort of sovereignty. Also, different external powers are competing with Russia for influence in each former Soviet country. Therefore, the imperatives of Russia and the other former Soviet states often clash, which sometimes leads to dynamic and occasionally volatile relations, even with some of Moscow's most loyal allies.

But power is a relative concept, and right now most former Soviet states are too weak to independently stand up to Russia and most external powers cannot match the strength Russia wields in its periphery. And with Putin set to return to the presidency and begin a new chapter for the Russian state, it is important to gauge the progress Moscow has made in its resurgence in the former Soviet Union and what this projection of Russian power will mean in the future.

Ukraine

Several factors make Ukraine crucial to Russia. Its location on the North European Plain and along the Black Sea has made Ukraine a traditional invasion route from the west. Ukraine is also the second-largest country in the former Soviet Union in terms of population.

Furthermore, Ukraine has the third-largest economy in the former Soviet Union, and its industrial, agricultural and energy sectors are integrated with Russia's.

Russia's Levers

- Political: Ukrainian President Viktor Yanukovich and his Party of Regions enjoy a supportive relationship with Moscow. Russia also has ties to Ukrainian opposition leaders such as former Prime Minister Yulia Timoshenko and prominent political figure Arseny Yatsenyuk. Furthermore, Ukrainian oligarchs like Dmitri Firtash and Rinat Akhmetov have maintained business relationships with Russia.
- Social: Ethnic Russians make up 17 percent of Ukraine's population, and 30 percent of Ukrainians speak Russian as a native language. Furthermore, Ukrainians come from the same East Slavic ethnic and language group as Russians (and Belarusians). Most of the country is Orthodox Christian, and more than 10 percent of Ukraine's population is under the Moscow patriarch.
- Security: Russia maintains a military presence in Ukraine by stationing its Black Sea Fleet in Crimea. Russia's Federal Security Service and its Ukrainian counterpart cooperate on intelligence and training. Although Ukraine is not a member of the Russian-led Collective Security Treaty Organization (CSTO), it is also not a NATO member.
- Economic: Ukraine gets more than 60 percent of its natural gas from Russia, which can manipulate the Ukrainian pipeline infrastructure by cutting off supplies. Russia owns many assets in Ukraine's metals industry and supplies the industry with energy (besides maintaining business relationships with the industry's oligarchs). Russia also gives Ukraine financial assistance and loans via Sberbank and other financial institutions.

Russia's Successes, Obstacles and Ambitions

Between 2010 and 2012, Russia achieved many of its goals in Ukraine. Moscow extended the Black Sea Fleet's lease of Sevastopol to 2042. Ukrainian legislation making NATO membership illegal limited Kiev's ties to the bloc, and the pro-Western faction in the Ukrainian government led by former President Viktor Yushchenko and his Our Ukraine-People's Self-Defense party has been marginalized. A major threat to Russia's plans, fast-tracked negotiations between Kiev and the European Union, were not completed in 2011 as planned, leaving Ukraine without association and free trade agreements with the union and without explicit prospects for EU membership.

In 2012, Moscow hopes to gain some degree of control over Ukraine's energy pipeline and storage system by maintaining high natural gas prices and forcing Ukraine to trade energy assets for cheaper natural gas. Russia also wants to keep Ukraine from growing closer to the European Union by creating and manipulating domestic challenges that will keep Yanukovich preoccupied and make Ukraine seem less desirable to the Europeans. Moreover, Moscow plans to keep specific EU members, particularly Sweden and Poland and their Eastern Partnership initiative, from focusing on Ukraine by keeping those countries divided and focused on other matters.

Still, this does not mean Moscow can do whatever it likes inside Ukraine. The largest challenge to Russia's ambitions in Ukraine has come from the Ukrainian government, despite the government's close ties to Moscow. It is not in Yanukovich's interest, or in the interest of the oligarchs who make up his power base, to give Russia control of the country's natural gas transit system, which is not only a vital economic asset but also a symbol of Ukraine's sovereignty. This is why Ukraine has continued to resist selling the system to Russia and joining Russian-led institutions like the customs union, which would further undermine Kiev's economic sovereignty.

Beyond 2012, Moscow wants to prepare Ukraine for closer integration via membership in the Eurasian Union as it evolves from the customs union and Common Economic Space.

Ukraine's Position and Strategy

Because it historically has been ruled by many external powers — Russia, Poland, Austria-Hungary and the Ottoman Empire among them — the territory that makes up modern Ukraine encompasses people from different cultures and with different worldviews. The broadest division in Ukraine is between the country's east, which is economically and culturally more integrated with Russia, and the country's west, which is more nationalist, closer to the West and more supportive of Ukrainian membership in Western institutions such as the European Union. The chief imperative for any Ukrainian state is to prevent the country from splitting apart and balance between external powers to maintain sovereignty.

Thus, Yanukovich, despite hailing from eastern Ukraine and campaigning on a much more Russia-friendly platform than his predecessor, has not been merely an unquestioning ally of Moscow during his presidency. Although he made numerous favorable gestures to Russia early in his term, such as passing legislation legally barring NATO membership and signing the Black Sea Fleet-for-natural gas deal, Yanukovich then sought to balance this by fast-tracking Ukraine's negotiations with the European Union on signing association and free trade agreements (which Kiev hoped would include a provision for eventual EU membership).

However, the failure of Ukraine's negotiations with the European Union due to the imprisonment of Timoshenko weakened Ukraine's counterbalance against Russia and forced Kiev into a difficult position. Ukraine can only afford to pay Russia more than $400 per thousand cubic meters for natural gas for so long before the high prices create a financial crisis, so it is really a question of when — not whether — Ukraine will have to give Russia at least some control over, or access to, its energy system in exchange for lower prices. This will diminish Kiev's ability to maneuver against Moscow even further and will ensure that, whether it wants to or not, Ukraine will have to take Russia's interests into account eventually.

Belarus

Geography plays a large role in Belarus' importance to Russia. The country is located on the North European Plain, a traditional invasion route from the west, and there are no meaningful geographic barriers to invaders because of the country's flat terrain. Belarus serves as a territorial buffer for Russia's core. Belarus also has one of the largest economies in the former Soviet Union, and its industry, energy and security mechanisms are integrated with Russia's.

Russia's Levers

- Political: Belarus and Russia are partners in the Union State, and Belarusian President Aleksandr Lukashenko receives support from Moscow. Russia has ties to Belarusian security leaders and Belarus' economic elite have business relationships with Russia.
- Social: Ethnic Russians make up 11 percent of the Belarusian population. The majority of the Belarusian population speaks Russian as a native language, and Russian and Belarusian are both official languages in the country. Most of the country is Orthodox Christian, with roughly 60 percent of the population under the Moscow patriarch. Belarusians and Russians have roots in the same East Slavic ethnic and language group and thus have cultural similarities.
- Security: Belarus' military-industrial complex is integrated with Russia's, and the countries have a unified air defense system. Belarus is a member of the Russian-led CSTO and hosts Russian military installations, such as S-300 air defense systems. Also, the Belarusian and Russian intelligence bodies have a cooperative relationship including training.

- Economy: Russia supplies 99 percent of Belarus' natural gas and most of its oil. Russia also owns a 100 percent stake in Beltransgaz, giving it full ownership of the country's pipeline infrastructure. Trade between the two countries is important for the Belarusian economy, as half of Belarus' exports go to Russia. Furthermore, Russia provides Belarus with financial assistance, including a $3 billion loan through the Eurasian Economic Community and a $1 billion Sberbank loan.

Russia's Successes, Obstacles and Ambitions

Russia's influence in Belarus did not go unchallenged over the past two years. In early 2010, Lukashenko lashed out at Moscow over high energy prices and began considering alternative suppliers (Venezuela and Azerbaijan, in particular) as a way to pressure Russia into lowering prices. But Russia kept prices high and cut off natural gas to Belarus until Minsk agreed to cede complete control of its pipeline system and Beltransgaz to Moscow.

Russia carried out several strategies to increase its influence in Belarus. Beginning in 2010, Russia and Belarus integrated economically as Belarus joined the Russian-led customs union, a body that became the Common Economic Space in 2012. Russia was able to limit Belarus' ties to the West and Polish-led EU overtures to Minsk ahead of Belarusian elections. After the elections, the West chose to isolate Belarus, giving Russia a chance to increase its economic and political support of Lukashenko. Moscow also enhanced its security integration with Minsk when Belarus joined the CSTO rapid reaction force and hosted deployments of S-300s.

In 2012, Russia wants to continue its integration efforts in Belarus. The Common Economic Space will serve Russia's interests economically, but Moscow wants access to more of Belarus' strategic economic assets, such as refineries and potash firm Belaruskali. Politically, Moscow wants Minsk to remain isolated from the European Union and the West. Militarily, Russia wants to use weapons sales and

CSTO participation to draw Belarus closer. Beyond 2012, Russia wants Belarus' complete strategic integration via the Eurasian Union.

Belarus' Position and Strategy

Unlike Russia or Ukraine, Belarus has a relatively homogenous society, both culturally and politically. This has facilitated the centralization of power under Lukashenko, who has dominated Belarus politically since 1994. Also unlike Russia or Ukraine, Belarus never developed a powerful class of oligarchs; rather, Lukashenko has maintained a social and economic model much like the old Soviet system since the early years of Belarus' independence. He rules the country with a close-knit group of elites, many of whom have ties to the security and intelligence apparatus.

While this dynamic has made consolidation of power easier, it complicates another imperative: the balancing of external powers to maintain economic, military and political sovereignty. Belarus has never strayed far from Russia in terms of security or economics, given the democratic and economic reform requirements needed to be considered for NATO or EU membership. However, Belarus' political relations with Russia have not been as steady; the two countries formed the Union State in 1997, but this closeness has not prevented spats over economic issues that have led Lukashenko to periodically look to the West for cooperation in order to gain leverage over Russia. Given the integration of Belarus' infrastructure with Russia and the political connotations of economic relationships, this is easier said than done. Testing Moscow on matters such as energy prices has usually backfired for Minsk, as Gazprom's recent acquisition of Beltransgaz has shown.

Countries like Poland and Lithuania have geopolitical interests in courting Belarus, such as the desire to establish the same kind of territorial buffer to the east that Russia desires from the west. But these countries cannot match Russia's influence over Belarus, so they have resorted to soft power maneuvers such as establishing ties to Belarusian opposition groups and spearheading EU sanctions against the Lukashenko government. The success of the first strategy has been limited, since opposition groups face numerous constraints. The second strategy is a more serious threat to the Belarusian government, since Lukashenko's rule depends on a populist economic model and such models weaken in poor economic and financial environments. However, this economic isolation has given Russia the opportunity to provide financial assistance and serve as Belarus' economic lifeline, a role Moscow will continue to play as long as Lukashenko stays in line.

Moving forward, Belarus will have no choice but to go along with Russia's strategy and broader resurgence, given Minsk's limited options for gaining support from other powers. Therefore, Russia will continue integrating Belarus as it moves toward the creation of the Eurasian Union in 2015.

Moldova

Moldova's location makes it important to Russia. It is situated in the Bessarabian Gap between the Carpathians and the Black Sea, a traditional invasion route from the southwest and the Balkan states. It is near the strategic port of Odessa and the Crimean Peninsula, where Russia stations its Black Sea Fleet, and it serves as part of the energy transit network linking Russia with Europe and Turkey.

Russia's Levers

- Political: Former Moldovan President Vladimir Voronin and his Communist Party are in a partnership with Russia. Moscow also has ties to leaders of the Alliance for European Integration (AEI), including Moldovan Prime Minister Vlad Filat and acting President Marian Lupu. Most notably, Russia subsidizes the leadership in the breakaway region of Transdniestria.
- Social: Only about 6 percent of the Moldovan population is ethnically Russian, though in Transdniestria 30 percent of the population is Russian (and another 30 percent is Ukrainian). Roughly 11 percent of Moldovans speak Russian as a native

language, and for approximately 16 percent of the population Russian is a primary language. Most of the country is Orthodox Christian but split between Romanian Orthodox and Russian Orthodox.

- Security: Russia maintains approximately 1,100 troops in Transdniestria (along with a smaller contingent of Ukrainian soldiers). Although Moldova is not part of the Russian-led CSTO, it also is not a member of NATO.
- Economic: Moldova depends on Russia for 100 percent of its natural gas and sends 20 percent of its exports to Russia (especially important is wine, imports of which Russia cut off for political reasons). Russia controls most of the economy in Transdniestria — which, although a breakaway region, is Moldova's industrial heartland — and provides financial assistance and subsidies to Transdniestria.

Russia's Successes, Obstacles and Ambitions

Russia rebuffed attempts to demilitarize Transdniestria or allow a Western presence in the territory. However, Moscow has faced some setbacks in Moldova proper; the Communists have not been in power since the Western-leaning AEI ousted them from power in 2009 following the "Twitter Revolution." Despite its position, the AEI has not been strong enough to elect a president, so Moldova has been in political deadlock for nearly three years.

Russia's goals for 2012 are to improve its position in Moldova proper by strengthening the Communist Party and forming independent relationships with AEI leaders and members. If Russia cannot help the Communists regain power, it at least wants to make sure Moldova remains divided and that the AEI remains incapable of electing a Western-oriented president. Moscow could accomplish this by complicating the political process and obstructing negotiations between Moldova and Transdniestria. Russia also wants to maintain its military presence and political influence in Transdniestria and begin laying the groundwork for Moldova's possible inclusion in the Eurasian Union.

Moldova's Position and Strategy

Like Ukraine, Moldova is both weak and divided. Unlike Ukraine, Moldova does not have traditional or ethnic ties to Russia; it is ethnically and linguistically Romanian. This, along with Moldova's small size and strategic location, is a main factor in the weakness of the state and its ability to balance between external powers.

Moldova is divided both territorially and politically. The Moldovan government does not hold territorial sovereignty over Transdniestria, which is home to a Russian military base and is populated largely by Russians and Ukrainians. The split within Moldova proper is a political one dominated by two large groups: the Russian-oriented Communists and the AEI, a collection of parties that want Moldova to become Western-oriented. The AEI is divided further, with some elements pledging close ties to Romania and NATO while others are more flexible in their loyalties, but in general all parties in the AEI support Moldovan integration with the European Union. Since 2009, neither the Communist Party nor the AEI has been able to gain enough votes in parliament (61 out of 101) to elect a president, so the country has been paralyzed and unable to form any decisive foreign policy for almost three years. These divisions mean that Moldova's view and strategy is not unified. Any leader of Moldova must overcome these divisions in order to consolidate the country; only then can the issue of Transdniestria and broader foreign policy questions be addressed in Chisinau.

External powers other than Russia have interests in Moldova; chief among them is Romania. Not only do Moldova and Romania share ethnic and linguistic ties, but also the territory that makes up Moldova and Transdniestria (as well as western parts of Ukraine) belonged to Romania's Moldavia province before Russia annexed the territory as a defensive bulwark. However, Romania is not strong enough to challenge Russia militarily in the country, and given that

Moldova is the poorest country in Europe and is substantially limited by Russia's presence and influence, EU membership prospects in the near- to midterm are very unlikely (though the distribution of Romanian passports to Moldovan citizens that allows them to travel in the European Union is one example of Romania's soft power in the country). Other individual EU states like Poland and Sweden want to bring Moldova closer to the West via the Eastern Partnership program, but this is a long-term process with limited effects.

Moldova's paralysis — political, territorial and geopolitical — can be expected to remain until an external power is able to contest Russia in the region in terms of hard power rather than soft power. This is not likely to happen in the short to medium term.

Estonia

Estonia's location makes it integral to Russia's security. It sits on the North European Plain, a traditional invasion route from the west and north, and is near St. Petersburg, part of Russia's core. Estonia is also on the Gulf of Finland and can obstruct access to the Baltic Sea.

Russia's Levers

- Political: Russia has ties to the opposition Center party (the main party ethnic Russians in Estonia support) and its leader, Edgar Savisaar. Moscow has only limited connections to other elites in the realms of politics, business and security.
- Social: Estonia has a sizable ethnic Russian minority (about 25 percent of the population). Roughly 10-15 percent of the country's population is Russian Orthodox.
- Security: Estonia is a committed member of NATO and has remained outside Russia's alliance system. However, Russia flanks Estonia militarily, with 23,000 troops in Kaliningrad and 8,000 stationed outside St. Petersburg, with thousands more that train and rotate through there. There are numerous

Russian nationalist movements within Estonia, and the country has been subject to cyberattacks traced back to Russia.

- Economic: Russia controls more than one-third of Estonia's energy firm Eesti Gas. Estonia imports all of its natural gas from Russia, but this makes up only about 10 percent of Estonia's energy consumption because of its domestic production of oil shale and renewable energy.

Russia's Successes, Obstacles and Ambitions

Militarily, Russia demonstrated its strength in the wider Baltic region between 2010 and 2012 with the purchase of two Mistral-class helicopter carriers from France and the buildup of its military presence in the Russian exclave of Kaliningrad and outside of St. Petersburg.

Estonia joined the eurozone in 2011, furthering its economic integration with the European Union. Moreover, Russia lost political ground in Estonia when the Center party lost seats in parliamentary elections in 2011, though it is still the largest party outside of the ruling coalition and the second-largest party overall.

Russia's overall strategy is to keep NATO divided and to prevent it from becoming more active in and committed to Estonia. To this end, Moscow hopes to neutralize the country or weaken its external support. Part of this strategy is to prevent cross-Baltic economic and energy projects (particularly the construction of liquefied natural gas facilities) and rail projects (specifically the EU-oriented Rail Baltica line).

Estonia's Position and Strategy

Estonia is a tiny country of 1.3 million people that sits in a geographically vulnerable area. Its size and location has made it necessary for Estonia to have an external power patron if it is to maintain its sovereignty and independence. Estonia has turned to the West, specifically the European Union and NATO, which are more favorable alliances for Estonia than bilateral relationships with stronger states or Russia-dominated groups. NATO is particularly important in preserving Estonian security as Russia continues its resurgence. Estonia reformed its economy in order to gain eurozone membership and has tried leveraging its technology sector in order to boost NATO's commitment to the country's security, particularly via the cybersecurity center based in Tallinn.

However, Estonia knows it cannot be too hostile toward Russia because of the countries' geographic proximity and because any Estonian state must account for the large Russian minority in the country. Estonia has a more nuanced policy toward Moscow than Lithuania (which is more aggressive) and Latvia (which is more cooperative). Estonia's eurozone membership limits Russia's strategic economic penetration (outside of energy supplies, which themselves are limited because of Estonia's domestic energy production). Estonia is more economically and financially integrated with Scandinavian countries like Sweden and Finland than are its Baltic neighbors. At the same time, Estonia is less inclined to directly challenge Russia's energy policy and seeks to minimize the polarization of the ethnic Russian community in the country.

Estonia's non-aggressive stance toward Russia and the difficulties Moscow faces in penetrating the country economically or politically mean that Russia's resurgence likely will not affect Moscow's relationship with Tallinn significantly in the near to mid-term. Russia will, however, continue to try to undermine Baltic unity and isolate the three Baltic states from each other and from NATO.

Latvia

Like Estonia, Latvia is located on the North European Plain and thus is important to Russia's sense of security. Furthermore, Riga is one of the most important ports in the former Soviet Union.

Russia's Levers

- Political: Russia is partnered with and supports the opposition Harmony Center party, the main party of the country's ethnic Russian population, and its leader, Riga Mayor Nils Usakovs. Moscow also has ties to some of Latvia's business elites, especially in Riga.
- Social: Approximately 27 percent of Latvia's population is ethnic Russian, and approximately 15 percent of its population is Russian Orthodox.
- Security: Like Estonia, Latvia is a committed member of NATO and has stayed outside of Russia's system of alliances. It is surrounded by Russia militarily, with Russian troops stationed in Kaliningrad (the base of Russia's Baltic Sea Fleet) and outside St. Petersburg.
- Economic: Russia controls one third of Latvia's energy firm Latvijas Gaze and supplies 100 percent of the country's natural gas and most of its oil.

Russia's Successes, Obstacles and Ambitions

Russia made political gains in Latvia in 2011 when the Harmony Center party gained the most seats in parliamentary elections, though the party was excluded from the ruling coalition. Russia has made business deals with Latvia, and the countries are in talks about the Moscow-Riga rail project, which Latvia has indicated greater interest in than the EU-oriented Rail Baltica project.

Russia demonstrated its military strength in the Baltics with its military buildup in Kaliningrad and neighboring Belarus, but Latvia is still oriented toward NATO and the European Union and is interested in regional groupings like the Nordic-Baltic group, a forum for cooperation by Nordic and Baltic countries.

Russia hopes to strengthen Harmony Center by creating instability within Latvia (protests, language referendums and the like) for as long as the party remains outside the ruling coalition. In line with its strategy to keep NATO divided and prevent further commitments to the Baltic states, Russia wants to neutralize Latvia or weaken its support base. Moscow wants to undermine Baltic unity by striking more business and economic deals with Latvia and creating a perception of partnership. Russia also wants to limit Latvia's participation in the European Union's Third Energy Package.

Latvia's Position and Strategy

Like Estonia, Latvia is a small country whose population includes a large ethnic Russian minority. This Russian population contributes to a political polarization between Latvian parties and ethnic Russian parties that any Latvian government must overcome in order to rule with a strong mandate. The strongest political lever Russia has in any of the Baltic states is the Harmony Center in Latvia, but the Latvian government has tried to limit Russia's political influence at all costs — including leaving the largest party in parliament out of the ruling coalition. In 2011, this created a weak government.

Latvia also needs an external power patron to maintain its sovereignty and independence. Like the other Baltic states, Riga has chosen the European Union and NATO to fill this role. But since Latvia is more dependent on Russian energy than Estonia and has less room to maneuver than Lithuania, it has been more cooperative with Russia on economic matters, regardless of the specific composition of its government. Latvia has been in discussions with Russia on the Riga-Moscow railway (which has complicated talks about the EU-oriented Rail Baltic project and thus could threaten Baltic unity) and has been less active in enforcing anti-Russian policies such as the Third Energy Package. Still, Latvia is strategically aligned with the West and has supplemented this relationship via its strong bilateral ties to Sweden and Finland and regional groupings like the Nordic-Baltic group.

Given the current government's weak status and the gains that Russia has made politically and socially in the country, 2012 will be a volatile year in Latvia. Russia will be able to limit Baltic and other regional projects meant to lure Latvia away from Russia, but it will not be able to change the country's Western orientation in a more strategic sense.

Lithuania

Like the other Baltics, Lithuania is located on the North European Plain. It has served as a traditional invasion route from the west and (along with Poland) has challenged Russia's control of Eastern Europe, particularly Belarus and Ukraine. Lithuania also borders the Russian exclave of Kaliningrad.

Russia's Levers

- Political: Russia has only limited ties to Lithuania's business elites and marginal political parties that lack representation in parliament.
- Social: Less than 10 percent of Lithuania's population is ethnic Russian, and roughly 4 percent of the population is Russian Orthodox.
- Security: Like the other Baltic states, Lithuania is a committed member of NATO and outside Russia's alliance system. Lithuania is flanked by Russian troops in Kaliningrad and outside of St. Petersburg, and has an alliance with Belarus.
- Economic: Russia controls 37 percent of Lithuania's energy firm Lietuvos Dujos and supplies 100 percent of the country's natural gas and most of its oil.

Russia's Successes, Obstacles and Ambitions

Lithuania has been one of Russia's most aggressive challengers, enacting the Third Energy Package relatively quickly and taking Gazprom to court. Lithuania is also pursuing the construction of a liquefied natural gas terminal and a nuclear power station, though

Russia has worked to undermine these plans by pursuing the construction of nuclear power plants in Kaliningrad and Belarus. Russia's talks with Latvia about the Moscow-Riga rail project are part of its plan to undermine Baltic unity over the EU-oriented Rail Baltica project.

Russia displayed its military strength in the Baltic region with a weapons buildup in Kaliningrad and showed its might in the field of energy with two projects in Kaliningrad and Belarus, both near Lithuania's borders. However, Lithuania is still oriented toward NATO and the European Union and is interested in regional groupings like the Nordic-Baltic group. Lithuania is also seeking more interest from NATO via its energy security center and from the United States by supporting its ballistic missile defense plans.

As in the other Baltic states, Russia wants to prevent cross-Baltic economic, energy and rail projects. It wants to neutralize Lithuania or weaken the support it gets from external players, particularly Germany. This strategy with Lithuania is part of Moscow's overall strategy to keep NATO divided and prevent further commitments to Baltic security.

Lithuania's Position and Strategy

Lithuania is unique among the Baltic states in that it has its own tradition of being a legitimate power whose interests historically have overlapped with Russia's in areas like Belarus and Ukraine. Lithuania is also unique in that it is more oriented (geopolitically and economically) toward Eastern and Central Europe than it is towards the Baltic region and Scandinavia. Additionally, Lithuania's relatively small population of ethnic Russians does not give Moscow the same foothold it has in Estonia and Latvia. All of this adds up to a government in Lithuania that is more willing to stand up to Russia in key areas such as energy (the Third Energy Package) and political ties to Eastern Europe (hosting and supporting Belarusian opposition figures).

Because Lithuania is a small country, it knows it cannot challenge Moscow alone, so it has sought regional partners. This can be seen in its efforts to secure NATO involvement in its energy diversification projects and support of regional security initiatives such as the Nordic-Baltic grouping and the U.S. ballistic missile defense system in Central Europe. It has partnered with Poland to counter Russian influence in Belarus and Ukraine, though traditional cultural and historical tensions with Poland have complicated this effort. Lithuania's overall strategy regarding Russia has been confrontational, resisting any overtures from Moscow in the economic or political spheres and attempting to reverse Russia's gains in the wider region.

Russia will find it difficult to make direct inroads into Lithuania because its levers there are relatively weak. Instead, Russia will work to undermine the regional and institutional support that Lithuania is trying to secure from the likes of NATO and regional countries like Poland and the other Baltic states. This will create increasing tensions that could lead to an eventual confrontation between the two countries, though is not likely to play out militarily.

Armenia

Armenia, located in the South Caucasus, serves as a territorial buffer for Russia to the south. It also gives Moscow a strategic foothold in the center of the Caucasus because it borders both Georgia and Azerbaijan, as well as Turkey and Iran.

Russia's Levers

- Political: Russia supports and is allied with Armenian President Serzh Sarkisian and his Republican Party of Armenia. Moscow also has ties to former presidents Levon Ter Petrosian and Robert Kocharian.
- Social: Armenia represents an Orthodox Christian foothold in the predominantly Muslim Caucasus. Also, a large Armenian diaspora of 1.5 million to 2.5 million people lives in Russia.

- Security: Russia is Armenia's security guarantor against Azerbaijan in the ongoing Nagorno-Karabakh dispute. More than 5,000 Russian troops are stationed in Armenia in Russia's 102nd Military Base in Gyumri, and Russia has extended its lease of military facilities to 2044. Armenia is a member of the Collective Security Treaty Organization and the Rapid Reaction Force.
- Economic: Russia owns most of the pipeline, energy, rail and telecommunications assets in Armenia. Remittances from Armenians working in Russia amount to around 10 percent of Armenia's gross domestic product.

Russia's Successes, Obstacles and Ambitions

During the past two years, Russia strengthened its military presence in Armenia by extending its lease of military facilities to 2044 and getting permission to move Russian troops throughout the country. Russia also manipulated normalization talks between Armenia and Turkey in order to strengthen its relationships with Armenia and Azerbaijan.

Russia's goals for Armenia for 2012 and beyond include maintaining its current levers in Armenia and preparing Armenia for possible integration into the Common Economic Space and Eurasian Union. Russia also wants to sustain the divisions between Armenia and Azerbaijan (and Baku's ally, Turkey).

Armenia's Position and Strategy

Any government in Armenia will operate in a difficult environment, both geographically and ethnically. Armenia is almost completely mountainous and is surrounded not only by three major powers — Russia, Turkey and Iran — but also Georgia, Azerbaijan and other smaller but independently minded ethnic groups. Armenia must, at a minimum, maintain internal consolidation in order to defend itself within the region, but it must also look for an external power patron to protect it from the larger powers. But given Armenia's location and lack of strategic natural resources, balancing external powers against each other to extract concessions is not much of an option.

Armenia has chosen Russia as its external power patron, with Moscow controlling much of the infrastructure in the country. Russia also has a substantial military presence in Armenia that serves as Armenia's security guarantor from Azerbaijan (its adversary in the Nagorno-Karabakh territorial dispute) and from Turkey and Iran (whose borders the Russian military patrols).

Other external powers have very limited influence in Armenia. The country maintains an economic relationship with Iran and has tried normalizing relations with Turkey (which, along with Azerbaijan, has economically blockaded Armenia), though these talks have failed because of Russia's manipulation and the wider geopolitical balance of power in the region. Although Armenia would like to open its borders with Turkey, Russia's security guarantee against Azerbaijan is more important. There is a sizable and influential Armenian diaspora in the United States and France, though its implications are more economic than political, as Armenia is firmly in Russia's orbit and not part of the Western-oriented camp in the former Soviet Union. Barring any substantial weakening of Russia's geopolitical position, Armenia can be expected to remain loyal to Moscow and to continue participating in Russia's regional initiatives.

Georgia

Like Armenia, Georgia is important to Russian security because its location in the Southern Caucasus makes it a territorial buffer from powers like Turkey and Iran. Georgia also flanks restive Northern Caucasus Russian republics like Chechnya, borders the Black Sea and possesses strategic ports.

Russia's Levers

- Political: Certain Georgian opposition leaders have espoused the need for closer ties with Russia, and some have met with Russian officials. Russia has weak ties to Georgia's government and business community, however.
- Social: Georgia has no significant Russian population. However, approximately 80 percent of the country is Orthodox Christian.
- Security: Russia occupies the breakaway Georgian territories of South Ossetia and Abkhazia, with about 3,500 troops stationed in each area. Also, Russian intelligence has penetrated Georgia proper. However, Georgia remains committed to NATO and EU membership and has stayed outside of Russia's alliance system.
- Economic: Russia financially supports Abkhazia and South Ossetia, and around 1 million Georgians live in Russia and send remittances back to Georgia.

Russia's Successes, Obstacles and Ambitions

Since 2010, Russia has built up its military presence in Abkhazia and South Ossetia and extended its lease of military facilities there by 49 years. Russia's relationship with important NATO members, particularly Germany and France, has kept the alliance from any meaningful interactions with or presence in Georgia. However, Russia has not been able to create or support a viable opposition movement capable of truly challenging the anti-Russian president of Georgia, Mikhail Saakashvili.

In the coming months and years, Russia wants to increase the likelihood of the formation of a viable opposition movement in Georgia. It also wants to prevent the West, particularly the United States, from re-engaging in the country.

Georgia's Position and Strategy

Like many former Soviet countries, Georgia is split internally, both in geographic and political terms. Georgia has two breakaway territories, Abkhazia and South Ossetia, and two regions with autonomous tendencies, Adjara and Samtskhe-Javakheti. Internal political consolidation is needed to overcome these autonomous tendencies, but that alone is not enough.

Georgia needs an external power patron to counter and potentially overcome Russia's influence and presence in Abkhazia and South Ossetia. For cultural and historical reasons, neither Iran nor Turkey is an attractive option for Tbilisi, so Georgia has chosen to take its chances with the West, particularly NATO and the U.S. security guarantee membership in NATO implies. However, given the region's geopolitical complexity and the strategic threat Russia poses to Georgia, the West has not been willing to become a reliable ally that guarantees Georgia's security against a resurgent Russia. While Georgia explicitly opposes Russia's resurgence and actively lobbies for Western engagement, it has not been able to receive significant assistance from the West.

This does not mean Georgia has no alternatives to Russia; it has partnered with Azerbaijan and Turkey to form a southern corridor for energy and trade that goes around Russia. But these alternatives are limited to economics and politics and leave Georgia militarily isolated and vulnerable. Lacking NATO membership, Georgia has sought to purchase weapons and build up its own military with help from the United States and Israel, but Russia has been able to obstruct these efforts.

As long as Russia maintains its strong and resurgent position, Georgia is unlikely to get the closer security relationship with the West that it wants. Russia will continue to have difficulties building political and economic ties inside of Georgia proper, but as long as it has its military foothold in the breakaway territories, Georgia's ability to challenge Russia is severely limited.

Azerbaijan

Azerbaijan, like the other former Soviet states in the Caucasus, serves as a territorial buffer for Russia from the south. It also borders the Caspian and has significant energy resources. Azerbaijan is an important part of a southern corridor that could undermine Russia's importance in the areas of trade and energy.

Russia's Levers

- Political: Russia dominates the negotiation process between Azerbaijan and Armenia in the territorial dispute over Nagorno-Karabakh. Moscow's political ties in Azerbaijan are limited compared to Armenia, but it does have strong connections to the political and security elites in Nagorno-Karabakh.
- Social: Russia has few ethnic or social ties to Azerbaijan, as most of the population is ethnic Azerbaijani and Muslim.
- Security: Russia has a radar installation in Garbala. Its military presence in Armenia and Georgia helps to keep Azerbaijan in check, and Russia has a significant intelligence presence in Azerbaijan. Azerbaijan is not part of Russia's alliance system, but it is also not part of NATO (though it has a bilateral security partnership with NATO member Turkey).
- Economy: Russia does not control Azerbaijan's energy resources but has offered to purchase all of its natural gas. Azerbaijanis working in Russia send home remittances, but the effect of these remittances on the Azerbaijani economy is minimal.

Russia's Successes, Obstacles and Ambitions

Since 2010, Russia has been able to limit Azerbaijan's expansion of energy projects like the Nabucco and Interconnector Turkey-Greece-Italy pipelines that work against Russia's interests. Russia has also manipulated Azerbaijan's relationship with Armenia and Turkey to its advantage in the wider region. However, Azerbaijan has not sold all of its energy supplies to Russia (it only delivered 2 billion cubic meters of natural gas to Russia in 2011), and it continues to increase exports to other countries and pursue other southern corridor projects.

Russia's goals for Azerbaijan include preventing Azerbaijan and Turkey from developing a stronger relationship in terms of energy and security. Russia also wants to expand and extend its lease for the Garbala radar station and continue to prevent pipeline projects from coming to fruition.

Azerbaijan's Position and Strategy

Like the other two former Soviet states in the Caucasus, Azerbaijan must have internal consolidation if it is to face the challenges of its difficult environment. Azerbaijan proper is consolidated via a centralized authority and security apparatus. However, its breakaway territory of Nagorno-Karabakh is supported by Armenia and secured by a military guarantee from Russia that undermines Azerbaijan's sovereignty in the territory.

Unlike Georgia and Armenia, Azerbaijan has had some success in its second imperative of balancing powers to preserve the sovereignty it has. It owes this success largely to its energy resources. Azerbaijan is the only country in the Caucasus that has avoided having foreign troops on its soil; it has leveraged its energy resources for this purpose. Azerbaijan exports energy to nearly all directions — to Russia, Iran and the West via Georgia and Turkey — but not to Armenia.

In terms of security, Azerbaijan knows it cannot be oriented toward Russia, which supports Armenia, or toward Iran, which historically possessed territory that is now part of Azerbaijan and has a large Azerbaijani minority in northern Iran. Therefore, it has partnered with Turkey for military and weapons deals, though Azerbaijan knows this is not enough of a deterrent to match Russia and the country prefers to keep some distance from Ankara. Baku has proceeded cautiously, despite the rhetoric about taking back Nagorno-Karabakh by force. It has focused on building up its energy sector and using its energy revenues to build up its military and economy.

Azerbaijan will continue using its energy and the accompanying pipeline projects in order to protect its sovereignty from its large neighbors, especially Russia. It will be able to maintain this strategy in 2012, and despite Russia's efforts to undermine its energy options Azerbaijan will be the most difficult country in the Caucasus for Russia's resurgence to penetrate, though Baku will certainly not be immune.

Kazakhstan

Kazakhstan's location makes it integral to Russia's internal security, as it lies on a traditional invasion route from the east and south and thus serves as a buffer from Asian powers. It is also a key access route for Russia to the rest of Central Asia and Asia proper. Kazakhstan and Russia share a nearly 5,000-mile border that is almost completely unguarded, so any instability in Kazakhstan could easily spread to Russia. Kazakhstan also possesses plentiful oil and natural gas resources and is a counterbalance to Uzbekistan, a relatively powerful Central Asian state that is not typically subservient to Moscow.

Russia's Levers

- Political: Moscow has strong ties to Kazakh President Nursultan Nazarbayev and other political, security and business elites including Prime Minister Karim Massimov and Nazarbayev's possible successor, Timur Kulibayev.
- Social: Russians make up nearly 25 percent of the Kazakh population; most Russians live in northern Kazakhstan. Russian is an official state language in Kazakhstan, and 20-30 percent of the population is Russian Orthodox.
- Security: Kazakhstan is a member of the Russia-led Collective Security Treaty Organization (CSTO), and Russia has a radar station in Balkhash and a cosmodrome at Baikonur. Most

of Kazakhstan's military officers are ethnically Russian, and nearly all of Kazakhstan's military uses Russian or Soviet-era equipment.

- Economy: Kazakhstan is a member of the customs union and Common Economic Space. Most of Kazakhstan's economic infrastructure — rails, roads, pipelines and energy facilities — is linked to Russia. Roughly 10 percent of Kazakhs work abroad, mostly in Russia.

Russia's Successes, Obstacles and Ambitions

Russia strengthened its alliance with Kazakhstan via the customs union in 2010 and the Common Economic Space in 2012. Although Kazakhstan expanded its energy relationships with other countries — especially China — most of its energy exports are still linked to Russia, and Moscow still influences the Kazakh energy distribution system.

Russia's goals for Kazakhstan are to continue integrating the Central Asian country via the Common Economic Space and eventually the Eurasian Union, and to manage the presidential succession process so that the outcome favors Russia.

Kazakhstan's Position and Strategy

Kazakhstan is roughly a third of the size of the continental United States but has a population of only 15 million scattered across different parts of the country. This makes internal consolidation a difficult task, and one that Nazarbayev (who has ruled the country since independence) has managed by centralizing the political system and security apparatus.

Because of its long and open border with Russia, Kazakhstan has difficulty balancing external powers in order to preserve its sovereignty and has allied with Moscow in terms of politics and security (Kazakhstan is one of the founding members of the Commonwealth of Independent States, the CSTO and the customs union). However, economically, Kazakhstan has been more capable of diversifying partners because of its enormous energy and mineral wealth, which the West helped build up in the 1990s and early 2000s, a time of Russian weakness.

Kazakhstan exports oil west via Azerbaijan and east to China, though most Kazakh energy is still connected to Russia, either via direct exports or Russia's distribution system in Central Asia. This makes Kazakhstan broadly cooperative regarding Russia's integration plans, though it is not a pawn of Moscow. China's growing economic presence in Kazakhstan is a challenge to Russian influence, as is growing Islamist militancy in Kazakhstan and the country's rivalry with Uzbekistan.

Kazakhstan will continue cooperating in Russia's integration efforts, though Nazarbayev's eventual departure from the political scene will create uncertainty and instability — in the realms of politics and security — in the country. Preventing this from obstructing its resurgence will be one of Russia's most difficult tasks.

Uzbekistan

Uzbekistan is a buffer between Russia and the Asian and Islamic powers and conflict-riddled countries like Afghanistan to the south. Its status as the most populous part of Central Asia and key to the region's heartland of the Fergana Valley makes it a natural regional leader and a potential challenger to Russia. Uzbekistan also is an energy producer and is an important part of Russia's regional energy network.

Russia's Levers

- Political: Russia has connections with Uzbekistan's military and security apparatus and regional elites. However, relations with the independent-minded Uzbek President Islam Karimov are not particularly close.

- Social: Russia has limited social influence in Uzbekistan, where most of the population are ethnic Uzbeks and are Muslims; about 5 percent of the population is Russian.
- Security: Uzbekistan is a member of the CSTO, but it is not as active in the organization as other Central Asian countries (for example, it is not part of the CSTO's Rapid Reaction Force). Russia has no troops inside Uzbekistan, but it flanks the country with forces in Kyrgyzstan and Tajikistan and has political links inside the Fergana region of the country.
- Economic: Approximately 20 percent of all Uzbek exports (including 75 percent of its natural gas) go to Russia. Uzbekistan relies on Russian imports, from refined energy products to processed foods. Remittances from Uzbeks working in Russia also contribute to the Uzbek economy; in 2010, remittances amounted to nearly $3 billion.

Russia's Successes, Obstacles and Ambitions

Russia increased its military and security presence in Kyrgyzstan and Tajikistan in order to contain any Uzbek engagement of its neighbors (particularly after an outbreak of Kyrgyz ethnic violence in June 2010). Russia also incorporated Uzbekistan into the Northern Distribution Network for sending U.S. and NATO supplies into Afghanistan. Uzbekistan, meanwhile, has retained its independence and has expressed interest in securing weapons from the West.

Russia's goals for Uzbekistan are to increase its isolation and put more pressure on the country by striking alliances with other Central Asian states, and also to manage the presidential succession process so that the result will be in line with Russia's interests.

Uzbekistan's Position and Strategy

Not surprisingly, Uzbekistan has its own ideas for the Fergana Valley that involve exercising more control over southern Kyrgyzstan and northern Tajikistan (both of which have sizeable Uzbek minorities).

Uzbekistan has used its large population and self-sufficiency in energy and other resources to remain strongly independent from and rebellious toward Russia and other powers. However, Uzbekistan is not strong enough to challenge Russia directly. Therefore, as with Azerbaijan, Russia is able to keep Uzbekistan in check indirectly, via its military presence in surrounding countries.

Uzbekistan has other problems as well, such as the spillover of militants from Afghanistan and its own indigenous Islamist militancy, which has been suppressed but not eliminated. This only spurs Uzbekistan's centralization of control and the resistance to influence from any external powers.

One such power — China — is focusing on Central Asia as a means of meeting its growing energy needs and diversifying away from sea-based energy import routes. China has increased its influence particularly in Uzbekistan, Turkmenistan and Kazakhstan by putting money into energy projects. Russia and the Central Asian states are concerned that Chinese economic involvement could grow and lead to Chinese influence in other realms, such as security.

Like Kazakhstan, Uzbekistan has been ruled by a single leader since independence from the Soviet Union, and Karimov's unclear succession plan throws the entire future orientation of the country into doubt. Russia will continue using its limited levers to pressure Uzbekistan, which will continue withstanding the pressure, while Karimov sorts out plans for his succession. This means Uzbekistan will be the least predictable country in terms of Russia's resurgence in Central Asia.

Turkmenistan

Turkmenistan's location makes it integral to Russia's security; it acts as a buffer state to the south, separating Russia from Iran and instability in Afghanistan and Pakistan. Turkmenistan is rich in natural resources, including natural gas and oil, and Russia wants to secure transit of those resources to its own territory. It also flanks regional leader Uzbekistan and is part of the drug route from Afghanistan into Russia.

Russia's Levers

- Political: Russia has ties to Turkmen President Gurbanguly Berdimukhammedov and the country's business and security elites. It also has connections to the population in southern Turkmenistan that controls the drug trade.
- Social: Russians make up only a small percentage of the population in Turkmenistan; most of the country's population are Turkmen, and most are Muslim.
- Security: Turkmenistan is not a member of the Russia-led CSTO, but it does rely on Russia as a security guarantor against external powers such as Iran, the West and Uzbekistan. Russia supplies Turkmenistan's military and security services with arms and training.
- Economic: Turkmenistan has the lowest number of immigrants working abroad of any Central Asian state, so remittances from workers in Russia do not amount to much. Turkmenistan historically has exported most of its energy to Russia, though this has changed recently — the country exported 10 billion cubic meters (bcm) of natural gas to Russia, 15-17 bcm to China, and 8 bcm to Iran in 2010. Russia wants to block any Caspian projects (such as the Trans-Caspian and Nabucco pipelines) that are not in its interests.

Russia's Successes, Obstacles and Ambitions

Russia faced a setback in Turkmenistan when its isolation of Turkmenistan's energy forced the country to increase exports to China and Iran. Particularly important is the Central Asia pipeline which, for China, is not only a chance to take advantage of Turkmenistan's diversification but is also an opportunity to increase its leverage against Russia. However, Russia prevented Turkmenistan from participating in southern corridor energy projects that are against Moscow's interests.

Russia wants to continue preventing Turkmenistan from forging energy relationships with the West and wants to manage Turkmenistan's energy ties to China and Iran. Moscow wants Turkmenistan to remain isolated from other players in the region and prepare for integration into the Eurasian Union.

Turkmenistan's Position and Strategy

Turkmenistan is mostly desert, and the majority of its population lives along two river oases in the country's northern and southern extremities — the Amu Darya and Karakum canals, respectively. The small population facilitates internal consolidation, making Turkmenistan one of the region's most consolidated countries under a centralized state.

However, the concentration of its population near the borders of two much larger powers — Uzbekistan and Iran — has led Turkmenistan to develop an attitude of isolation and resistance toward these powers, and the centralization of control has limited Turkmenistan's engagement with the West. Russia is seen as Turkmenistan's security guarantor against these countries but is also viewed as a potential threat, hence Turkmenistan's preference for a neutral policy and avoidance of Russia's alliance system as much as possible. The other main driver of Turkmenistan's foreign policy is its vast energy resources, particularly natural gas. These resources until recently were almost entirely integrated into Russia's energy system. However, a cutoff of supplies in 2009 due to Russia's own energy glut led Turkmenistan to seek other markets, notably China and Iran. Turkmenistan prefers to use energy to balance between Russia and China in order to maintain its isolation and maximize its energy revenues.

Turkmenistan's energy diversification will be the key issue for Russia to manage, though Russia will maintain a strong foothold in Turkmenistan due to the country's security concerns and isolationist policy. Turkmenistan will be one of the last countries in the region to participate in Russia's integration efforts.

Kyrgyzstan

Kyrgyzstan provides Russia with a buffer to the south against China and Afghanistan. It is part of the drug route from Afghanistan into Russia. Its location in the highlands of the Fergana Valley keeps regional power Uzbekistan in check.

Russia's Levers

- Political: Russia has ties to Kyrgyzstan's security, business and political elites. Current Kyrgyz President Almazbek Atambayev is a strategic partner for Russia.
- Social: Russians make up about 9 percent of the Kyrgyz population, constituting a considerable minority. Russian is one of Kyrgyzstan's official languages.
- Security: Kyrgyzstan is a member of the Russia-led CSTO. Russia maintains a military base in Kant and other military installations in Kara Balta, Bishkek and Karakol. In July 2009 Kyrgyzstan granted Russia permission to build another base in Osh, near the Uzbek border.
- Economic: Kyrgyzstan has officially applied to join the Russia-led customs union. Russia pays Kyrgyzstan rent for its Kant airbase and provides most of the country's refined energy supplies. Russia also provides financial assistance through loans and grants. Many Kyrgyz migrants work in Russia and send home remittances that made up more than 15 percent of the Kyrgyz gross domestic product in 2009.

Russia's Successes, Obstacles and Ambitions

Russia facilitated the April 2010 revolution that deposed Kyrgyz President Kurmanbek Bakiyev and installed a more Kremlin-friendly government. Russia also increased its security presence in the country and granted financial assistance to gain the new government's loyalty.

Russia's goals for 2012 and beyond include building up its military presence in the country, particularly in the south. Moscow also wants to formalize Kyrgyzstan's membership in the Customs Union and prepare the country for membership in the Eurasian Union.

Kyrgyzstan's Position and Strategy

Kyrgyzstan is almost entirely mountainous, a geography which greatly hampers the internal consolidation of any government in the country. The mountains split parts of the country from each other, creating a divide between the north (centered in Bishkek) and the south (centered in the Fergana Valley). Leaders have come from one of these two regions and had difficulty controlling the other region. Other factors, such as a large Uzbek minority in the south and increasing separatist and militant activity have also undermined the Kyrgyz state's internal consolidation.

Kyrgyzstan's pervasive internal instability has complicated its foreign policy, but the country has largely depended on Russia as a security guarantor against Tajikistan and Uzbekistan. Kyrgyzstan's previous leaders — Bakiyev and Askar Akayev before him — attempted to balance between outside powers, particularly Russia and the United States and their use of military bases in the country, and were deposed in large part because of it. Kyrgyzstan has built up its economic ties with China, but Russia still has the most important role because it supplies refined energy products and financial assistance. Among Central Asian countries Kyrgyzstan is one of the most loyal to Russia and its interests.

Kyrgyzstan likely will support Russia's integration efforts in the region and the rest of the former Soviet Union, though chronic internal instability will make the country difficult for Russia to rely on fully.

Tajikistan

Tajikistan serves Russia as a buffer to the south in the Pamir Mountains against China and South Asian powers. Its geography and border with Afghanistan also puts it along a primary route for drug smuggling from Afghanistan into Russia.

Russia's Levers

- Political: Russia has some ties to Tajik political and security elites and, despite occasional diplomatic tensions, supports Tajik President Emomali Rakhmon.
- Social: Russians used to make up a sizable minority in Tajikistan, but most emigrated after independence. The population now is predominantly Muslim and ethnic Persian.
- Security: Tajikistan is a member of the CSTO. Russia has several military bases in the country and assists Tajik authorities in counterterrorism operations and sweeps.
- Economic: Remittances from Tajik migrants working in Russia make up 35 percent of Tajikistan's gross domestic product. Russia also gives Tajikistan billions of dollars worth of food and financial aid each year and mediates between Tajikistan and its neighbors to secure electricity supplies.

Russia's Successes, Obstacles and Ambitions

Russia has strengthened its military presence in Tajikistan over the past few years. However, it has not been able to secure use of the Ayni air base or resume patrols along the Tajik-Afghan border.

Russia intends to strengthen its security presence in Tajikistan by reaching a deal on the use of the Ayni airbase and arranging to resume patrols along the Tajik-Afghan border. Moscow also wants to prepare Tajikistan for membership in the customs union and eventually the Eurasian Union after Kyrgyzstan joins.

Tajikistan's Position and Strategy

Like Kyrgyzstan, Tajikistan is almost entirely mountainous and is therefore difficult to consolidate internally. Indeed, the country fell into civil war immediately after gaining independence from the Soviets. An uneasy peace was reached when Rakhmon gained the presidency in 1994. The eastern part of the country, particularly the Rasht Valley region, remains a rebel stronghold, and the government has limited control over many parts of the country. Militants, separatists and the country's proximity to the conflict in neighboring Afghanistan further undermine internal consolidation.

Also like Kyrgyzstan, Tajikistan depends on Russia as its security guarantor against Uzbekistan and other external threats. Several Russian military bases are located throughout the country. China has an economic presence in the country, and Iran has social and cultural ties to Tajikistan, but these are limited compared to Russia's influence and levers in the country. Tajikistan has sought to elicit concessions from Russia for the military access it has granted to Moscow, such as lower prices for refined products and Russian participation in hydroelectricity projects, and has stood up to Russia on some security concessions like the Ayni air base or the return of Russian border guards (which is key to controlling the drug flow from Afghanistan).

Russia's resurgence in Tajikistan will be slow and difficult, due to threats like militant and drug-trade spillover from Afghanistan and Rakhmon's resistance to giving Russia full access to the country. However, Russia's influence in Tajikistan will continue to grow.

PART 3: INDIA

The Geopolitics of India: A Shifting, Self-Contained World

December 16, 2008

The geopolitics of India must be considered in the geographical context of the Indian subcontinent — a self-contained region that includes India, Pakistan, Bangladesh and, depending how one defines it, Nepal and Bhutan. We call the subcontinent "self-contained" because it is a region that is isolated on all sides by difficult terrain or by ocean. In geopolitical terms it is, in effect, an island.

This "island" is surrounded on the southeast, south and southwest by the Bay of Bengal, the Indian Ocean and the Arabian Sea. To the west, it is isolated by mountains that rise from the Arabian Sea and run through Pakistan's Baluchistan province, stretching northward and rising higher and higher to the northwestern corner of Pakistan. There, at the Hindu Kush, the mountain chain swings east, connecting with the Pamir and Karakoram ranges. These finally become the Himalayas, which sweep southeast some 2,000 miles to the border of Myanmar, where the Rakhine Mountains emerge, and from there south to India's border with Bangladesh and to the Bay of Bengal. The Rakhine are difficult terrain not because they are high but because, particularly in the south, they are covered with dense jungle.

SOUTH ASIAN GEOGRAPHY

The Geography of the Subcontinent

The subcontinent physically divides into four parts:

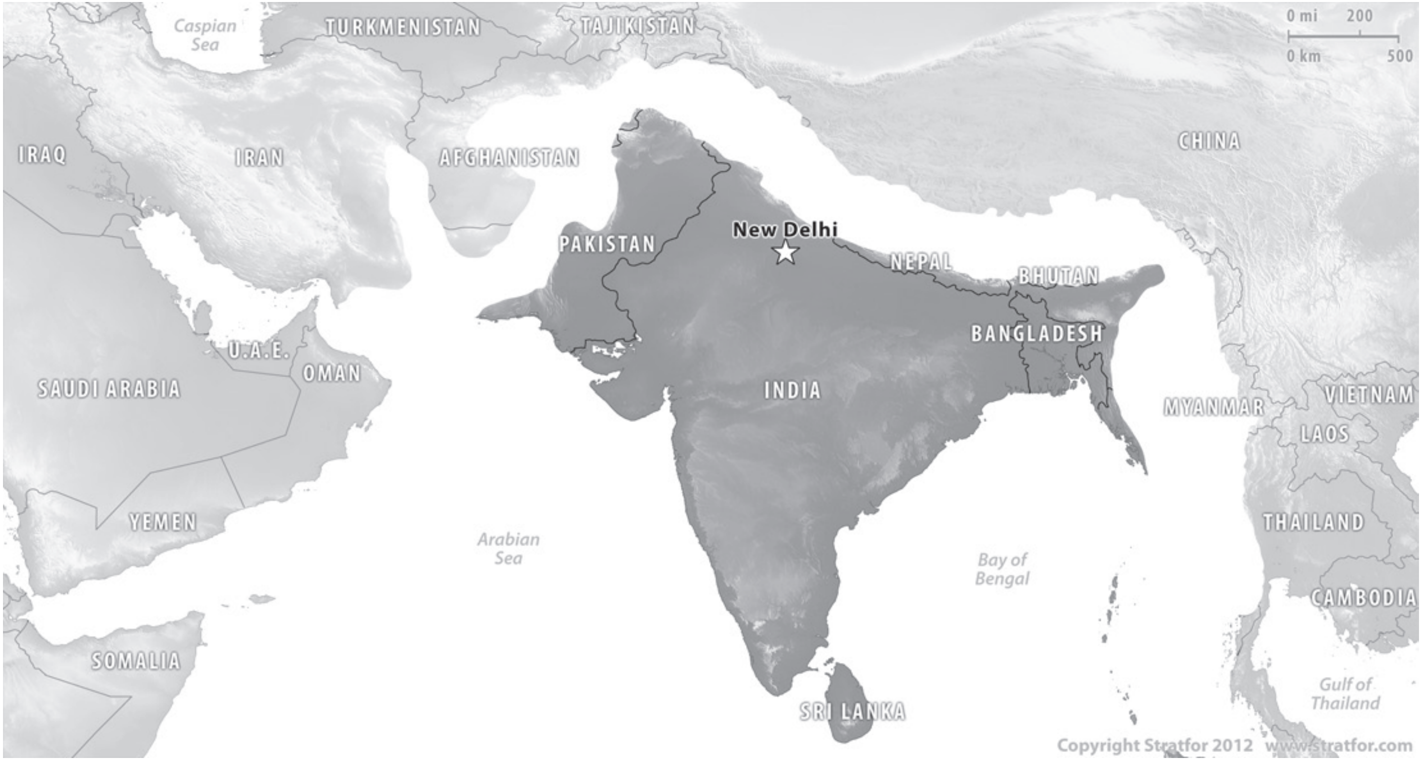
- the mountainous frame that stretches in an arc from the Arabian Sea to the Bay of Bengal;
- the North Indian Plain, stretching from Delhi southeast through the Ganges River delta to the Myanmar border, and from the Himalayas in the north to the southern hills;
- the Indian Peninsula, which juts southward into the Indian Ocean, consisting of a variety of terrain but primarily hilly;
- the deserts in the west between the North Indian Plain and Pakistan's Indus River Valley.

Pakistan occupies the western region of the subcontinent and is based around the Indus Valley. It is separated from India proper by fairly impassable desert and by swamps in the south, leaving only Punjab, in the central part of the country, as a point of contact. Pakistan is the major modern-day remnant of Muslim rule over medieval India, and the country's southwest is the region first occupied by Arab Muslims invading from what is today southwestern Iran and southern Afghanistan.

The third major state in the subcontinent is the Muslim-majority Ganges delta state of Bangladesh, which occupies the area southeast of Nepal. Situated mainly at sea level, Bangladesh is constantly vulnerable to inundations from the Bay of Bengal. The kingdoms of Nepal and Bhutan rest on the heights of the Himalayas themselves, and therefore on the edge of the subcontinent. There is also a small east-west corridor between Nepal and Bangladesh connecting the bulk of India to its restive northeastern states and its eastern border with Myanmar. In this region is India's easternmost state, Arunachal Pradesh, whose territory is also claimed by China.

The bulk of India's population lives on the northern plain. This area of highest population density is the Indian heartland. It runs through the area around Lahore, spreading northwest into Pakistan

INDIA AS AN ISLAND



and intermittently to Kabul in Afghanistan, and also stretching east into Bangladesh and to the Myanmar border. It is not, however, the only population center. Peninsular India also has an irregular pattern of intense population, with lightly settled areas intermingling with heavily settled areas. This pattern primarily has to do with the availability of water and the quality of soil. Wherever both are available in sufficient quantity, India's population accumulates and grows.

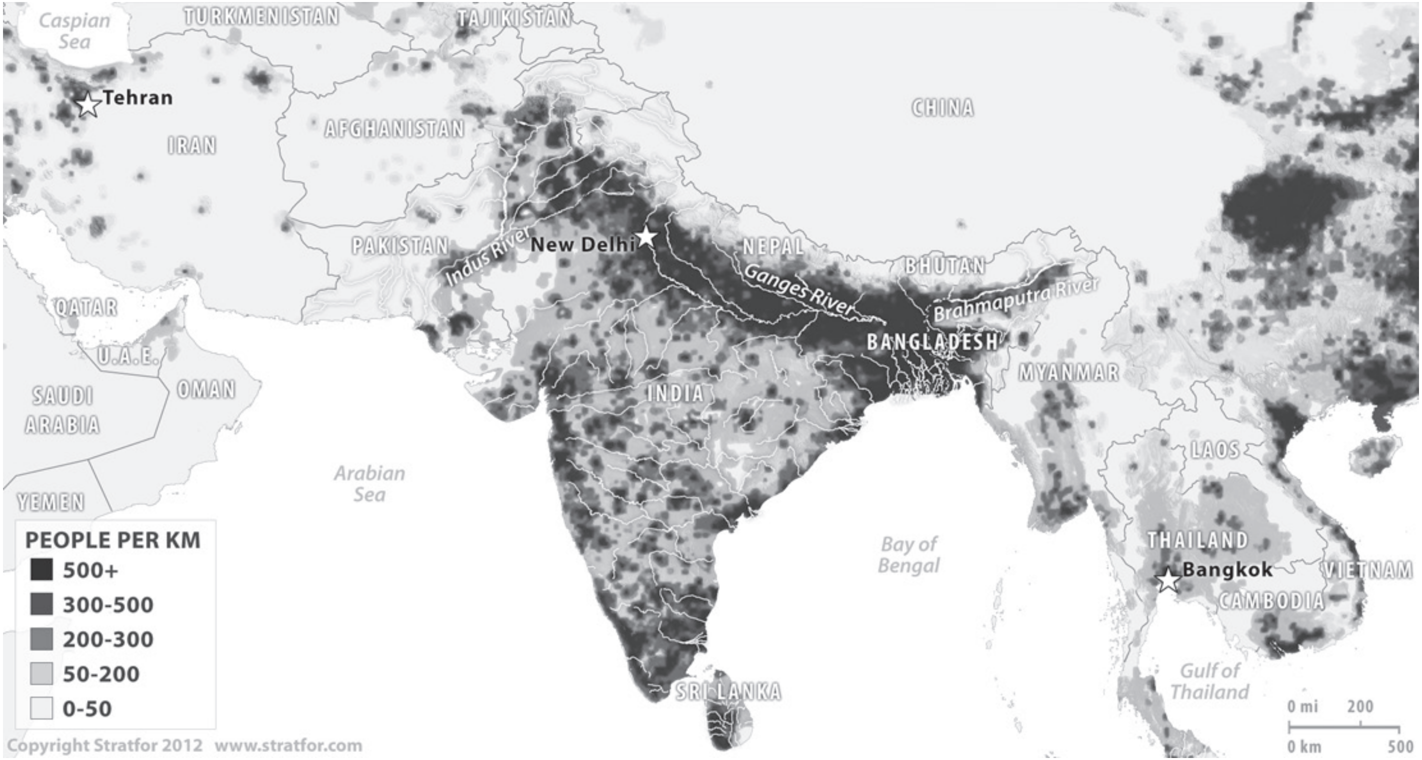
India is frequently compared geographically to non-Russian Europe because both are peninsulas jutting out of the Eurasian land mass. They have had radically different patterns of development, however.

The Europeans developed long-standing and highly differentiated populations and cultures, which evolved into separate nation-states such as Spain, France, Germany and Poland. Their precise frontiers and even independence have varied over time, but the distinctions have been present for centuries — in many cases predating the Roman Empire. The Indian subcontinent, on the other hand, historically has been highly fragmented but also fluid (except when conquered from the outside). Over fairly short periods of time, the internal political boundaries have been known to shift dramatically.

The reason for the difference is fairly simple. Europe is filled with internal geographic barriers: The Alps and Pyrenees and Carpathians present natural boundaries and defensive lines, and numerous rivers and forests supplement these. These give Europe a number of permanent, built-in divisions, with defined political entities and clear areas of conflict. India lacks such definitive features. There are no internal fortresses in the Indian subcontinent, except perhaps for the Thar Desert.

Instead, India's internal divisions are defined by its river systems: the Ganges, the Brahmaputra, the Narmada and so on. All of India's major cities are centered around one of these river systems, a fact that has been instrumental in the rise of so many distinct cultures in India — Punjabis, Gujaratis, Marathis, Tamils and others — which have manifested in modern times as states within India. That said, Indian nationalism is very strong and counters the separatist tendencies.

SOUTH ASIAN POPULATION DENSITY



There is a balance between a strong central governance and substantial regional autonomy.

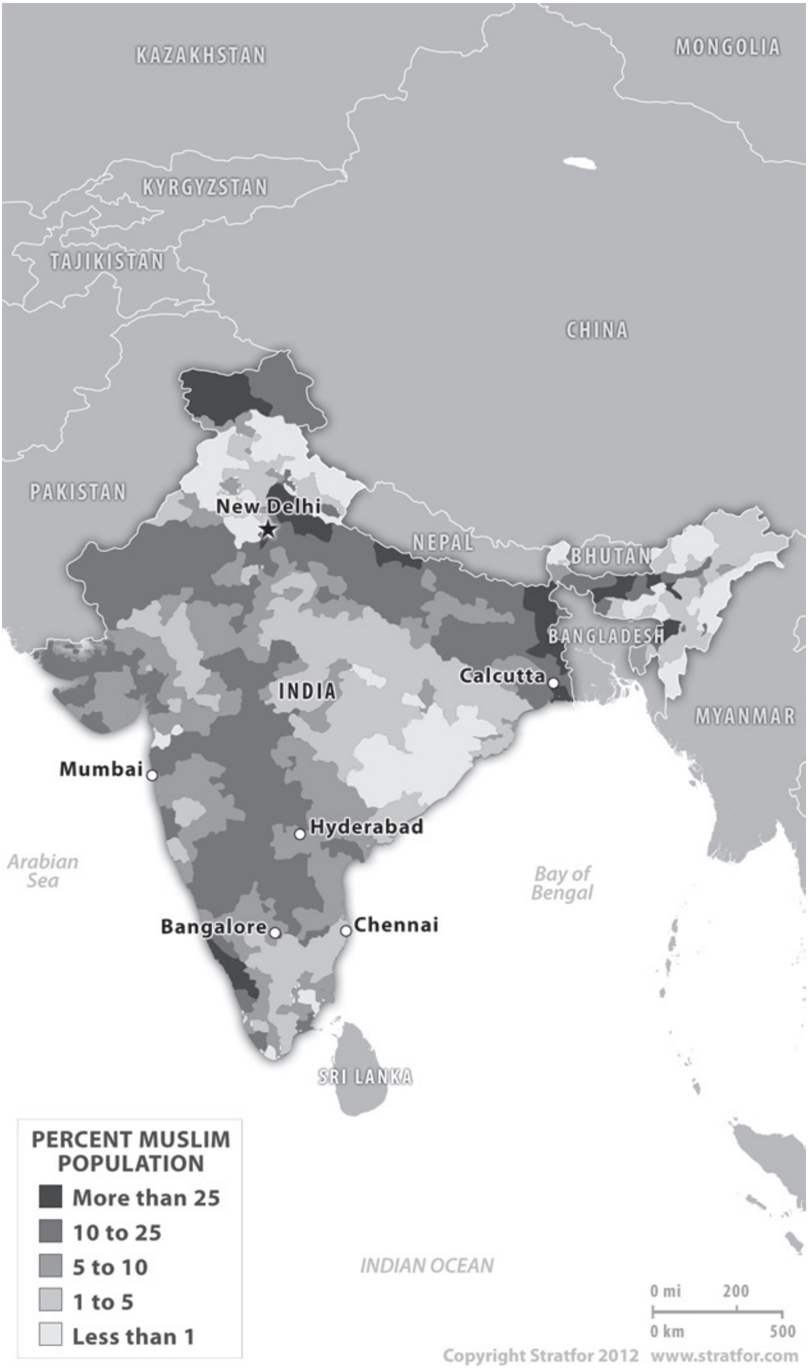
What is permanent in the subcontinent is the frame, the mountains, and beyond these the wastelands. We can see this most clearly when looking at the population distribution of the surrounding regions. The subcontinent is isolated as a population center, surrounded by comparatively empty regions. It is not only a question of the mountains around it, although those are substantial barriers; the terrain beyond the mountains in every direction is sparsely populated, and in many ways its resources are insufficient to support a sizable, sedentary civilization. As a result, India has rarely demonstrated an appetite for adventurism beyond the subcontinent. If India can find a way to manage Pakistan and Bangladesh, there is little pressure to do anything more.

India's Geopolitical Imperatives

The geography of the subcontinent constrains the behavior of governments that arise there. If there is to be an independent India, and if it is to be a stable and secure nation-state, it must do the following things:

- Achieve suzerainty in the Ganges River basin. The broad, braided plains of the Ganges basin are among the most fertile in the world and guarantee a massive population. India must become the premier power in this heartland. This does not mean that such power must be wielded by a unified, centralized authority. A coalition of powers can be functional, and even somewhat hostile powers such as Bangladesh can be tolerated so long as they do not challenge India's authority or security.
- Expand throughout the core of the subcontinent until it reaches all natural barriers. Forests, hills and rivers aside, there is little else in the confines of the subcontinent that limits India's writ. "Control" of the additional territories can be a somewhat informal and loose affair. The sheer population of the Ganges basin

INDIA'S MUSLIM DISTRIBUTION



really requires only that no foreign entity be allowed to amass a force capable of overwhelming the Ganges region.

- Advance past the patch of land separating the Ganges basin from the Indus River basin and dominate the Indus region (meaning Pakistan). The Indus Valley is the only other significant real estate within reach of India, and the corridor that accesses it is the only viable land invasion route into India proper. (Modern India has not achieved this objective, with implications that will be discussed below.)
- With the entire subcontinent under the control (or at least the influence) of a centralized power, begin building a navy. Given the isolation of the subcontinent, any further Indian expansion is limited to the naval sphere. A robust navy also acts as a restraint upon any outside power that might attempt to penetrate the subcontinent from the sea.

These imperatives shape the behavior of every indigenous Indian government, regardless of its ideology or its politics. They are the fundamental drivers that define India as a country, shaped by its unique geography. An Indian government that ignores these imperatives does so at the risk of being replaced by another entity — whether indigenous or foreign — that understands them better.

A History of External Domination

India's geopolitical reality — relative isolation from the outside world, a lack of imposed boundaries, the immense population and the dynamic of a central government facing a vast region — has created localized systems that shift constantly, resist central authority, and ultimately cannot be organized into a coherent whole, either by foreign occupiers or by a native government. It is a landscape of shifting political entities, constantly struggling against each other or allying with each other, amid an endless kaleidoscope of political entities and coalitions. This divided landscape historically has created opportunities for foreign powers to divide India and conquer it — and indeed, the subcontinent was under foreign domination from the 11th century until 1947.

Externally, the threats to India historically have come from the passes along the Afghan-Pakistani border and from the sea. India's solution to both threats has been to accommodate them rather than resist directly, while using the complexity of Indian society to maintain a distance from the conqueror and preserve the cultural integrity of India. (In a sense, Mahatma Gandhi's strategy of nonviolent resistance represents the foundation of India's historical strategy, although the historical basis for Indian nonviolent resistance has been more commercial than ethical.) But essentially, India's isolation, coupled with its great population, allows it to maintain a more or less independent foreign policy and balance itself between great powers.

Between the 11th and 18th centuries, India was ruled by Muslims. The first invasion occupied the area of what is today Pakistan. Over the centuries — under various rulers and dynasties, particularly the Mughals — Muslims expanded their power until they dominated much of India. But that domination was peculiar, because the Muslims did not conquer the Hindus outright. Except in the area west of the Thar Desert and the Ganges delta, they did not convert masses of Indians to their religion. What they did was take advantage of the underlying disunity of India to create coalitions of native powers prepared to cooperate with the invaders. The urge to convert Hindus to Islam was secondary to the urge to exploit India's wealth. Political and military power was a means toward this end, rather than toward conversion, and because of this, the Hindus were prepared to collaborate. In the end, the Indians' internal tensions were greater than their resentment of outsiders.

European powers followed the Muslims into India en masse. Unlike the Muslims, they arrived from the sea, but like the Muslims, their primary motive was economic, and they sought political power as a means toward economic ends. The British, the most permanent European presence in the subcontinent, used India's internal tensions to solidify their own position. They did not conquer India so much as they managed the internal conflicts to their advantage.

What was left behind when the British departed was the same sea of complex and shifting divisions that had defined India before they came. Most of the regions that were Muslim-majority areas became Islamic entities, eventually dividing into Pakistan and Bangladesh. The rest of India was united under a single government, but in a sense, that government ruled in the same way the British had.

The Geopolitics of Modern India

Modern India has its origins in the collapse of the British Empire. Indeed, it was the loss of India that ultimately doomed the British Empire. The entire focus of imperial Britain, from the Suez Canal to Gibraltar and Singapore, was to maintain the lines of supply to India. Many of the colonies and protectorates around the world secured by Britain in the 19th century were designed to provide coaling stations to and from India. In short, the architecture of the British Empire was built around India, and once India was lost, the purpose of that architecture dissolved as well. The historical importance of India could not be overestimated. Lenin once referred to it as the supply depot of humanity — which overstated the case perhaps, but did not overstate India's importance to Britain.

The British gave up India for several reasons, the most important of which was commercial: The cost of controlling India had outstripped the value derived. This happened in two ways. The first was that the cost of maintaining control of the sea-lanes became prohibitive. After World War II, the Royal Navy was far from a global navy. That role had been taken over by the United States, which did not have an interest in supporting British control of India. As was seen in the Suez crisis of 1956, when the British and French tried to block Egyptian nationalization of the canal, the United States was unprepared to support or underwrite British access to its colonies (and the United States had made this clear during World War II as well). Second, the cost of controlling India had soared. Indigenous political movements had increased friction in India, and that friction had increased the cost of exploiting India's resources. As the economics shifted, the geopolitical reality did as well.

The independence of India resulted in the unification of the country under an authentically Indian government. It also led to the political subdivision of the subcontinent. The Muslim-majority areas — the Indus Valley region west and northwest of the Thar Desert, and the Ganges River basin — both seceded from India, forming a separate country that itself later split into modern-day Pakistan and Bangladesh. It was this separatism that came to frame Indian geopolitics.

India and Pakistan, for the bulk of their mutual existence, have had an adversarial relationship. For a long time, the Indian sentiment was that Pakistan's separation from India could have been avoided. This attitude, coupled with Pakistan's own geographic, demographic and economic inferiority, has forced Islamabad to craft its entire foreign policy around the threat from India. As a result, the two sides have fought four wars, mostly over Kashmir, along with one that resulted in the hiving off of Bangladesh.

As noted earlier, the Indian heartland is the northern plain of the Ganges River basin. This plain is separated from Pakistan's heartland, the Indus Valley, only by a small saddle of easily traversed land; fewer than 200 miles separate the two rivers. If India is to have any ambition in terms of expansion on land, the Indus is the only option available — all other routes end either in barriers or in near-wasteland. Meanwhile, the closeness — and sheer overwhelming size — of India is central to Pakistan's mind-set. The two are locked into rivalry.

China and the Himalayan Wall

Apart from this enmity, however, modern India has faced little in the way of existential threats. On its side of the mountain wall, there are two states, Nepal and Bhutan, which pose no threat to it. On the other side lies China.

China has been seen as a threat to India, and simplistic models show them to be potential rivals. In fact, however, China and India might as well be on different planets. Their entire frontier runs through the highest elevations of the Himalayas. It would be impossible for a substantial army to fight its way through the few passes that exist, and it would be utterly impossible for either country to sustain an army there in the long term. The two countries are irrevocably walled off from each other. The only major direct clash between Indian and Chinese forces, which occurred in 1962, was an inconclusive battle over border territories high in the mountains — both in the northeast Indian state of Arunachal Pradesh and the Kashmiri border region of Aksai Chin — that could lead nowhere.

A potential geopolitical shift would come if the status of Tibet changed, however. China's main population centers are surrounded by buffer states — Manchuria, Inner Mongolia, Xinjiang and Tibet. So long as all are in Chinese hands, the core of China is invulnerable to land attack. If, however, Tibet were to become independent, and if it allied with India, and if it permitted India to base substantial forces in its territory and to build major supply infrastructure there, then — and only then — India could be a threat to China. This is why the Indians for a long time championed the Dalai Lama and Tibetan independence movements, and why the Chinese until fairly recently regarded this as a major threat. Had a pro-Indian, independent government been installed in Tibet, the threat to China would be significant. Because New Delhi held open the option of supporting Tibetan independence, Beijing saw the Indians as engaged in developing a threat to China.

The Chinese tried to develop equivalent threats in India, particularly in the form of Maoist communist insurgencies. Indian Maoists (Naxalites) and Nepalese Maoists have been supported by Beijing, though that support is no longer what it used to be. The Chinese have lost interest in aggressive Maoism, but they do have an interest in maintaining influence in Nepal, where the Maoists recently increased their power through electoral gains. This is China's counter to India's Tibet policy.

But for both, this is merely fencing. Neither would be in a position militarily to exploit an opening. Stationing sufficient force in Tibet to challenge the Chinese People's Liberation Army would outstrip India's resources, and for little purpose. Using Nepal as a base from which to invade India would be similarly difficult and pointless for Beijing. At the moment, therefore, there is no Indo-Chinese geopolitical hostility. However, these would be points of friction if such hostility were to occur in the distant future.

Russia, the United States and Pakistan

In the absence of direct external threats, modern India's strategic outlook has been shaped by the dynamics of the Cold War and its aftermath. The most important strategic relationship that India had after gaining independence from Britain in 1947 was with the Soviet Union. There was some limited ideological affinity between them. India's fundamental national interest was not in Marxism, however, but in creating a state that was secure against a new round of imperialism. The Soviets and Americans were engaged in a massive global competition, and India was inevitably a prize. It was a prize that the Soviets could not easily take: The Soviets had neither an overland route to India nor a navy that could reach it.

The United States, however, did have a navy. The Indians believed (with good reason) that the United States might well want to replace Britain as a global maritime power, a development that might put India squarely in Washington's sights. The Indians saw in the United States all the same characteristics that had drawn Britain to India. Elsewhere, India saw the United States acting both to hurry the disintegration of the European empires and to fill the ensuing vacuum. India did not want to replace the British with the Americans — its fundamental interest was to retain its internal cohesion and independence. Regardless of American intent — which the Indians saw as ambiguous — American capability was very real, and from the beginning the Indians sought to block it.

For the Indians, the solution was a relationship, if not quite an alliance, with the Soviet Union. The Soviets could provide economic aid and military hardware, as well as a potential nuclear umbrella (or at least nuclear technical assistance). The relationship with the Soviet Union was perfect for the Indians, since they did not see the Soviets as able to impose satellite status on India. From the American point of view, however, there was serious danger in the Indo-Soviet relationship. The United States saw it as potentially threatening U.S. access to the Indian Ocean and lines of supply to the Persian Gulf. If the Soviets were given naval bases in India, or if India were able to construct a navy significant enough to threaten American interests and were willing to act in concert with the Soviets, it would represent a serious strategic challenge to the United States.

In the late 1950s and early 1960s, the United States was facing a series of challenges. The British were going to leave Singapore, and the Indonesian independence movement was heavily influenced by the Soviets. The Egyptians, and therefore the Suez Canal, also were moving into the Soviet camp. If India became a pro-Soviet maritime power, it would simply be one more element along Asia's southern rim threatening U.S. interests. The Americans had to act throughout the region, but they needed to deal with India fast.

The U.S. solution was an alliance with Pakistan. This served two purposes. First, it provided another Muslim counterweight to Nasserite Egypt and left-leaning Arab nationalism. Second, it posed a potential threat to India on land. This would force India to divert resources from naval construction and focus on building ground and air forces to deal with the Pakistanis. For Pakistan, geographically isolated and facing both India and a not-very-distant Russia, the relationship with the United States was a godsend.

It also created a very complex geographical situation.

The Soviet Union did not directly abut Pakistan — the two were separated by a narrow strip of territory in the northeasternmost confines of Afghanistan known as the Wakhan Corridor. The Soviets could not seriously threaten Pakistan from that direction, but the U.S. relationship with Pakistan made Afghanistan a permanent Soviet interest (with full encouragement of the Indians, who wanted Pakistan bracketed on both sides). The Soviets did not make a direct move into Afghanistan until late 1979, but well before then they tried to influence the direction of the Afghans — and after moving, they posed a direct threat to Pakistan.

China, on the other hand, did border on Pakistan and developed an interest there. The aforementioned Himalayan clash in 1962 did not involve only India and China. It also involved the Soviets. India and China were both putatively allied with the Soviet Union. What was not well known at the time was that Sino-Soviet relations had deteriorated. The Chinese were very suspicious of Soviet intentions and saw Moscow's relationship with New Delhi as potentially an alliance against China. Like the Americans, the Chinese were uneasy about the Indo-Soviet relationship. Therefore, China also moved to aid Pakistan. It was a situation as tangled as the geography, with Maoist China and the United States backing the military dictatorship of Pakistan and the Soviets backing democratic India.

From the Indian point of view, the borderland between Pakistan and China — that is, Kashmir — then became a strategically critical matter of fundamental national interest. The more of Kashmir that India held, the less viable was the Sino-Pakistani relationship. Whatever emotional attachment India might have had to Kashmir, Indian control of at least part of the region gave it control over the axis of a possible Pakistani threat and placed limits on Chinese assistance. Thus, Kashmir became an ideological and strategic issue for the Indians.

Shifting Alliances and Enduring Interests

In 1992, India's strategic environment shifted: The Soviet Union collapsed, and India lost its counterweight to the United States. Uncomfortable in a world that had no balancing power to the United States, but lacking options of its own, India became inward and cautious. It observed uneasily the rise of the pro-Pakistani Taliban government in Afghanistan — replacing the Indian-allied Soviets — but it lacked the power to do anything significant. The indifference of the United States and its continued relationship with Pakistan were particularly troubling to India.

Then, 2001 was a clarifying year in which the balance shifted again. The attack on the United States by al Qaeda threw the United States into conflict with the Taliban. More important, it strained the American relationship with Pakistan almost to the breaking point. The threat posed to India by Kashmiri groups paralleled the threat to the United States by al Qaeda. American and Indian interests suddenly were aligned. Both wanted Pakistan to be more aggressive against radical Islamist groups. Neither wanted further development of Pakistan's nuclear weapons. Both were happy to be confronting the Pakistanis with more and more aggressive demands.

The realignment of Indian relations with the United States did not represent a fundamental shift in Indian geopolitics, however. India continues to be an island contained by a ring of mountains. Its primary interest remains its own unity, something that is always at risk due to the internal geography of the subcontinent. It has one enemy on the island with it, but not one that poses a significant threat — there is no danger of a new generation of Muslim princes entering from Pakistan to occupy the Indian plain. Ideally, New Delhi wants to see a Pakistan that is fragmented, or at least able to be controlled. Toward this end, it will work with any power that has a common interest and has no interest in invading India. For the moment, that is the United States, but the alliance is one of convenience.

India will go with the flow, but given its mountainous enclosure it will feel little of the flow. Outside its region, India has no major strategic interests — though it would be happy to see a devolution of Tibet from China if that carried no risk to India, and it is always interested in the possibility of increasing its own naval power (but never at the cost of seriously reshaping its economy). India's fundamental interest will always come from within — from its endless, shifting array of regional interests, ethnic groups and powers. The modern Indian republic governs India. And that is more important than any other fact in India.

India Between China and Russia

December 23, 2010

Chinese Premier Wen Jiabao concluded a five-day trip to India and Pakistan on Dec. 19. Now that the fanfare has died down it is time to take stock of what exactly transpired. On the surface, Wen and his hosts signed billions of dollars of deals of every kind, but on a deeper level, Wen reinforced India's impression that China's support for Pakistan is deepening to a degree commensurate with India's increasing suspicion of China's strategic intentions in the region.

Though the press was rife with conflicting details, it appears Wen agreed to $16 billion worth of deals while in India. This headline figure, of course, will not be immediately actualized; it is simply the estimated sum total of a series of deals regarding projects of various types, at various stages of realization, and on various time frames for completion. According to The Hindu and other Indian press reports:

- China Development Bank signed an agreement to provide $4.63 billion worth of financing to Reliance Power Ltd., including $1.1 billion for the Sasan Ultra Mega Power Project, and a $400 million credit facility to ICICI Bank (formerly Industrial Credit and Investment Corporation of India).
- China Development Bank also signed a financing agreement worth $2 billion with Reliance Communications.
- Bank of China agreed to provide $1.2 billion worth of credit for IDBI Bank (Industrial Development Bank of India).
- Industrial and Commercial Bank of China (ICBC) agreed to provide a $1 billion credit facility for ICICI Bank.
- Sepco and Shandong agreed to provide power equipment to the Adani Group for $3.63 billion.
- Shandong and Tamil Nadu Power Corporation agreed to a purchase contract of $800 million in equipment.

- China Aluminum agreed to $330 million in exports of metal products for Vedanta.
- Dofang Electric agreed with Abhijeet Projects to a sale of power equipment worth $2.5 billion.

The grand total of these deals is indeed around $16 billion, though about $9 billion of that is in loans or other financial instruments. Still the sum is larger than the nominal amounts agreed to when U.S. President Barack Obama ($10 billion) and French President Nicolas Sarkozy ($13 billion) visited India earlier this year on similar trade-heavy tours. Furthermore, just before Wen's trip, Chinese telecommunications giant Huawei declared it would invest $2 billion in creating a research and development site in Bangalore and a factory in Chennai.

China's Goals for Pakistan

Reports from Pakistan also featured the signing of several mega-deals. The Associated Press of Pakistan reported that the two sides forged agreements worth $10 billion for public-private partnerships and $5 billion for private sector-only partnerships, including $6.5 billion for wind and solar power projects. Some reports even claimed the totals were $20 billion and $15 billion, but as previously mentioned a good portion of these deals remain theoretical. More concretely, Beijing gave $229 million to help Pakistan recover from devastating flooding this summer, a $400 million loan without a specific target (one of the reasons countries like Pakistan love China), and $35 million to start a cultural center. The agreements focused on natural resource extraction, oceanography, space, electronics and heavy industry. Financial integration also progressed, with ICBC set to open a branch in Islamabad and Karachi, while gaining agreement from the Pakistani side to have a currency swap arrangement, part of Beijing's effort to gradually acquaint foreign states with holding the Chinese yuan, in anticipation of eventual internationalization of the currency.

But most interesting by far were reports that China would continue helping Pakistan build infrastructure, including improving the obstacle-prone Karakorum Highway that links Pakistan to China's restive Xinjiang region and helping to "operationalize" Pakistan's Gwadar port. The port was built by Chinese construction companies but at present is still serviced by inadequate roads and no rail; moreover, the Pakistanis have suggested that China could become the operator after dissatisfaction over the current Singaporean operator. Strategically, China's goal is to have a pipeline and railroad linking Gwadar, via the Karakorum route, to Kashgar in Xinjiang, with the purpose of accessing the Indian Ocean by land and thus bypassing the maritime bottlenecks of Southeast Asia. Stratfor sources in Beijing suggest that Chinese investments in Pakistani mineral extraction, processing and distribution are more extensive than appears from these prominent deals, and that Beijing continues to entrench itself deeper into Pakistan's production of precious metals and energy while building extensive infrastructure with strategic value.

These projects are precisely what have caused India to become even more uneasy about China's deepening assistance for Pakistan. India became exceedingly alarmed earlier this year when it learned that Chinese People's Liberation Army engineers and troops were assisting and guarding over construction on the Chinese side of the Karakorum Highway, with some allegedly working on the Pakistani side. China and Pakistan are old allies, yet India's primary security threat emanates from Pakistan, including state-condoned militancy. In contrast to widespread criticism, Wen explicitly praised Pakistan for its successes in fighting militancy. Thus, India sees China's support for Pakistan as crucial in enabling unstable Pakistan to continue threatening India. New Delhi likely sees analogy in the way that China's unconditional support for North Korea has emboldened it to act more aggressively toward South Korea and fears something similar taking place in its neighborhood. From the Chinese point of view, needless to say, these projects are legitimate in themselves, and the fact that they aim at connecting China to the Indian Ocean does not mean they threaten India.

Thus while Wen's trip created buzz about deepening economic relations between China and India — and no doubt a number of big-ticket business deals were signed — the real story here is the further entrenching of Chinese economic influence in Pakistan and India's growing insecurity. India's insecurity is compounded by its frustration that its major counterweight to China is supposed to be the United States, and yet the U.S. dependence on Pakistan for assistance in combating the Taliban and al Qaeda has prevented it from exerting excessive pressure on Pakistan in the way that India would prefer. Similarly, Washington and Beijing have a relationship separate from India. Though China harbors anxieties over the budding Indo-American strategic partnership, India has pointed to difficulties in this arrangement and frustration over what it fears may be empty American promises.

A Russian Counterbalance

Thus, India is interested in cultivating other options. It is no coincidence that after a year of top-level delegations from the United States, France, Britain and China seeking to invest in Indian growth, Russia, too, would pay a visit. Russian President Dmitri Medvedev arrived Dec. 20 to discuss the full spectrum of Russo-Indian ties. These two states cooperated nicely throughout the Cold War and have little cause for insecurity about each other. However, Russian attention waned after the Soviet collapse and subsequent focus on rebuilding influence in former Soviet territories over the past 10 years. Moscow has delayed delivering on major arms sales to India, dampening optimism over the agreement that Medvedev and Indian Prime Minister Manmohan Singh signed Dec. 21 to jointly develop a fifth-generation stealth fighter jet and build 250-300 of them by 2030, a deal theoretically worth around $30 billion. The Russians have also moved slowly in implementing agreements on assistance in civil nuclear cooperation, such as making operational the nuclear power plant at Kudankulam (the first of two units is set to begin running in 2011) and setting a price to build two more proposed units.

But none of this means the relationship has turned cold. Medvedev's trip showed the countries not only striking their own set of major deals in several sectors but also showing Moscow reaffirm its support of India's stance on a number of international issues. Medvedev's sharply worded statements calling for the capture and extradition of international terrorists was received as moral support for India in its squabbles with Pakistan, and he spoke approvingly of India joining the Nuclear Supplier's Group and the Shanghai Cooperation Organization as a full member (rather than observer) and becoming a permanent member in a reformed U.N. Security Council. These proposals do not sit well with China, which would prefer not to dilute its power in these organizations, especially for the sake of India gaining power in them. Russia's support for a broad-based regional solution in Afghanistan also comes across as helpful from India's point of view, lest the United States, Afghanistan and Pakistan decide how the situation will conclude without Indian input.

Though Russia has not yet lived up to some of its grander promises, it potentially provides India with an option for counterbalancing China without relying wholly on the United States. China cannot approve of this, but it has found some common ground with Russia that it would prefer to hold, making for an interesting dynamic between the three and in the region.

India Looks East to Malaysia and Japan

February 20, 2011

As part of India's "Look East" policy (LEP), India signed a Comprehensive Economic Partnership Agreement (CEPA) with Japan on Feb. 16 and a Comprehensive Economic Cooperation Agreement (CECA) with Malaysia on Feb. 18. The agreements embody India's deepening interests in Southeast and East Asia, especially following the signing of $15 billion in business deals with

Indonesia in January. While New Delhi's relationship with Malaysia is primarily economic with a security component, its relations with Japan have a distinctly strategic cast.

The two-decade-old LEP originated in the economic turmoil that followed the collapse of India's former patron and main trade partner, the Soviet Union. India adopted a foreign policy initiative of embracing its East Asian neighbors as a new source of growth. Over the past decade, India's exports to the Association of Southeast Asian Nations (ASEAN) member states have boomed, making the block an Indian trading partner roughly equal in size to China.

The LEP is not about economics alone, however; it also encompasses efforts to deepen security ties. India intensified its LEP in light of China's rise, a rise that has sounded alarms in New Delhi and throughout Southeast and East Asia. China has become more obtrusive in the region in the past two years especially, prompting India to move faster.

While the ASEAN states want to continue trading and expanding economic integration with China, they have begun to deepen their relationships with larger powers, particularly the United States, as a hedge against the threat of being overwhelmed by China. The United States, which has renewed its engagement with the region, has encouraged its allies in Asia to strengthen economic and security ties among each other to shape and constrain China's rise. India's eastward drive meshes relatively well with both ASEAN's search for alternate options and the United States' goals for the region's economic and security architecture.

Malaysia

As part of India's LEP, Malaysia has participated in India's Milan naval war games since 1997, and in 2008 the Indian air force began a two-year commitment to train Malaysian pilots to operate the Russian-made Sukhoi Su30-MKM Flankers. But the Indo-Malaysian CECA is an alliance of convenience in which each side hopes to promote economic growth. The bilateral agreement builds on the 2009 India-ASEAN free trade agreement covering goods. By contrast, CECA will cover goods, services and investments, with the expectation that it should boost bilateral trade from $8.5 billion in 2010 to $15 billion by 2015 by removing red tape and cutting tariffs on more than 90 percent of goods.

Malaysia hopes to boost trade along the lines of what happened when India and Singapore signed a CECA in 2005. Malaysia, India's second-largest trade partner in ASEAN, needs to reboot its exports and attract investment after suffering massive capital flight during the global recession. The coalition that has ruled Malaysia throughout its modern history has lived in fear since it lost a parliamentary supermajority in national elections in 2008; it worries it will suffer a further erosion of popular support in upcoming elections if it cannot deliver economic growth. This desire has helped it overcome previous reservations it had about ASEAN's developing a deeper relationship with India. Of course, a potential sore spot in Indo-Malaysian relations is that Malaysia has a large Indian diaspora of approximately 2 million. This group is poorer than the average majority Malay and capable of swinging to support the opposition to Malaysia's ruling party as it did in 2008. Malaysia will thus hope that better ties with India bring economic benefits while helping to manage, or at least not complicating, this aspect of its domestic politics.

Japan

While India's relationship with Japan has economic dimensions, there is a decidedly more strategic substance to it.

Recently, Japan expressed its desire to rejuvenate its outward economic strategy by signing more trade deals with partners like India and increasing high-tech exports. Despite its size and wealth, Japan takes in roughly the same share of India's exports as Malaysia does. India and Japan occupy economic niches that do not conflict, as India is a large service, information technology and agricultural economy and Japan concentrates on high technology and machinery manufacturing. Neither India nor Japan is particularly comfortable exposing protected areas of their economy, such as retail and agriculture for Japan or agriculture and manufacturing for India, to foreign competition or influence. The underlying lack of economic threat from each other and their mutual economic needs have given more impetus to signing their deal, however.

While both countries' legislatures still need to ratify the deal, which could be a deliberate process, the trade agreement would eliminate tariffs on 90 percent of Japanese exports to India, such as electric appliances and auto parts, and on 97 percent of imports from India by 2021. It also would allow Japanese companies to acquire controlling stakes in Indian corporations and establish franchises in India. In return, tariffs on Indian fisheries, mining and some agricultural products will be lifted. Notably, the two are discussing lifting employment restrictions to allow Indians to work in Japan as caregivers and nurses. Japan has a rapidly aging population and needs the labor, but it has a strong political aversion to immigration — thus, this element of the deal may imply that Japan is becoming more willing to make compromises in order to sign trade deals.

On the security front, in the past decade Japan has sought to enhance its supply line security through a greater naval presence in the Indian Ocean. Consequently, Japan has envisioned a greater security relationship with India as a means of accessing this ocean. India welcomes Japanese involvement, knowing that China's push into its periphery continues apace. Both India and Japan share an interest in preventing China from becoming an overbearing regional power, yet neither poses a direct threat to the other, enabling them to work together out of their self-interested desires to distract China's energies.

The United States has recently taken to encouraging India's eastward drive and stronger Indo-Japanese coordination. But even without American urging, Japan and India would be inclined to take advantage of each other as a means of undercutting China.

Assessment

There are constraints to India's LEP, however. Although India historically projected power into Southeast Asia, it is a relative latecomer to the contemporary Southeast Asian game. Moreover, India's deepest concerns lie in its own periphery. Pakistan remains the greatest security threat. Unlike China, Japan, South Korea and others, India does not depend on Southeast Asian sea-lanes for its vital supplies, though it has taken a much greater interest in sea-lane security due to its growing trade with the region and desire not to cede space to China.

Ultimately, while agreements like CEPA and CECA are not paradigm-shifting moments, they mark the advance of India's LEP at a time when Southeast and East Asia are evolving in rapid and potentially volatile ways.

The Indian Prime Minister's Visit to Afghanistan

May 11, 2011

Indian Prime Minister Manmohan Singh will make an official visit to Afghanistan from May 12 to May 13 at the invitation of Afghan President Hamid Karzai. Singh said in a May 11 statement that India takes a "long-term view" of its partnership with Afghanistan and described Indian aid to Afghanistan, currently measured at $1.5 billion since the war began, as "enduring" and welcomed by the majority of the Afghan populace.

Singh's carefully timed visit to Afghanistan will take place amid high geopolitical tensions on the subcontinent. The last time Singh made a high-level visit to Afghanistan was in 2005, when the United States was far more focused on its war effort in Iraq than it was on Afghanistan. Over the course of the past decade, India has used the fall of the Taliban as an opening to develop a strategic foothold in Pakistan's western periphery. It has relied mostly on developmental projects to bolster ties with Kabul while building up intelligence assets to keep an eye on Pakistan's activities and maintain ties with an array of mostly Tajik anti-Taliban and anti-Pakistan forces in the country. Pakistan, focused on extending its strategic depth in Afghanistan and on keeping its much larger and more powerful Indian rival at bay, has made no secret of its objections to India's gradually growing presence in Afghanistan. In fact, Pakistan has demanded that the United States actively block Indian influence in Afghanistan as part of the price Islamabad has set for Pakistani cooperation in the U.S. war efforts there.

Pakistan's hard rejection of an Indian presence in Afghanistan and the nature of some attacks on Indian targets have fueled speculation that Pakistan's Inter-Services Intelligence (ISI) agency has had a hand in militant plots against Indian diplomatic targets in Afghanistan. For instance, New Delhi viewed a 2008 suicide bombing on the Indian Embassy in Kabul that killed 58 people, including the Indian defense attache and political and information counselor, as a warning by Islamabad to keep off Pakistan's turf. Just a day before Singh's scheduled visit to Kabul, Afghanistan's intelligence agency announced it had arrested two suspected Afghan men "paid by a foreign intelligence service" to attack the Indian Consulate in Nangarhar province, reflecting the security concerns with which India has been dealing in trying to obscure details of Singh's visit to Kabul.

Pakistan is not the only country wary of Singh's upcoming visit to Kabul. India's attempts to stake a claim in Afghanistan are a major complicating factor to the U.S. relationship with Pakistan. In the early days of the war, the United States could more easily rely on India in trying to coerce Pakistan into cooperation, but that policy is riskier now. With the May 2 killing of al Qaeda leader Osama bin Laden, the United States is now in a position to hasten its withdrawal from Afghanistan. India is concerned that any U.S. exit strategy for the war in Afghanistan is dependent on cooperation from Pakistan, as Islamabad has the vital intelligence links and relationships with the Afghan Taliban that the United States needs to forge the political understanding necessary to end the war. This entails a long and arduous process between Washington and Islamabad. For New Delhi, this means that while the United States will take care to maintain its relationship with India, it is unlikely to make any moves that would overly aggravate Islamabad, including moves that underscore a burgeoning U.S.-India strategic partnership and show strong U.S. support for an Indian role in Afghanistan. This could explain why U.S. special envoy for Afghanistan and Pakistan Mark Grossman asked India prior to the May 2 killing of bin Laden to delay Singh's trip to Afghanistan.

India is on the losing end of this battle for influence in Afghanistan. Not only does it face logistical difficulty in operating in a land separated by its principal enemy and largely devoid of security, but it also lacks the diplomatic support to further develop its presence in Afghanistan beyond its development projects currently under way and the relationships it has maintained with anti-Taliban elements in the former Northern Alliance. India has also attempted to involve itself in a number of international forums on Afghanistan's development and political future, but is usually excluded from the discussion due to the host's sensitivities to Pakistan, as illustrated by previous Afghanistan summits led by the United States and Turkey.

The reality of New Delhi's limits in Afghanistan amounts to a significant security risk for India, as the Indian government cannot be guaranteed that Pakistani cooperation with the United States on the war in Afghanistan would ensure Islamabad's ending its policy of sponsoring militants with an eye on Indian targets. India was more than pleased to learn that the world's most wanted terrorist was killed not in the lawless borderlands between Afghanistan and Pakistan but deep in Pakistani territory in Abbottabad. That fact alone has been used by India to bolster its claim that more needs to be done to pressure Pakistan into ending its alleged state sponsorship of terrorism, including groups that focus their militant activity on India. Building on U.S.-Pakistani tensions in the wake of the bin Laden killing, India released to the media May 11 a list of 50 criminals allegedly being harbored by Pakistan that it wants extradited. The list includes prominent underworld figures like Dawood Ibrahim; members of al Qaeda, Lashkar-e-Taiba and Jaish-e-Mohammed; and, notably, ranking officers in the Pakistani army.

However, India's appeals against Pakistan and Singh's trip to Kabul are unlikely to garner much enthusiasm from Washington. In the longer term, the United States will continue its efforts to broaden its relationship with India into a more strategic partnership that allows it not only to contain Pakistan but also to hedge in China with Japanese cooperation.

In the more immediate future, the United States will try to maintain a complex balance on the subcontinent. Nevertheless, as long as the United States is accelerating the search for a way out of its war in Afghanistan, Pakistan will occupy a much higher spot on the U.S. priority list than India in the coming weeks and months.

Blasts Kill 13 in Mumbai

July 13, 2011

The Indian city of Mumbai went on high alert July 13 when three blasts were reported within 10 minutes of each other. The blasts occurred at Zaveri Bazar in southern Mumbai at 6:54 p.m. local time, at the Prasad Chambers in the Opera House area at 6:55 p.m. and in the Dadar West area in central Mumbai at 7:04 p.m. Chief Minister Prithviraj Chavan told NDTV that 13 people have been confirmed dead and 81 people were injured.

Police confirmed that the explosion at Dadar West occurred as a result of an improvised explosive device (IED) inside a taxicab. Media reports indicate that the explosion near the Opera House was also the result of an IED in a car. Police reported that the explosion at the Zaveri Bazar occurred as a result of an IED inside an electric meter box, though other reports said it was hidden in an umbrella on a motor scooter. There are reports of as many as seven IEDs around

Mumbai, four of which did not explode, but those reports could be inaccurate.

This attack involved a series of explosive devices timed to create chaos at soft targets. The IEDs probably were not large but were well coordinated. The targeting and method of this attack is similar to previous attacks claimed by the Indian Mujahideen, such as the December 2010 attack at a Hindu prayer site in Varanasi and the attacks in Bangalore and Ahmedabad in July 2008. A similar attack occurred in Pune in February 2010, which the Indian Mujahideen originally claimed, but later reports revealed that David Headley, who worked as a surveillance operative and operational planner for the Pakistan-based militant groups Lashkar-e-Taiba (LeT) and Harkat-ul-Jihad e-Islami (HuJI), had done the surveillance work ahead of the Pune attack.

Unlike the 2008 Mumbai attacks, the July 13 attack did not involve the use of suicide attackers. Rather, it used remote explosions in crowded locations, similar to the attacks in Varanasi, Bangalore, Ahmedabad and Pune. However, it is possible that remnants of the former LeT along with elements of HuJI were behind the attack.

India, Vietnam: Testing China's Patience

September 26, 2011

On Sept. 22, India downplayed recent Chinese objections to its joint oil-exploration venture with Vietnam in the South China Sea, pointing out that India has been drilling in the area since 1988 and has no plans to stop. This diplomatic spat followed China's announcement Sept. 17 of its "oceanic science and development" plan, which the New Delhi-based Times of India said would have "security implications." The plan did not specify where this oceanic development would occur, but Beijing received approval from the U.N.

International Seabed Authority on July 11 to explore for polymetallic sulphides in the Southwest Indian Ocean Ridge.

Asked to comment on plans by ONGC Videsh, India's largest oil company, to undertake two oil-exploration projects with Vietnam's state-owned oil major PetroVietnam in the South China Sea — almost all of which China claims as territorial waters — a Chinese Foreign Ministry spokeswoman reaffirmed China's "indisputable sovereignty right" without referring to India, though the warning was implicit. The exploration would occur in the Phu Khanh Basin, about 100 kilometers (62 miles) east of Vietnam's central Phu Yen province and in an area of marginal interest to China. Nevertheless, Beijing's position was later elaborated on by China's partly state-owned Global Times, which called the joint venture a "serious political provocation."

In fact, ONGC Videsh and PetroVietnam signed a seven-year contract in 2006 without any major diplomatic reaction from Beijing. Both companies are expected to sign a memorandum of understanding regarding drilling activities during Vietnamese President Truong Tan Sang's state visit to India in early October.

Once again, diplomatic jousting among powers in the region is revolving around oil and mineral exploration in contested waters, but the most significant development is the strengthening relationship between India and Vietnam. India appears to be turning more toward Vietnam as it tries to gain a foothold in Southeast Asia and counter China's influence in the region, and Vietnam sees a natural partner in India as it tries to secure some level of control in the South China Sea. But there is a limit to how far India can go in this dalliance, which China is watching very closely.

Common Interests

Vietnam and India have enjoyed a stable strategic partnership for more than a decade, but, in a series of high-level exchanges over the past month, both countries appeared to express a growing interest in bilateral cooperation, particularly in the security realm. Aside from oil exploration projects in the South China Sea, India is seeking the right to use Nha Trang on the southern coast of Vietnam as a naval port and has offered to help the Vietnamese navy learn to operate a Kilo-class submarine, which Vietnam recently purchased from Russia, as well as train its forces in anti-submarine warfare.

The recent strengthening of the partnership is likely due to China's assertiveness over disputed waters in the South China Sea and its intention to contain Vietnam's and India's strategic spheres of influence. The alignment was accelerated following renewed tensions with China early in 2011, when Chinese navy patrol boats reportedly harassed Vietnamese and Philippine seismic research vessels. Cooperation between Vietnam and India in the South China Sea definitely falls into the strategic sphere for Vietnam. The South China Sea, particularly the Paracel Islands, serves as an important maritime buffer to defend the country's narrow, vulnerable waist, roughly where North Vietnam and South Vietnam were once split at the 17th parallel.

The South China Sea also provides a sea route for Vietnam to import raw materials and to export manufactured goods and other commodities, and it is thought to be an abundant source of energy and other natural resources important for development of regional economies. Hence, Vietnam's new maritime strategy prioritizes exploration of the South China Sea, where longstanding territorial disputes with China have prompted Vietnam to multilateralize the issue.

India, a regional player that rivals China in size and power, is a natural choice for a strategic partnership with Vietnam. But unlike Vietnam, India is not strategically focused on the South China Sea, nor is the sea critical to its economic and energy security at the moment. For India, the alignment with Vietnam reflects a desire to jump into an increasingly internationalized issue in hopes of gaining a foothold in the region and helping counterbalance China's influence. More important strategic issues brew elsewhere. New Delhi and Beijing are embroiled in a border dispute involving some 125,000 square kilometers (48,000 square miles) of land that India needs as a buffer, and cooperating with a country having a territorial dispute in the South China Sea helps distract Beijing from the border dispute. India is much more interested in what happens in the Indian Ocean, along its border with Kashmir and in neighboring countries such as Myanmar, Nepal and Sri Lanka.

India and China have long competed for control in the Indian Ocean, especially the Andaman Sea, which lies along the west coast of Myanmar and leads to the entrance to the Strait of Malacca. And Beijing is clearly on the move in the region, establishing port agreements with Pakistan, Sri Lanka and Bangladesh and expanding its economic and political clout in other peripheral countries. This, along with expanded Chinese infrastructure and a growing troop presence in Kashmir, has enabled Beijing to gain the upper hand in its border dispute with India.

With its reinvigorated "Look East" policy, New Delhi envisions a trilateral defense arrangement with Japan and the United States to contain China. Bringing Vietnam into the equation helps achieve that by allowing access to coastal Vietnamese military bases on the South China Sea. Moreover, with Washington's renewed interest in the Asia-Pacific region, increased Indian involvement in the South China Sea — the geopolitical center point of Asian affairs — could help India gain some strategic leverage and economic benefit by broadening its security sphere and tapping into other external markets.

However, despite the strengthening relationship between India and Vietnam, many obstacles remain to a long-term strategic partnership. While Vietnam sees India as a natural partner, it understands that India has a limited interest in the South China Sea and higher priorities elsewhere and would not likely intervene in a quarrel between China and Vietnam. Given how sensitive China is about third-party involvement in the South China Sea, India knows there is a limit to how much China will tolerate in terms of an Indian-Vietnamese alignment.

A Possible Warning from Beijing

Beijing may have already fired a warning shot. Media spotlighted a brief confrontation July 22 between a Chinese warship and Indian naval vessel in the South China Sea, 45 nautical miles off the Vietnamese coast, following the latter's visits to the southern Vietnamese port of Nha Trang and the northern port of Hai Phong. A Chinese warship reportedly demanded that the Indian ship, the Shardule-class amphibious warfare vessel INS Airavat, identify itself and explain its presence in the South China Sea. Later, both China and India downplayed the issue and denied that there was a confrontation.

China has long held the upper hand over Vietnam, which has resisted Chinese domination for centuries. Since uniting North Vietnam and South Vietnam in 1975, Hanoi has also resisted Beijing's attempts to limit Vietnam's dominance over Indochina and presence in the South China Sea. Beijing is particularly sensitive over any foreign power's involvement with Vietnam. The latest tensions between China and Vietnam in the South China Sea paralleled harsher rhetoric from Vietnamese state media. Hanoi and Ho Chi Minh City also saw large anti-China protests, which may have been encouraged by authorities. The July 22 confrontation between China and India, if there were one, would have been intended not only to warn India but also to send a message to Vietnam.

India may have limited options, but its growing interest in Southeast Asian affairs and its strategic need to counterbalance China could pay dividends. The South China Sea is growing in importance as an economic focal point for the Association of Southeast Asian Nations, and the renewed interest in the region by the United States and Japan could be beneficial to India. Whether China likes it or not, a number of multilateral mechanisms are already planned or are in place, including a proposed U.S.-Japan-India trilateral meeting and the Sixth East Asia Summit, which will be held in mid-November in Jakarta, Indonesia. The East Asia Summit is an annual gathering of countries in the region that began primarily as an economic conclave but is growing and evolving into a platform for discussing regional security issues as well.

But while India and Vietnam do have common interests and want closer military ties, their different priorities and levels of exposure to China will prevent them from moving too far too fast.

Limits in the Modernization of India's Air Force

February 11, 2012

France's Dassault Aviation announced Jan. 31 that India has selected its Rafale fighter in the Medium Multi-Role Combat Aircraft (MMRCA) competition. Assuming negotiations on the estimated $10.4 billion contract proceed smoothly, Dassault Aviation will supply India with 126 aircraft over a 10-year period. The final contract has yet to be signed. The first 18 aircraft will be bought directly from Dassault Aviation, while India's state-owned Hindustan Aeronautics Ltd. (HAL) will assemble and produce the rest in Bangalore.

The MMRCA competition is the latest in a series of significant upgrades and improvements, particularly the purchase of advanced aircraft and improvement of the overall infrastructure of the force, intended to advance the capabilities of the IAF. However, the bulk of IAF aircraft today are outmoded, and overall the force structure is deteriorating. Even more worrisome is the status of IAF flight training, a problem that is compounded by maintenance issues and the constraints imposed by a large bureaucracy. While new aircraft are an important part of modernizing the IAF, there are underlying challenges that are equally important to a robust force.

Origin and Evolution of the IAF

The IAF was officially established Oct. 8, 1932. Since Indian independence in 1947, the IAF has participated in four wars against Pakistan and one against China. These conflicts and continued tensions with Pakistan and China have led the IAF to emphasize maintaining a large force structure capable of engaging in large-scale conventional wars against enemy air forces and ground formations. This entailed the continuous purchase of large numbers of fighters and interceptors as well as ground attack aircraft. Additionally, given the huge size of potential theaters of operation as well as often-mediocre transportation infrastructure, the IAF has stressed the maintenance of an effective logistical support capacity since the early 1950s. In practice, this has led to large purchases of aircraft that can be used for parts.

The IAF has five operational and two functional commands. Two of the operational commands are oriented toward Pakistan, two are primarily oriented toward China, and the fifth and most recent, Southern Command, was established in 1984 and focuses on conducting operations over the Indian Ocean, though such operations remain the principle domain of the Indian Navy Air Arm.

Since the 1960s, the IAF has increasingly relied on Soviet equipment and material. There were two large acquisition periods: From 1963 to 1971, MiG, Tupolev and Sukhoi aircraft were purchased, and Soviet MiG aircraft figured prominently in a 1978-1988 modernization program. The two significant exceptions were the introduction of British Jaguars in 1979 and French Mirage-2000s in 1985.

Aside from the purchase of Russian Su-30MKIs in 2002, the IAF has not made any additions to its fighter fleet since the 1980s. Indeed, many of the aircraft acquired during the 1978-1988 modernization program have either been retired or are falling into disrepair. Thus, the IAF is currently developing significant plans to modernize some aircraft types and replace others with newer and far more advanced warplanes.

Recent Modernization, Purchases and Upgrades

In addition to the MMRCA competition, the IAF has launched the "Super 30" program, which will see the upgrading of 40 Su-30MKI fighters with new radars, electronic warfare systems and

BrahMos missiles. The IAF has also invested almost a billion dollars in modernizing its MiG-29s to the multi-role MiG-29UPG variant. Furthermore, the IAF finalized a deal in July 2010 to upgrade its French Mirage-2000 aircraft to the Mirage-2000-5 Mk2 variant, and in January 2012 it decided to purchase 490 MICA air-to-air missiles for the Mirages.

Beginning in 2020, the IAF plans to induct 250-300 PAK-FA stealth fifth-generation fighter aircraft, which are currently being jointly developed with Russia, but remain in a very preliminary stage of development. At a cost of around $35 billion dollars, the project is expected to be India's most expensive defense project ever. With these future purchases, the IAF is expected to grow to 42 squadrons by 2022, about 10 more squadrons than are currently in the IAF. By comparison, Pakistan is believed to have fewer than 20 fixed-wing combat squadrons.

In addition to the modernization and improvement of its fixed-wing fighter fleet, the IAF is also seeking to improve its transport and aerial-refueling tanker force. As of February 2011, the IAF operated six IL-78MKI tankers, but with its growing number of squadrons and force projection needs, the IAF in 2010 initiated the Multi-Role Tanker Transport competition for an approximately $2 billion contract to provide the IAF with another six tankers. The IAF is also improving its transport fleet, with a $4.1 billion deal signed in June 2011 for 10 American C-17 Globemaster IIIs. The IAF had signed an approximately $1 billion deal for six C-130J transports in 2008, and it is currently seeking to purchase six more aircraft of the same type.

The IAF is also looking to double its force of Airborne Early Warning and Control (AEW&C) aircraft, which currently comprises three IL-76 Phalcons. Additionally, India has issued a number of requests for proposals involving AEW&C aircraft and eventually hopes to have 24 domestically built AEW&C planes.

The IAF's Problems

Despite the extensive modernization program and overall purchases, the development of the IAF is limited by a number of acute problems. If not adequately addressed, these constraints will prohibit the IAF from taking full advantage of its new infrastructure and equipment.

A major problem of the IAF is the very high crash and accident rate within its fleet. The most recent incident occurred Jan. 31 when a Kiran MK II trainer exploded in flight. (The two pilots managed to eject beforehand). In 2011 alone, the Indian defense forces suffered at least a dozen aircraft crashes.

The high IAF crash rate is due to three main variables. The first is the age of many of the aircraft types flown. For instance, the MiG-21 first entered service with the IAF in 1964, and it is not only one of the most numerous jets operated in the IAF, but it also is expected to be in service for a few more years.

Poor industrial maintenance is also a problem. In November 2011, India's first astronaut, Rakesh Sharma, who also has much experience as a test pilot with Hindustan Aeronautics, blamed faulty planning in public defense companies (known in India as public sector undertakings, or PSUs) for the high rate of crashes, indicating that "the PSUs have the infrastructure but they do not have the expertise." Sharma said that he would send back fighter planes to the laboratories if he detected defective parts but that he soon found out that instead of doing research and development on these parts, the laboratories fitted them in other fighter planes.

The third variable in the high crash rate is the state of the IAF trainer fleet. The Comptroller and Auditor General (CAG) of India said in 2008 that the IAF was facing an acute shortage of effective pilots after failing to impart quality training. The CAG blamed a lack of adequate state-of-the-art training aircraft in the IAF for the shortage. The bulk of the IAF trainer fleet is composed of indigenously made platforms by HAL. These aircraft have largely proved inadequate and have not met expectations. For instance, the HPT-32

Deepak fleet was grounded in 2009 due to recurrent engine failure that led to numerous crashes.

The lack of a capable training fleet has forced new IAF pilots to undergo their basic training on the HAL Kiran, which is powered by jet engines. By comparison, most Western pilots begin on a turboprop trainer then graduate to training in jets. Due to age and quality issues, even the more advanced Kiran fleet has proved inadequate. The IAF's training academy in Hyderabad reportedly has less than 100 Kirans, which has forced the Surya Kiran and Sagar Pawan aerobatic teams to lend their aircraft for training purposes.

An even more serious development is that, due to the shortage of trainer aircraft, the IAF has cut down flying time for new pilots to one-third of the usual rate (25 flight hours of basic training instead of the usual 75). By comparison, the U.S. Air Force offers more than 100 flight hours of basic training to its cadets. The number of basic training hours had reportedly dwindled even lower over the past two years but has now been stabilized thanks to better management of resources. One of the ways the IAF has sought to maximize its training fleet is to train some of its pilots on MiG-21 trainer variants.

In the next few years there is the potential for a reversal of this trend. The IAF has sought to acquire a number of proven twin-seat Hawk AJTs, some 55 of which are already in service in the IAF, for use as trainers. These aircraft were ordered in March 2004, but bureaucratic issues have delayed their purchase and introduction. The IAF has also selected the Swiss PC-7 to be its next basic trainer, but it is anticipated that it will be at least three more years before the aircraft is delivered.

The IAF's attempts to improve its capabilities by upgrading its existing aircraft and equipment and purchasing new aircraft may be moderately successful. However, the IAF continues to face significant underlying challenges.

PART 4: CHINA

The Geopolitics of China: A Great Power Enclosed
November 23, 2011

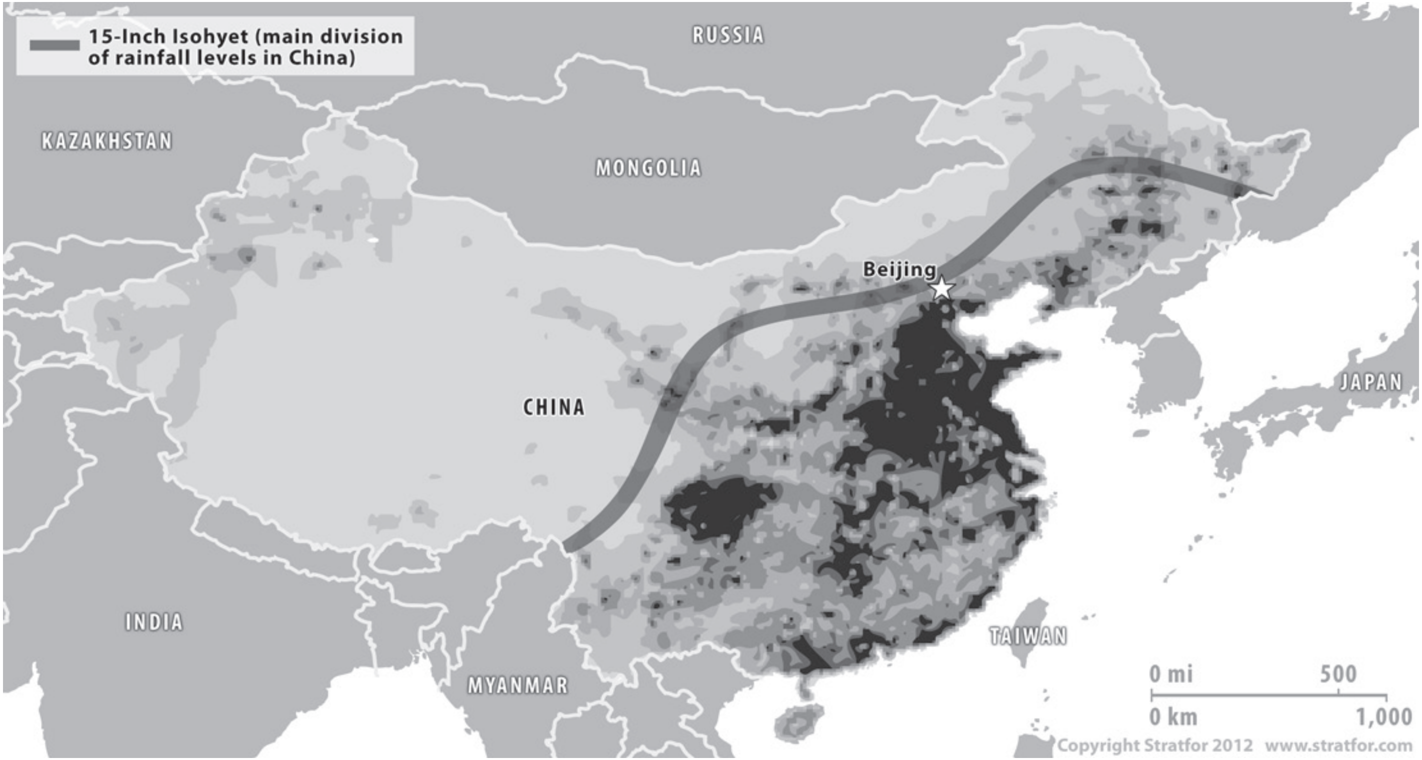
Contemporary China is an island. Although it is not surrounded by water (which borders only its eastern flank), China is bordered by terrain that is difficult to traverse in virtually any direction. There are some areas that can be traversed, but to understand China we must begin by visualizing the mountains, jungles and wastelands that enclose it. This outer shell both contains and protects China.

Internally, China must be divided into two parts: the Chinese heartland and the non-Chinese buffer regions surrounding it. There is a line in China called the 15-inch isohyet, east of which more than 15 inches of rain fall each year and west of which the annual rainfall is less. The vast majority of Chinese live east and south of this line, in the region known as Han China — the Chinese heartland. The region is home to the ethnic Han, whom the world regards as the Chinese. It is important to understand that more than a billion people live in this area, which is about half the size of the United States.

The Chinese heartland is divided into two parts, northern and southern, which in turn is represented by two main dialects, Mandarin in the north and Cantonese in the south. These dialects share a writing system but are almost mutually incomprehensible when spoken. The Chinese heartland is defined by two major rivers — the Yellow

CHINA AS AN ISLAND

15-INCH ISOHYET AND CHINA POPULATION DENSITY



River in the north and the Yangtze in the South, along with a third lesser river in the south, the Pearl. The heartland is China's agricultural region. However — and this is the single most important fact about China — it has about one-third the arable land per person as the rest of the world. This pressure has defined modern Chinese history — both in terms of living with it and trying to move beyond it.

A ring of non-Han regions surround this heartland — Tibet, Xinjiang province (home of the Muslim Uighurs), Inner Mongolia and Manchuria (a historical name given to the region north of North Korea that now consists of the Chinese provinces of Heilongjiang, Jilin and Liaoning).

These are the buffer regions that historically have been under Chinese rule when China was strong and have broken away when China was weak. Today, there is a great deal of Han settlement in these regions, a cause of friction, but today Han China is strong.

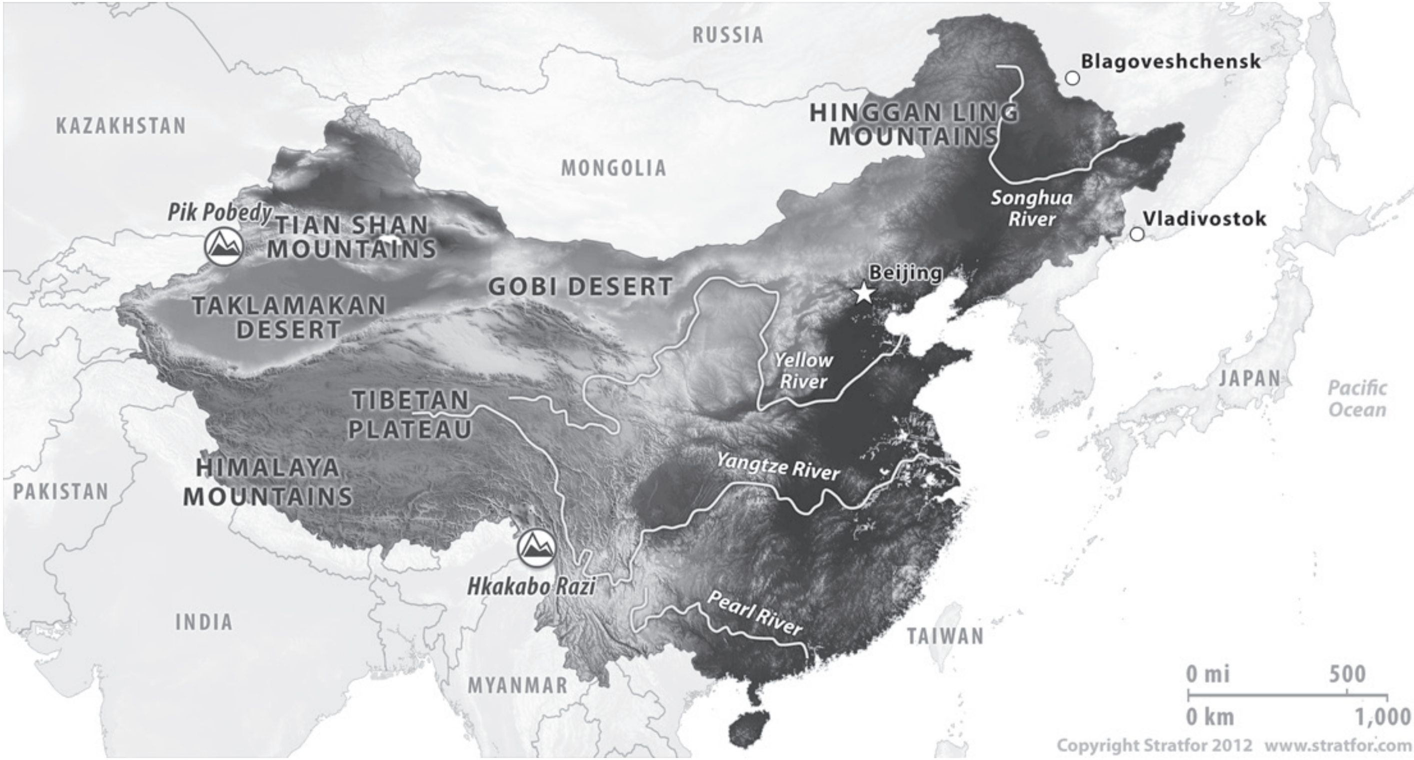
These are also the regions where the historical threat to China originated. Han China is a region full of rivers and rain. It is therefore a land of farmers and merchants. The surrounding areas are the land of nomads and horsemen. In the 13th century, the Mongols under Ghenghis Khan invaded and occupied parts of Han China until the 15th century, when the Han reasserted their authority. Following this period, Chinese strategy remained constant: the slow and systematic assertion of control over these outer regions in order to protect the Han from incursions by nomadic cavalry. This imperative drove Chinese foreign policy. In spite of the imbalance of population, or perhaps because of it, China saw itself as extremely vulnerable to military forces moving from the north and west. Defending a massed population of farmers against these forces was difficult. The easiest solution, the one the Chinese chose, was to reverse the order and impose themselves on their potential conquerors.

There was another reason. Aside from providing buffers, these possessions provided defensible borders. With borderlands under their control, China was strongly anchored. Let's consider the nature of China's border sequentially, starting in the east along the southern border with Vietnam and Myanmar. The border with Vietnam

CHINESE PROVINCES AND BUFFER REGIONS

Manchuria is the older name for the mountainous region of northeastern China comprising the modern-day provinces of Heilongjiang, Jilin, and Liaoning.

CHINA TERRAIN



is the only border readily traversable by large armies or mass commerce. In fact, as recently as 1979, China and Vietnam fought a short border war, and there have been points in history when China has dominated Vietnam. However, the rest of the southern border where Yunnan province meets Laos and Myanmar is hilly jungle, difficult to traverse, with almost no major roads. Significant movement across this border is almost impossible. During World War II, the United States struggled to build the Burma Road to reach Yunnan and supply Chiang Kai-shek's forces. The effort was so difficult it became legendary. China is secure in this region.

Hkakabo Razi, almost 19,000 feet high, marks the border between China, Myanmar and India. At this point, China's southwestern frontier begins, anchored in the Himalayas. More precisely, it is where Tibet, controlled by China, borders India and the two Himalayan states, Nepal and Bhutan. This border runs in a long arc past Pakistan, Tajikistan and Kyrgyzstan, ending at Pik Pobedy, a 25,000-foot mountain marking the border with China, Kyrgyzstan and Kazakhstan. It is possible to pass through this border region with difficulty; historically, parts of it have been accessible as a merchant route. On the whole, however, the Himalayas are a barrier to substantial trade and certainly to military forces. India and China — and China and much of Central Asia — are sealed off from each other.

The one exception is the next section of the border, with Kazakhstan. This area is passable but has relatively little transport. As the transport expands, this will be the main route between China and the rest of Eurasia. It is the one land bridge from the Chinese island that can be used. The problem is distance. The border with Kazakhstan is almost a thousand miles from the first tier of Han Chinese provinces, and the route passes through sparsely populated Muslim territory, a region that has posed significant challenges to China. Importantly, the Silk Road from China ran through Xinjiang and Kazakhstan on its way west. It was the only way to go.

There is, finally, the long northern border first with Mongolia and then with Russia, running to the Pacific. This border is certainly passable. Indeed, the only successful invasion of China took place when

Mongol horsemen attacked from Mongolia, occupying a good deal of Han China. China's buffers — Inner Mongolia and Manchuria — have protected Han China from other attacks. The Chinese have not attacked northward for two reasons. First, there has historically not been much there worth taking. Second, north-south access is difficult. Russia has two rail lines running from the west to the Pacific — the famous Trans-Siberian Railroad (TSR) and the Baikal-Amur Mainline (BAM), which connects those two cities and ties into the TSR. Aside from that, there is no east-west ground transportation linking Russia. There is also no north-south transportation. What appears accessible really is not.

The area in Russia that is most accessible from China is the region bordering the Pacific, the area from Russia's Vladivostok to Blagoveschensk. This region has reasonable transport, population and advantages for both sides. If there were ever a conflict between China and Russia, this is the area that would be at the center of it. It is also the area, as you move southward and away from the Pacific, that borders on the Korean Peninsula, the area of China's last major military conflict.

Then there is the Pacific coast, which has numerous harbors and has historically had substantial coastal trade. It is interesting to note that, apart from the attempt by the Mongols to invade Japan, and a single major maritime thrust by China into the Indian Ocean — primarily for trade and abandoned fairly quickly — China has never been a maritime power. Prior to the 19th century, it had not faced enemies capable of posing a naval threat and, as a result, it had little interest in spending large sums of money on building a navy.

China, when it controls Tibet, Xinjiang, Inner Mongolia and Manchuria, is an insulated state. Han China has only one point of potential friction, in the southeast with Vietnam. Other than that it is surrounded by non-Han buffer regions that it has politically integrated into China. There is a second friction point in eastern Manchuria, touching on Siberia and Korea. There is, finally, a single opening into the rest of Eurasia on the Xinjiang-Kazakh border.

China's most vulnerable point, since the arrival of Europeans in the western Pacific in the mid-19th century, has been its coast. Apart from European encroachments in which commercial interests were backed up by limited force, China suffered its most significant military encounter — and long and miserable war — after the Japanese invaded and occupied large parts of eastern China along with Manchuria in the 1930s. Despite the mismatch in military power and more than a dozen years of war, Japan still could not force the Chinese government to capitulate. The simple fact was that Han China, given its size and population density, could not be subdued. No matter how many victories the Japanese won, they could not decisively defeat the Chinese.

China is hard to invade; given its size and population, it is even harder to occupy. This also makes it hard for the Chinese to invade others — not utterly impossible, but quite difficult. Containing a fifth of the world's population, China can wall itself off from the world, as it did prior to the United Kingdom's forced entry in the 19th century and as it did under Mao Zedong. All of this means China is a great power, but one that has to behave very differently from other great powers.

China's Geopolitical Imperatives

China has three overriding geopolitical imperatives:

1. Maintain internal unity in the Han Chinese regions.
2. Maintain control of the buffer regions.
3. Protect the coast from foreign encroachment.

Maintaining Internal Unity

China is more enclosed than any other great power. The size of its population, coupled with its secure frontiers and relative abundance of resources, allows it to develop with minimal intercourse with the rest of the world, if it chooses. During the Maoist period, for example, China became an insular nation, driven primarily by internal interests and considerations, indifferent or hostile to the rest of the world. It was secure and, except for its involvement in the Korean War and its efforts to pacify restless buffer regions, was relatively peaceful. Internally, however, China underwent periodic, self-generated chaos.

The weakness of insularity for China is poverty. Given the ratio of arable land to population, a self-enclosed China is a poor China. Its population is so poor that economic development driven by domestic demand, no matter how limited it might be, is impossible. However, an isolated China is easier to manage by a central government. The great danger in China is a rupture within the Han Chinese nation. If that happens, if the central government weakens, the peripheral regions will spin off, and China will then be vulnerable to foreigners taking advantage of Chinese weakness.

For China to prosper, it has to engage in trade, exporting silk, silver and industrial products. Historically, land trade has not posed a problem for China. The Silk Road allowed foreign influences to come into China and the resulting wealth created a degree of instability. On the whole, however, it could be managed.

The dynamic of industrialism changed both the geography of Chinese trade and its consequences. In the mid-19th century, when Europe — led by the British —compelled the Chinese government to give trading concessions to the British, it opened a new chapter in Chinese history. For the first time, the Pacific coast was the interface with the world, not Central Asia. This in turn massively destabilized China.

As trade between China and the world intensified, the Chinese who were engaged in trading increased their wealth dramatically. Those in the coastal provinces of China, the region most deeply involved in trading, became relatively wealthy while the Chinese in the interior (not the buffer regions, which were always poor, but the non-coastal provinces of Han China) remained poor, subsistence farmers.

The central government was balanced between the divergent interests of coastal China and the interior. The coastal region, particularly its newly enriched leadership, had an interest in maintaining and intensifying relations with European powers and with the United States and Japan. The more intense the trade, the wealthier the coastal leadership and the greater the disparity between the regions. In due course, foreigners allied with Chinese coastal merchants and politicians became more powerful in the coastal regions than the central government. The worst geopolitical nightmare of China came true. China fragmented, breaking into regions, some increasingly under the control of foreigners, particularly foreign commercial interests. Beijing lost control over the country. It should be noted that this was the context in which Japan invaded China, which made Japan's failure to defeat China all the more extraordinary.

Mao's goal was threefold, Marxism aside. First, he wanted to recentralize China — re-establishing Beijing as China's capital and political center. Second, he wanted to end the massive inequality between the coastal region and the rest of China. Third, he wanted to expel the foreigners from China. In short, he wanted to recreate a united Han China.

Mao first attempted to trigger an uprising in the cities in 1927 but failed because the coalition of Chinese interests and foreign powers was impossible to break. Instead he took the Long March to the interior of China, where he raised a massive peasant army that was both nationalist and egalitarian and, in 1948, returned to the coastal region and expelled the foreigners. Mao re-enclosed China, recentralized it, and accepted the inevitable result. China became equal but extraordinarily poor.

China's primary geopolitical issue is this: For it to develop it must engage in international trade. If it does that, it must use its coastal cities as an interface with the world. When that happens, the coastal cities and the surrounding region become increasingly wealthy. The influence of foreigners over this region increases and the interests of foreigners and the coastal Chinese converge and begin competing with the interests of the central government. China is constantly challenged by the problem of how to avoid this outcome while engaging in international trade.

Controlling the Buffer Regions

Prior to Mao's rise, with the central government weakened and Han China engaged simultaneously in war with Japan, civil war and regionalism, the center was not holding. While Manchuria was under Chinese control, Outer Mongolia was under Soviet control and extending its influence (Soviet power more than Marxist ideology) into Inner Mongolia, and Tibet and Xinjiang were drifting away.

At the same time that Mao was fighting the civil war, he was also laying the groundwork for taking control of the buffer regions. Interestingly, his first moves were designed to block Soviet interests in these regions. Mao moved to consolidate Chinese communist control over Manchuria and Inner Mongolia, effectively leveraging the Soviets out. Xinjiang had been under the control of a regional warlord, Yang Zengxin. Shortly after the end of the civil war, Mao moved to force him out and take over Xinjiang. Finally, in 1950 Mao moved against Tibet, which he secured in 1951.

The rapid-fire consolidation of the buffer regions gave Mao what all Chinese emperors sought, a China secure from invasion. Controlling Tibet meant that India could not move across the Himalayas and establish a secure base of operations on the Tibetan Plateau. There could be skirmishes in the Himalayas, but no one could push a multidivisional force across those mountains and keep it supplied. So long as Tibet was in Chinese hands, the Indians could live on the other side of the moon. Xinjiang, Inner Mongolia and Manchuria buffered China from the Soviet Union. Mao was more of a geopolitician than an ideologue. He did not trust the Soviets. With the buffer states in hand, they would not invade China. The distances, the poor transportation and the lack of resources meant that any Soviet invasion would run into massive logistical problems well before it reached Han China's populated regions, and become bogged down — just as the Japanese had.

China had geopolitical issues with Vietnam, Pakistan and Afghanistan, neighboring states with which it shared a border, but the real problem for China would come in Manchuria or, more precisely, Korea. The Soviets, more than the Chinese, had encouraged a North Korean invasion of South Korea. It is difficult to speculate on Joseph Stalin's thinking, but it worked out superbly for him. The United States intervened, defeated the North Korean Army and drove to the Yalu, the river border with China. The Chinese, seeing the well-armed and well-trained American force surge to its borders, decided that it had to block its advance and attacked south. What resulted was three years of brutal warfare in which the Chinese lost about a million men. From the Soviet point of view, fighting between China and the United States was the best thing imaginable. But from Stratfor's point of view, what it demonstrated was the sensitivity of the Chinese to any encroachment on their borderlands, their buffers, which represent the foundation of their national security.

Protecting the Coast

With the buffer regions under control, the coast is China's most vulnerable point, but its vulnerability is not to invasion. Given the Japanese example, no one has the interest or forces to try to invade mainland China, supply an army there and hope to win. Invasion is not a meaningful threat.

The coastal threat to China is economic, though most would not call it a threat. As we saw, the British intrusion into China culminated in the destabilization of the country, the virtual collapse of the central government and civil war. It was all caused by prosperity. Mao had solved the problem by sealing the coast of China off to any real development and liquidating the class that had collaborated with foreign business. For Mao, xenophobia was integral to national policy. He saw foreign presence as undermining the stability of China. He preferred impoverished unity to chaos. He also understood that, given China's population and geography, it could defend itself against potential attackers without an advanced military-industrial complex.

His successor, Deng Xiaoping, was heir to a powerful state in control of China and the buffer regions. He also felt under tremendous pressure politically to improve living standards, and he undoubtedly understood that technological gaps would eventually threaten Chinese national security. He took a historic gamble. He knew that China's economy could not develop on its own. China's internal demand for goods was too weak because the Chinese were too poor.

Deng gambled that he could open China to foreign investment and reorient the Chinese economy away from agriculture and heavy industry and toward export-oriented industries. By doing so he would increase living standards, import technology and train China's workforce. He was betting that the effort this time would not destabilize China, create massive tensions between the prosperous coastal provinces and the interior, foster regionalism, or put the coastal regions under foreign control. Deng believed he could avoid all that by maintaining a strong central government, based on a loyal army and Communist Party apparatus. His successors have struggled to maintain that loyalty to the state and not to foreign investors, who can make individuals wealthy. That is the bet that is currently being played out.

China's Geopolitics and its Current Position

From a political and military standpoint, China has achieved its strategic goals. The buffer regions are intact and China faces no threat in Eurasia. It sees a Western attempt to force China out of Tibet as an attempt to undermine Chinese national security. For China, however, Tibet is a minor irritant; China has no possible intention of leaving Tibet, the Tibetans cannot rise up and win, and no one is about to invade the region. Similarly, the Uighur Muslims represent an irritant in Xinjiang and not a direct threat. The Russians have no interest in or capability of invading China, and the Korean Peninsula does not represent a direct threat to the Chinese, certainly not one they could not handle.

The greatest military threat to China comes from the United States Navy. The Chinese have become highly dependent on seaborne trade and the United States Navy is in a position to blockade China's ports if it wished. Should the United States do that, it would cripple China. Therefore, China's primary military interest is to make such a blockade impossible.

It would take several generations for China to build a surface navy able to compete with the U.S. Navy. Simply training naval aviators to conduct carrier-based operations effectively would take decades — at least until these trainees became admirals and captains. And this does not take into account the time it would take to build an aircraft carrier and carrier-capable aircraft and master the intricacies of carrier operations.

For China, the primary mission is to raise the price of a blockade so high that the Americans would not attempt it. The means for that would be land- and submarine-based anti-ship missiles. The strategic solution is for China to construct a missile force sufficiently dispersed that it cannot be suppressed by the United States and with sufficient range to engage the United States at substantial distance, as far as the central Pacific.

This missile force would have to be able to identify and track potential targets to be effective. Therefore, if the Chinese are to pursue this strategy, they must also develop a space-based maritime reconnaissance system. These are the technologies the Chinese are focusing on. Anti-ship missiles and space-based systems, including anti-satellite systems designed to blind the Americans, represent China's military counter to its only significant military threat.

China could also use those missiles to blockade Taiwan by interdicting ships going to and from the island. But the Chinese do not have the naval ability to land a sufficient amphibious force and sustain it in ground combat. Nor do they have the ability to establish air superiority over the Taiwan Strait. China might be able to harass Taiwan but it will not invade it. Missiles, satellites and submarines constitute China's naval strategy.

For China, the primary problem posed by Taiwan is naval. Taiwan is positioned in such a way that it can readily serve as an air and naval base that could isolate maritime movement between the South China Sea and the East China Sea, effectively leaving the northern Chinese coast and Shanghai isolated. When you consider the Ryukyu Islands that stretch from Taiwan to Japan and add them to this mix, a non-naval power could blockade the northern Chinese coast if it held Taiwan.

Taiwan would not be important to China unless it became actively hostile or allied with or occupied by a hostile power such as the United States. If that happened, its geographical position would pose an extremely serious problem for China. Taiwan is also an important symbolic issue to China and a way to rally nationalism. Although Taiwan presents no immediate threat, it does pose potential dangers that China cannot ignore.

There is one area in which China is being modestly expansionist — Central Asia and particularly Kazakhstan. Traditionally a route for trading silk, Kazakhstan is now an area that can produce energy, badly needed by China's industry. The Chinese have been active in developing commercial relations with Kazakhstan and in developing roads into Kazakhstan. These roads are opening a trading route that allows oil to flow in one direction and industrial goods in another.

In doing this, the Chinese are challenging Russia's sphere of influence in the former Soviet Union. The Russians have been prepared to tolerate increased Chinese economic activity in the region while being wary of China's turning into a political power. Kazakhstan has been European Russia's historical buffer state against Chinese expansion and it has been under Russian domination. This region must be watched carefully. If Russia begins to feel that China is becoming too assertive in this region, it could respond militarily to Chinese economic power.

Chinese-Russian relations have historically been complex. Before World War II, the Soviets attempted to manipulate Chinese politics. After World War II, relations between the Soviet Union and China were never as good as some thought, and sometimes these relations became directly hostile, as in 1968, when Russian and Chinese troops fought a battle along the Ussuri River. The Russians have historically feared a Chinese move into their Pacific maritime provinces. The Chinese have feared a Russian move into Manchuria and beyond.

Neither of these things happened because the logistical challenges involved were enormous and neither had an appetite for the risk of fighting the other. We would think that this caution will prevail under current circumstances. However, growing Chinese influence in Kazakhstan is not a minor matter for the Russians, who may choose to contest China there. If they do, and it becomes a serious matter, the secondary pressure point for both sides would be in the Pacific region, complicated by proximity to Korea.

But these are only theoretical possibilities. The threat of an American blockade on China's coast, of using Taiwan to isolate northern China, of conflict over Kazakhstan — all are possibilities that the Chinese must take into account as they plan for the worst. In fact, the United States does not have an interest in blockading China and the Chinese and Russians are not going to escalate competition over Kazakhstan.

China does not have a military-based geopolitical problem. It is in its traditional strong position, physically secure as it holds its buffer regions. It has achieved it three strategic imperatives. What is most vulnerable at this point is its first imperative: the unity of Han China. That is not threatened militarily. Rather, the threat to it is economic.

Economic Dimensions of Chinese Geopolitics

The problem of China, rooted in geopolitics, is economic and it presents itself in two ways. The first is simple. China has an export-oriented economy. It is in a position of dependency. No matter how large its currency reserves or how advanced its technology or how cheap its labor force, China depends on the willingness and ability of other countries to import its goods — as well as the ability to physically ship them. Any disruption of this flow has a direct effect on the Chinese economy.

The primary reason other countries buy Chinese goods is price. They are cheaper because of wage differentials. Should China lose that advantage to other nations or for other reasons, its ability to export would decline. Today, for example, as energy prices rise, the cost of production rises and the relative importance of the wage differential decreases. At a certain point, as China's trading partners see it, the value of Chinese imports relative to the political cost of closing down their factories will shift.

And all of this is outside of China's control. China cannot control the world price of oil. It can cut into its cash reserves to subsidize those prices for manufacturers but that would essentially be transferring money back to consuming nations. It can control rising wages by imposing price controls, but that would cause internal instability. The center of gravity of China is that it has become the industrial workshop of the world and, as such, it is totally dependent on the world to keep buying its goods rather than someone else's goods.

There are other issues for China, ranging from a dysfunctional financial system to farmland being taken out of production for factories. These are all significant and add to the story. But in geopolitics we look for the center of gravity, and for China the center of gravity is that the more effective it becomes at exporting, the more of a hostage it becomes to its customers. Some observers have warned that China might take its money out of American banks. Unlikely, but assume it did. What would China do without the United States as a customer?

China has placed itself in a position where it has to keep its customers happy. It struggles against this reality daily, but the fact is that the rest of the world is far less dependent on China's exports than China is dependent on the rest of the world.

Which brings us to the second, even more serious part of China's economic problem. The first geopolitical imperative of China is to ensure the unity of Han China. The third is to protect the coast. Deng's bet was that he could open the coast without disrupting the unity of Han China. As in the 19th century, the coastal region has become wealthy. The interior has remained extraordinarily poor. The coastal region is deeply enmeshed in the global economy. The interior is not. Beijing is once again balancing between the coast and the interior.

The interests of the coastal region and the interests of importers and investors are closely tied to each other. Beijing's interest is in maintaining internal stability. As pressures grow, it will seek to increase its control of the political and economic life of the coast. The interest of the interior is to have money transferred to it from the coast. The interest of the coast is to hold on to its money. Beijing will try to satisfy both, without letting China break apart and without resorting to Mao's draconian measures. But the worse the international economic situation becomes the less demand there will be for Chinese products and the less room there will be for China to maneuver.

The second part of the problem derives from the first. Assuming that the global economy does not decline now, it will at some point. When it does, and Chinese exports fall dramatically, Beijing will have to balance between an interior hungry for money and a coastal region that is hurting badly. It is important to remember that something like 900 million Chinese live in the interior while only about 400 million live in the coastal region. When it comes to balancing power, the interior is the physical threat to the regime while the coast destabilizes the distribution of wealth. The interior has mass on its side. The coast has the international trading system on its. Emperors have stumbled over less.

Conclusion

Geopolitics is based on geography and politics. Politics is built on two foundations: military and economic. The two interact and support each other but are ultimately distinct. For China, securing its buffer regions generally eliminates military problems. What problems are left for China are long-term issues concerning northeastern Manchuria and the balance of power in the Pacific.

China's geopolitical problem is economic. Its first geopolitical imperative, maintain the unity of Han China, and its third, protect the coast, are both more deeply affected by economic considerations than military ones. Its internal and external political problems flow from economics. The dramatic economic development of the last generation has been ruthlessly geographic. This development has benefited the coast and left the interior — the vast majority of Chinese — behind. It has also left China vulnerable to global economic forces that it cannot control and cannot accommodate. This is not new in Chinese history, but its usual resolution is in regionalism and the weakening of the central government. Deng's gamble is being played out by his successors. He dealt the hand. They have to play it.

The question on the table is whether the economic basis of China is a foundation or a balancing act. If the former, it can last a long time. If the latter, everyone falls down eventually. There appears to be little evidence that it is a foundation. It excludes most of the Chinese from the game, people who are making less than $100 a month. That is a balancing act and it threatens the first geopolitical imperative of China: protecting the unity of the Han Chinese.

China's Charm Offensive and the BRICS Summit

April 14, 2011

Leaders of Brazil, Russia, India, China and South Africa — the so-called BRICS — met in Sanya city, Hainan province, China on April 14 to promote economic cooperation and diplomatic discussion between each other and to criticize the global order, which they see as dominated by traditional Western powers. The BRICS began as a concept by a high-profile Western financial investor but has grown into an actual talk shop with annual meetings.

The participating states are distant geographically, politically and militarily, and despite being more plausibly labeled as the world's leading developing countries, their economic structures are substantially different. The differences are so stark as to make the group incapable of meaningful alliance or binding agreements. Tensions between China, with its giant economy, and the others in particular impede collective action. India and China are longstanding rivals; Russia and China are occasional rivals; and Brazil and China are suffering new strains from growing economic interdependence. Moreover, each state has a different relationship with the United States, which remains powerful enough that it can still divide any one member of the group from the others.

But the BRICS can serve their individual interests by dealing with each other on specific bilateral or multilateral issues and creating the appearance of presenting a new coalition of states that stands apart from the U.S.-led world system and is worthy of foreign investment. This year, the group has touted the inclusion of South Africa, helping Pretoria seal its position as a regional African leader and adding more credibility to the claims by the BRICS of representing the entire developing world. It also has criticized NATO operations in Libya, warned against destabilizing capital inflows into emerging markets blamed primarily on American money printing and pledged to work toward stabilizing commodity prices. And the group has repeated promises to try to reform the United Nations and the global financial system, namely by promoting not only cross-border trade in each other's currencies but also cross-border local-currency credit, while denouncing the U.S. dollar as the global reserve currency.

China as the Host

One theme at this year's BRICS summit stands out: China's attempt, as host, to use the affair to display its amiable and cooperative side.

China's general international friendliness contrasts with its behavior in 2010, when Beijing alarmed the United States and its neighbors by supporting North Korea amid surprise attacks on the South, increasing its naval activity and hardening its stance on territorial claims. China's neighbors — India foremost among them — repeatedly emphasized concerns over this increasingly assertive behavior.

China was framed, especially in its region, as an increasingly strident and forceful power whose regional intentions were becoming more threatening even as it concealed its growing capabilities.

Near the end of the year in 2010, Stratfor began receiving word from Washington and Beijing that China would adjust its foreign policy away from these obtrusive positions in order to deflate the concerns. Beijing's rhetoric on the South China Sea security disputes seemed to soften in the latter half of the year. The United States and China made a show of warming relations in January when presidents Hu Jintao and Barack Obama met, and since then China has re-emphasized the positive side of relations with most of its neighbors and competitors.

In the lead-up to the BRICS summit, Beijing seemed especially congenial. After reportedly stopping the issuance of a different kind of visa for citizens of the disputed region of Jammu and Kashmir, a practice that greatly incensed India in recent years, Beijing and India said defense exchanges would resume. Beijing also sought to appease the Brazilians with large business and investment deals during President Dilma Rousseff's bilateral visit before the BRICS summit to mitigate rising tensions over China's massive exports and undervalued currency, which the nascent Rousseff administration has prioritized. China is also emphasizing that its cooperation with South Africa is not limited to a desire for more natural resources but will benefit South Africa's other economic sectors. Negotiations over energy cooperation with Russia are ongoing and said to be on track for a natural gas pricing agreement by mid-2011.

China's apparent friendliness extends beyond the BRICS. In addition to its high tempo of friendly diplomacy with smaller states, Beijing has invested in European economic recovery; is preparing for a high-level meeting with Australian Prime Minister Julia Gillard in April (and released an Australian citizen suddenly after detaining him amid a domestic security crackdown); and will host Philippine President Benigno Aquino III to talk about big new investments. In the past month, the Chinese security forces and military have also had exchanges with their Vietnamese counterparts.

China and South Korea have claimed to step up strategic ties after Premier Wen Jiabao and Prime Minister Kim Hwang Sik met, and China is facilitating six-party talks, which could occur in the next two to three months. It has held exchanges with the United States leading up to the next round of Strategic and Economic Dialogue, increased military to military communication and facilitated Vice President Joe Biden's upcoming visit with Vice President Xi Jinping. Beijing so far has even avoided taking advantage of Japan's weakened position after the March 11 earthquake. What appears increasingly to be an all-around Chinese charm offensive — or at least an all around attempt to be inoffensive — seemed confirmed when U.S. Pacific Command chief Adm. Robert Willard explicitly said April 12 that the Chinese navy has retrenched somewhat and is acting notably less assertive in 2011.

Balancing Internal and External Concerns

None of the above should suggest that Beijing has discarded its assertive tactics. China has revealed growing military capabilities with its supposed fifth-generation fighter and first aircraft carrier. It has continued sending naval forces near Japanese ships in disputed areas, clashed with the Philippines in the Spratlys and continues supporting North Korea, which Washington and Seoul warn may be plotting another provocation for this spring.

Beijing is attempting a more moderate and pragmatic approach to foreign relations. Realizing it cannot play a game of constant assertion, China seems to be holding these tactics in reserve. Foreign states are not fooled by this change, though they are eager to resume business as usual.

China's recent attempts to adopt a friendlier face come as Beijing is undertaking a large-scale security operation at home to silence dissidents and tighten control over society amid fears that socio-economic troubles could erupt into political unrest similar to the Middle Eastern and North African turmoil. Therefore, renewed attempts at smoothing relations with neighbors may have something to do with a need to mitigate external problems so they do not distract from the government's response to domestic challenges. While China occasionally may use confrontations with foreign states as a way to instill nationalism in its citizens, now is not the time it wants people gathering in the streets. Smoother foreign relations may help to prevent international criticism of China's domestic crackdown from developing into concerted international action. Whether this policy shift is the result of coherent central decision-making, or the reassertion of certain factions and institutions over others that drove the more assertive policy, is an open question.

Countries like India, Brazil and South Africa are already uneasy about China's mercantilist economic policies. And China's human rights problems have in the past inspired Western states to impose sanctions, such as after Tiananmen Square. Now that China is larger economically and has a particular advantage over other states in terms of economic growth at the moment, states are more reluctant to take a stand against China. Whether driven by domestic pressure or the desire to use Chinese internal troubles as a lever against the country, foreign states may attempt to punish China if there were to be a glaring incident. Beijing still depends on a high degree of forbearance internationally because of its need for exports to survive as it attempts to restructure its economic model. And since regime preservation is its primary goal, it will suppress domestic opposition brutally if it must, which may necessitate a policy for mitigating hostilities abroad.

Now is a good time for China to try to stay on the world's good side, and that means maintaining cordial relations with the United States and other major developed states and working to minimize rifts with major developing states. It would not be a good strategy for China to drive its competitors in the developing world into the arms of a U.S.-led coalition aiming to control China's rise. Ultimately, Beijing is not likely to meet with great success in any kind of charm offensive, but it may reduce foreign frictions at a time when it is fragile in a domestic sense.

The End of the Deng Dynasty
April 19, 2011

Beijing has become noticeably more anxious than usual in recent months, launching one of the more high-profile security campaigns to suppress political dissent since the aftermath of the Tiananmen Square crackdown in 1989. Journalists, bloggers, artists, Christians and others have been arrested or have disappeared in a crackdown prompted by fears that foreign forces and domestic dissidents have hatched any number of "Jasmine" gatherings inspired by recent events in the Middle East. More remarkable than the small, foreign-coordinated protests, however, has been the state's aggressive and erratic reaction to them.

Meanwhile, the Chinese economy has maintained a furious pace of credit-fueled growth despite authorities' repeated claims of working to slow growth down to prevent excessive inflation and systemic financial risks. The government's cautious approach to fighting inflation has emboldened local governments and state companies, which benefit from rapid growth. Yet the risk to socio-political stability posed by inflation, expected to peak in springtime, has provoked a gradually tougher stance. The government thus faces twin perils of economic overheating on one side and overcorrection on the other, either of which could trigger an outburst of social unrest — and both of which have led to increasingly erratic policymaking.

These security and economic challenges are taking place at a time when the transition from the so-called fourth generation of leaders to the fifth generation in 2012 is under way. The transition has heightened disagreements over economic policy and insecurities over social stability, further complicating attempts to coordinate effective policy. Yet something deeper is driving the Communist Party of China's (CPC's) anxiety and heavy-handed security measures: the need to transform the country's entire economic model, which carries hazards that the Party fears will jeopardize its very legitimacy.

Deng's Model

Former paramount leader Deng Xiaoping is well known for launching China's emergence from Mao's Cultural Revolution and inaugurating the rise of a modern, internationally oriented economic giant. Deng's model rested on three pillars.

The first was economic pragmatism, allowing for capitalist-style incentives domestically and channels for international trade. Deng paved the way for a growth boom that would provide employment and put an end to the preceding decade of civil strife. The CPC's legitimacy thus famously became linked to the country's economic success rather than to ideological zeal and class warfare.

The second pillar was a foreign policy of cooperation. The lack of emphasis on political ideology opened space for international maneuver, with economic cooperation the basis for new relationships. This gave enormous impetus to the Sino-American detente Nixon and Mao initiated. In Deng's words, China would maintain a low profile and avoid taking the lead. China would remain unobtrusive to befriend and do business with almost any country — as long as it recognized Beijing as the one and only China.

The third pillar was the primacy of the CPC's system. Reform of the political system along the lines of Western countries could be envisioned, but in practice would be deferred. That the reform process in no way would be allowed to undermine Party supremacy was sealed after the mass protests at Tiananmen, which the military crushed after a dangerous intra-Party struggle. The People's Liberation Army (PLA) and the People's Armed Police would serve as Deng's "Great Wall of steel" protecting the Party from insurrection.

For three decades, Deng's model remained mostly intact. Though important modifications and shifts occurred, the general framework stands because Chinese-style capitalism and partnership with the United States have served the country well. Deng also secured his policy by establishing a succession plan: He was instrumental in setting up his immediate successor, Jiang Zemin, and Jiang's successor, current President Hu Jintao.

Hu's policies have not differed widely in practice from Deng's. China's response to the global economic crisis in 2008 revealed that Hu sought recourse to the same export- and investment-driven growth as his predecessors. Hu's plans of boosting household consumption have failed, the economy is more off-balance than ever, and the interior remains badly in need of development. But along the general lines of Deng's policy, the country has continued to grow and stay out of major conflict with the United States and others, and the Party has maintained indisputable control.

Emergent Challenges

Unprecedented challenges to Deng's model have emerged in recent years. These are not challenges involving individuals; rather, they come from changes in the Chinese and international systems.

First, more clearly than ever, China's economic model is in need of restructuring. Economic crisis and its aftermath in the developed world have caused a shortfall in foreign demand, and rising costs of labor and raw materials are eroding China's comparative advantage even as its export sector and industries have built up extraordinary overcapacity.

Theoretically, the answer has been to boost household consumption and rebalance growth — the Hu administration's policy — but this plan carries extreme hazards if aggressively pursued. If consumption cannot be generated quickly enough to pick up the slack — and it cannot within the decade period that China's leaders envision — then growth will slow sharply and unemployment will rise. These would be serious threats to the CPC, the legitimacy of which rests on providing growth. Hence, the attempt at economic transition has hardly begun.

Not coincidentally, movements have arisen that seek to restore the Party's legitimacy to a basis not of economics but of political power. Hu's faction, rooted in the Chinese Communist Youth League (CCYL), has a doctrine of wealth redistribution and Party orientation. It is set to expand its control when the sixth generation of leaders arrives. This trend also exists on the other side of the factional divide. Bo Xilai, the popular Party chief in Chongqing, is a "princeling." Princelings are the children of Communist revolutionaries, who often receive prized positions in state leadership, large state-owned enterprises and the military. This group is expected to gain the advantage in the core leadership after the 2012 transition. Bo made himself popular by striking down organized-crime leaders who had grown rich and powerful from new money and by bribing officials. Bo's campaign of nostalgia for the Mao era, including singing revolutionary songs and launching a "Red microblog" on the Internet, has proved hugely popular. It also has added an unusual degree of public support to his bid for a spot on the Politburo Standing Committee in 2012. Both sides appeal to the inherent value of the Party, rather than its role as economic steward, for justification.

The second challenge to Deng's legacy has arisen from the military's growing self-confidence and confrontational attitude toward foreign rivals, a stance popular with an increasingly nationalist domestic audience. The foreign policy of inoffensiveness for the sake of commerce thus has been challenged from within. Vastly more dependent on foreign natural resources, and yet insecure over prices and vulnerability of supply lines, China has turned to the PLA to take a greater role in protecting its global interests, especially in the maritime realm. As a result, the PLA has become more forceful in driving its policies.

In recent years, China has pushed harder on territorial claims and more staunchly defended partners like North Korea, Iran, Pakistan and Myanmar. This trend, especially observable throughout 2010, has alarmed China's neighbors and the United States. The PLA is not the only institution that seems increasingly bold. Chinese government officials and state companies have also caused worry among foreigners. But the military acting this way sends a particularly strong signal abroad.

And third, Deng's avoidance of political reform may be becoming harder to maintain. The stark disparities in wealth and public services between social classes and regions have fueled dissatisfaction.

Arbitrary power, selective enforcement of the law, official and corporate corruption, and other ills have gnawed at public content, giving rise to more and more frequent incidents and outbursts. The social fabric has been torn, and leaders fear that it could ignite with widespread unrest. Simultaneously, rising education, incomes and new forms of social organization like non-governmental organizations and the Internet have given rise to greater demands and new means of coordination among dissidents or opposition movements.

In this atmosphere, Premier Wen Jiabao has become outspoken, calling for the Party to pursue political reforms in keeping with economic reforms. Wen's comments contain just enough ambiguity to suggest that he is promoting substantial change and diverging from the Party, though in fact he may intend them only to pacify people by preserving hope for changes in the unspecified future. Regardless, it is becoming harder for the Party to maintain economic development without addressing political grievances. Political changes seem necessary not only for the sake of pursuing oft-declared plans to unleash household consumption and domestic innovation and services, but also to ease social discontent. The Party realizes that reform is inevitable, but questions how to do it while retaining control. The possibility that the Party could split on the question of political reform, as happened in the 1980s, thus has re-emerged.

These new challenges to the Deng approach reveal a rising uncertainty in China about whether his solutions are adequate to secure the country's future. Essentially, the rise of Maoist nostalgia, the princelings' glorification of their Communist bloodline and the CCYL's promotion of ideology and wealth redistribution imply a growing fear that the economic transition may fail, and that the Party therefore may need a more deeply layered security presence to control society at all levels and a more ideological basis for the legitimacy of its rule. Meanwhile, a more assertive military implies growing fears that a foreign policy of meekness and amiability is insufficient to protect China's access to foreign trade from those who feel threatened by China's rising power, such as Japan, India or the United States. Finally, a more strident premier in favor of political reform suggests fear that growing demands for political change will lead to upheaval unless they are addressed and alleviated.

Containing the Risks

These emerging trends have not become predominant yet. At this moment, Beijing is struggling to contain these challenges to the status quo within the same cycle of tightening and loosening control that has characterized the past three decades. Though the cycle is still recognizable, the fluctuations are widening — and the policy reactions are becoming more sudden and extreme.

The country is continuing to pursue the same path of economic development, even sacrificing more ambitious rebalancing to re-emphasize, in the 2011-15 Five-Year Plan, what are basically the traditional methods of growth. These include massive credit expansion fueling large-scale infrastructure expansion and technology upgrades for the export-oriented manufacturing sector, all provided for by transferring wealth from depositors to state-owned corporations and local governments. Modifications to the status quo have been slight, and radical transformation of the overall growth model has not yet borne fruit.

In 2011, China's leaders also have signaled a swing away from last year's foreign policy assertiveness. Hu and Obama met in Washington in January and declared a thaw in relations. Recently, Hu announced a "new security concept" for the region. He said that cooperation and peaceful negotiation remain official Chinese policy, and that China respects the "presence and interests" of outsiders in the region, a new and significant comment in light of the U.S. re-engagement with the region. The United States has approved China's backpedaling, saying the Chinese navy has been less assertive this year than the last, and Washington has since toned down its own threats. China's retreat is not permanent, and none of its neighbors have forgotten its more threatening side. But China has signaled an attempt to diminish tensions, as it has done in the past, to avoid provoking real trouble abroad (while focusing on troubles at home) for the time being.

Finally, the security crackdown under way since February — part of a longer trend of security tightening since at least 2008, but with remarkable new elements — shows that the state remains committed to Deng's general deferral of political reform, choosing strict social control instead.

The Deng model thus has not yet been dismantled. But the new currents of military assertiveness, ideological zeal and demand for political reform have revealed not only differences in vision among the elite, but a rising concern among them for their positions ahead of the leadership transition. Sackings and promotions already are accelerating. Unorthodox trends suggest that leaders and institutions are hedging political bets to protect themselves, their interests and their cliques in case the economic transition goes wrong or foreigners take advantage of China's vulnerabilities, or ideological division and social revolt threaten the Party. And this betrays deep uncertainties.

The Gravity of 2012

As the jockeying for power ahead of the 2012 transition has already begun in earnest, signs of vacillating and conflicting policy directives suggest that the regime is in a constant state of policy adjustment to try to avoid an extreme shift in one direction or another. Tensions are rising between leaders as they try to secure their positions without upsetting the balance and jeopardizing a smooth transfer of power. The government's arrests of dissidents underline its fear of these growing tensions, as well as its sharp reactions to threats that could disrupt the transition or cause broader instability. Everything is in flux, and the cracks in the system are widening.

One major question is how long the Party will be able to maintain the current high level of vigilance without triggering a backlash. The government effectively has silenced critics deemed possible of fomenting a larger movement. The masses have yet to rally in significant numbers in a coordinated way that could threaten the state. But the regime has responded disproportionately to the organizational capabilities that the small Jasmine protests demonstrated, and has extended this magnified response to a number of otherwise-familiar spontaneous protests and incidents of unrest.

As security becomes more oppressive in the lead up to the transition — with any easing of control unlikely before then or even in the following year as the new government seeks to consolidate power — the heavy hand of the state runs the risk of provoking exactly the type of incident it hopes to prevent. Excessive brutality, or a high-profile mistake or incident that acts as a catalyst, could spark spontaneous domestic protests with the potential to spread.

Contrasting Deng's situation with Hu's is illuminating. When Deng sought to step down, his primary challenges were how to loosen economic control, how to create a foreign policy conducive to trade, and how to forestall democratic challenges to the regime. He also had to leverage his prestige in the military and Party to establish a reliable succession plan from Jiang to Hu that would set the country on a prosperous path.

As Hu seeks to step down, his challenges are to prevent economic overheating, counter any humiliating turn in foreign affairs such as greater U.S. pressure, and forestall unrest from economic left-behinds, migrants or other aggrieved groups. Hu cannot allow the Party (or his legacy) to be damaged by mass protests or economic collapse on his watch. Yet, like Jiang, he has to control the process without having Deng's prestige among the military ranks and without a succession plan clad in Deng's armor.

More challenging still, he has to do so without a solid succession plan. Hu is the last Chinese leader Deng directly appointed. It is not clear whether China's next generation of leaders will augment Deng's theory, or discard it. But it is clear that China is taking on a challenge much greater than a change in president or administration. It is an existential crisis, and the regime has few choices: continue delaying change even if it means a bigger catastrophe in the future; undertake wrenching economic and political reforms that might risk regime survival; or retrench and sacrifice the economy to maintain CPC rule and domestic security. China has already waded deep into a total economic transformation unlike anything since 1978, and at the greatest risk to the Party's legitimacy since 1989. The emerging trends suggest a likely break from Deng's position toward heavier state intervention in the economy, more contentious relationships with neighbors, and a Party that rules primarily through ideology and social control.

China's Rising Middle Class
June 24, 2011

The Chinese Academy of Social Science (CASS), the country's top think tank, recently released the 2011 Blue Book of China's Commercial Sector. In the annual report, CASS estimated that the country's middle class could number 104 million (nearly 8 percent of the country's population) by the end of the year. Interestingly, this number was significantly lower than another report released by CASS just a year ago, which predicted that the middle class would account for nearly one-fourth of the country's population by the end of 2010. This discrepancy can largely be attributed to the nebulous definition of middle class; the criteria includes socio-economic status, ownership of property and purchasing power as well as many other things with different weights assigned to different indicators.

Nonetheless, whether the middle class is growing is not the primary issue for Beijing. Theoretically, the middle class is an important pillar sustaining the development of society — it identifies with mainstream values and serves to maintain social stability; its comparatively higher economic status means it can bolster domestic consumption and help to sustain dynamic economic growth; and it naturally embraces progressive ideas and thus could facilitate gradual economic and political reform. However, the Chinese government is much more concerned with retaining the support of the elites who form the foundation of the Party's power. Beijing must, however, be wary of the mounting financial burdens that could eventually cause its middle class to shrink — an outcome that would threaten economic growth and risk widespread social frustration.

Benefits for Elites

Though the influence of the middle class is expanding, the elites are still the dominant group in Chinese society. Elites enjoy benefits dating back to the time of Deng Xiaoping, who believed that a few must get rich before the country as a whole can become wealthy. According to an estimate by Boston Consulting Group, 70 percent of China's wealth is controlled by only 0.2 percent of its population. Furthermore, the elites have formed various political and business connections to secure and pass on their wealth to their children and grandchildren and other networks of their choosing.

Ironically, while they enjoy the highest socio-economic status and hold most of the wealth, China's elites are much less apt to invest in their home country than elites in other countries — particularly in recent years. They often seek alternative destinations for their wealth. The latest Personal Fortune of Chinese Report for 2011 shows that investment immigration, whereby a person is allowed to reside or gain citizenship in a foreign country in exchange for a substantial investment in real estate or open enterprises, has become the preference among individuals who have more than 10 million yuan ($1.55 million) in personal investment assets. Of the roughly 500,000 individuals who constitute this group, 27 percent have become immigrant investors in countries including the United States, Canada and Singapore. Large sums of assets also are transferred out of China by other means, including a great deal by corrupt political officials.

This trend of capital flight reveals a less-than-optimistic attitude among China's elites about the country's financial future and its ability to safeguard their assets. Equally worrisome is that the trend will cause elite-driven domestic investment and consumption to diminish. The tremendous wealth gap that the elites have fostered through their investment decisions will further constrain the ability of the country's poor and middle class to grow.

Disproportionate Burdens on the Middle Class

The socio-economic burden of the poor and middle classes in China stands in stark contrast to that of the country's elite. Based on the ambiguous criteria that define it, the middle class normally has stable jobs that require relatively higher levels of education and bring greater social status. They enjoy salaries in the upper-middle range, which in China may range from 5,000 to 30,000 yuan per month, depending on the region. Under different circumstances, this income would translate into decent living standards in most Chinese urban areas. However, China's middle class must deal with extremely high housing prices, rising living and educational costs and a weak social welfare system. These obstacles mean that China's middle class feels the least safe financially and probably is one of the least happy of all the country's social groups. In fact, as the wealth gap between the middle class and elites grows, the distance between the middle class and poor shrinks.

Unlike the rural class, which views ownership of a plot of land as its most valuable asset, the priority of most of the Chinese middle class, particularly in urban areas, is home ownership. This desire is partly driven by culture and partly by investment rationale. In particular, home ownership has become an important precondition of family building among young people since the late 1990s when the government and state-owned companies canceled a program of allocating homes to employees.

Housing prices have soared since the early 2000s. Prices have especially risen since Beijing began subsidizing the real estate sector in 2008 to sustain economic growth. In many urban areas, housing prices have more than tripled, creating large asset bubbles and the single largest burden on the country's middle class. This situation means that not only are huge down payments required but these decades-long mortgages can often consume 30-60 percent of a middle class individual's income — a development known as "housing slavery." Skyrocketing housing prices also serve as a barrier preventing many from joining the middle class. Other financial burdens on the middle class include supporting parents and grandparents — a problem compounded by the one-child policy, which demands many young families to provide for four or more elders. The lack of a sufficient pension and medical network as well as the high cost of education and other services merely compounds the pressure.

Moreover, the middle class has borne greater social responsibility in the country's wealth distribution. According to an estimate from the Ministry of Finance, nearly two-thirds of China's income tax revenue comes from the mid-to-low income groups (those with a monthly income below 10,000 yuan) with the rising middle class accounting for the greatest part. Since 2008, Beijing has been discussing raising the income tax threshold to 3,000 yuan from the current 2,000 yuan, an idea that reflects the government's reluctance to upset the various interest groups and political-economic elites even at the expense of threatening the growth of the middle class. The proposal to raise the threshold aims to offset the rising living costs and to reduce the number of people who pay taxes. The plan has drawn widespread criticism, particularly from the low-to-middle-income group, because it would only offset inflation and would not change this group's status as the largest contributor to the country's income tax revenue.

Beijing may be coming to realize the importance of supporting its rising middle class, especially as the country gradually transforms its economy from being export-driven to being dependent on domestic consumption. Additionally, with its inherent concern for the social stability, the middle class could help to support the regime if it is properly assimilated into the Party system. The Chinese government would like to broaden the criteria used to define the middle class so that it could point to its development as some sort of economic achievement. Nevertheless, in practice, nothing is significantly changing to help develop this population. Beijing continues to place great significance in the support of the elites to secure the Party's power. Regardless, the government must carefully set up supports and cultivate the middle class to avoid its shrinking — a path that would only weaken the economy and give rise to social frustrations.

China's Real Estate Dilemma

December 12, 2011

Nearly two years after Beijing enacted policies to curb the housing bubble expanded by the massive 2008-2009 stimulus, the approach has yielded some modest results: Property price increases have slowed in major cities, and some reductions have even been reported in a number of first- and second-tier cities (spreading to lower tier cities as well). The property transactions and land sales in many areas have stagnated, and the land prices offered by local governments also fell considerably, with an increasing number of auctions.

However, Beijing has also seen less desirable consequences from these real estate- and credit-tightening policies. Land sales, a major source of local government revenue, have decreased — some estimated at 30 percent year on year — creating budgetary problems. Price declines have also generated some stability concerns, as real estate has been an important investment channel for personal assets in China, leading to sporadic protests involving investors and middle-class Chinese against real estate developers in cities where price drops have been recorded. And declining prices have raised worries about undermining the value of real estate used as investment or collateral for loans from individuals and state-owned or private enterprises.

For years, Beijing has known that the fundamental tension in its real estate policy must be addressed. China knows it needs to stabilize housing prices because the rapid collapse of the housing bubble could pose a systemic risk to its economy — especially given how connected real estate has become with other important sectors like banking and construction. But the central government is unable to use more forceful measures to put the problem in check for fear of hampering growth, which has been fueled in part by the housing bubble. This is particularly challenging as the country's growth is entering a downward trend, with the export sector no longer providing sufficient drivers to sustain the economy.

Resolving its real estate dilemma would require China to take on some of the most difficult, long-standing issues in the country. These include the divide between the wealthier urban population and the much larger poor, rural population, as well as the conflict between central and local authority and the need for banking sector restructuring. Whichever path Beijing chooses, it risks a backlash from whoever loses out.

Real Estate's Role

The 2008-2009 stimulus did not create the housing bubble, but it greatly expanded it. Since the 1998 housing reforms that allowed privatization of residential property, strong demand in urban areas and an accelerated urbanization process have kept prices steadily increasing. Large investment and speculative money in the real estate sector also flowed into the market, causing soaring prices in many cities, far beyond public affordability. By 2009, the total expenditure on housing reached 12-15 times the Chinese average annual middle-class income in major cities (roughly those with a monthly income below 10,000 yuan, or about $1,600). In first- and second-tier cities such as Beijing, Shanghai and Hangzhou, the ratio was 20-30 times higher, which is significantly higher than the World Bank's suggested affordability ratio of 5:1 and the United Nations' ratio of 3:1. The real estate sector has grown to account for 10 percent of China's gross domestic product (GDP), but together with the economic activity it generates in associated industries such as construction and finance, it totals closer to 20 percent of the country's GDP. Real estate-related construction, services and industries provide extensive job opportunities, particularly for migrant workers, sustaining China's employment.

Real estate has become an attractive sector for investing personal assets due to the limited options for personal investment — many Chinese are reluctant to participate in the volatile stock market, and other viable options such as interest from savings accounts have low returns. Soaring prices over the past decade established an expectation that there is little chance of losing money on tangible assets such as real estate. These expectations have been shaken by Beijing's relatively cautious moves to contain the housing bubble.

The country's banking sector has also come to depend on real estate. Aside from large purchases and bank loan investments, real estate is increasingly associated with the banking system through financing tools. Unlike the Western system, China's banking system is largely based on collateral loans. According to estimates, 70 percent of bank lending and 90 percent of individual lending are through collateral loans, as opposed to loans on credit alone, with real estate and property being the primary collateral offered for loans. With Beijing limiting access to credit for small- and medium-size industries as part of its monetary tightening policy, property has increasingly been used as collateral through both formal and informal lending channels.

The threat from falling real estate prices affects not only individuals holding mortgages at rates higher than they can afford, but also entities that have borrowed money using property that has now dropped in value as collateral, thereby threatening the financial health of China's banking system.

These transactions often consist of individuals and enterprises seeking loans from state banks, small credit firms or individuals (such as loan sharks) through a lease of a property or a piece of land, though the parties offering the loan often use the real estate-based collateral to take out their own loans. Official estimates from the Chinese central bank put outstanding real estate-related loans at about 10.46 trillion yuan — about 1.5 times the total official lending in 2010. The real number of housing market loans could be far more than reported. And given how many parties can be involved (and thus vulnerable) in each loan taken out with real estate as collateral, this can quickly become a systemic risk if prices fall suddenly and significantly.

Local vs. Central Authority

Real estate is also at the center of a government financing problem. Since the 1994 tax reforms, Beijing has taken a larger share of fiscal revenue, increasing from 22 percent in 1994 to a current rate of around 60 percent, leading local governments to seek out other funding sources. One problem has been land sales, which currently account for around 40-60 percent of local revenue. With strong incentive to promote land sales for increasing revenue, local governments have a fundamental interest to drive up real estate prices and collaborate with developers to maintain high prices.

As a result of policies intended to contain the housing bubble, however, the total volume of land sales in China's 130 cities has decreased by 30 percent. In major first- and second-tier cities, falling property transactions also resulted in a 10-30 percent decline in land prices offered by the local government. Falling real estate prices will limit local governments' ability to obtain the resources they need to sustain public expenditures. These financial constraints are one reason local governments have proved resistant to the central government's aim to construct more affordable housing, its key strategy for dealing with the negative consequences from the curbing of real estate prices.

Social Stability and Beijing's Solution

Housing is critical to the country's social stability, which is the ruling Communist Party's paramount concern. This cuts two ways. Investors and purchasers who bought at peak prices oppose efforts to rein in the housing bubble because they threaten investments. Meanwhile, China's massive rural, low- and middle-income classes would benefit from efforts to make housing more affordable via stabilized, lower prices, but even with lower prices, they still may not be able to afford property.

Beijing sees the construction of new affordable housing as the solution. In March, it initiated a plan to construct 10 million new affordable housing units by the end of the year and as many as 36 million by 2016. From Beijing's point of view, a massive wave of residential construction and all that it would entail in terms of employment and manufacturing would help offset the economic slowdown and the tightening real estate market. Meanwhile, a greater supply of affordable housing would help meet the increasing demand in urban areas, thereby stabilizing housing prices. This dovetails with the accelerating urbanization plan, which could also boost domestic consumption and reduce the wage gap, with more rural workers entering the coastal economy.

However, this has been consistently hampered by the lack of local incentive to build affordable houses, due in part to weakened local financial health and decreased commercial gain stemming from efforts to deflate the housing bubble. Even after Beijing's call to accelerate construction, of the 10 million houses that Beijing announced as completed, about a third are reportedly unfinished, not to mention the numbers that are from previous allocated houses faked by local governments. Some of the new buildings have also been reportedly given to unintended recipients (some to people who already have houses, or even mid- to high-income people with political connections).

Local governments could scale up their participation in constructing affordable housing, but in exchange they would probably demand Beijing weaken its tightening measures and refrain from pursuing additional ones. This would allow the very problem Beijing was hoping to contain — unsustainable housing prices — to expand again, making a push for affordable housing to offset the consequences of real estate tightening an unrealistic one.

The central government has tolerated or even encouraged the real estate asset bubble as a way to fuel growth for years, but with declining global consumption eating into already low profit margins for Chinese exporters, Beijing is being forced to address the issue. While it wants to squeeze the huge bubble to make the market more sustainable, squeezing too hard could lead investors to abandon the real estate sector, causing a sell-off that would damage local governments, middle-class personal investments and corporate savings channeled into property-related activities. Beijing can neither endure the risks associated with an out-of-control housing bubble, nor face the remedies needed to cure it, but it must soon make a decision on which interests to protect.

The Viability of the 'Chongqing Model'
January 20, 2012

Chinese state-run media recently published a series of reports detailing the economic success and social achievements of the southwestern city of Chongqing. The reports praised the so-called Chongqing model, which is characterized by its unique approach to stimulating both the economy and ideological passion in its citizens, saying it is a reflection of current Communist Party of China (CPC) doctrines. Also, Chinese leadership has been visiting the city in the past few months.

This praise suggests Beijing may be reversing its earlier perceptions of the Chongqing model — and its architect, CPC Chongqing Party Secretary Bo Xilai — and may be a sign that both are gaining acceptance from China's political leadership. However, while the merits to the model are evidenced by Chongqing's successes, there will be constraints to its widespread implementation.

An Unorthodox New Direction

Chongqing, one of four Chinese municipalities administered by the central government, is located far inland from the country's political and economic center along the coast. Its heavy industry-based economy, its position as one of the Yangtze River's largest inland ports and its history as a political center in the 1930s-40s have made it the economic hub of Western China. However, the country's economic base has migrated eastward in the intervening years. The industrial upgrading of coastal cities since the mid-1980s and a massive reform of Chongqing's state-owned enterprises resulted in Chongqing lagging behind most first- and many second-tier Chinese cities economically. At the same time, factors such as deep-rooted corruption among the political and business elite, powerful organized criminal elements and high urban unemployment exacerbated by a large influx of rural migrants made it an environment conducive to social instability.

Upon his appointment to Chongqing in 2007, Bo implemented a series of initiatives to address both economic and social problems, including a massive crackdown on organized crime and the eradication of powerful political clans in the city. At the same time, Bo began a "Red campaign" that promoted CPC ideology by, among other tactics, advocating the teachings of former Chinese leader Mao Zedong and mandating the recital of nationalist songs. These high profile, controversial initiatives made Bo a polarizing figure among Chinese politicians, but little attention was paid to Chongqing's development.

For the economy, Bo took the municipality's focus away from the traditional export-based model of Chinese coastal cities and began developing domestic investment and consumption through government-led infrastructure projects, favorable policy incentives and relatively equalized social allocation. With abundant labor and resources in the region, Chongqing is largely self-sufficient — and thus largely shielded from external vulnerability: During the 2008 economic crisis the country's gross domestic product (GDP) growth slowed to 9 percent, but Chongqing's GDP grew by 14.3 percent. Domestic consumption rose to about 50 percent of the economy, far above the national average of about 30 percent. Chongqing also became an attractive destination for foreign investment, which increased from $311 million in 2003 to $6.3 billion in 2010.

Importantly, this economic boom has not deepened the wealth gap among its residents, as has happened elsewhere. The social initiatives on which the Chongqing model is based encourage massive urbanization through relatively equalized wealth distribution and expanding coverage of social security networks (one official described these initiatives in terms of dividing a cake more equally, giving rise to the term "cake theory"). In 2011, household income for the Chongqing municipality's urban and rural populations increased by 15.5 percent and 22 percent respectively, significantly higher than the national average. Meanwhile, unlike in other Chinese cities where governments would make massive profits from land grabs, Chongqing allowed the rural population to retain ownership of their land even after urbanizing and helped them with temporary social welfare. As a result, the urbanization of 3.2 million people has not resulted in major unrest or grievances.

Beijing Takes Notice

The 2008 financial crisis accentuated the need for Chinese leadership to restructure the economy. For decades, China's economic model was based on a low-end manufacturing sector sustained by an abundance of inexpensive labor and booming external demand, as well as on support for small- to medium-sized private enterprises. However, the former was hit hard by its vulnerability to the global economy and increasing social instability resulting from a combination of low wages, rising unemployment and increasing costs of goods, while the latter was affected by growing governmental favoritism toward large state-owned businesses and centralized economic control.

With the coastal model risking failure, Beijing has taken notice of Chongqing's success, which appears to provide a solution to these issues in a way that appeals to renewed leftist sentiment in the central government. As China faces greater economic and social complexities, the central government may see the Chongqing model as something that can be applied across the country with regional modifications.

However, there are several issues inherent in the model that may impede its long-term success and widespread adoption. First, unlike in coastal regions where businesses and lower-level authorities are granted greater autonomy in their activities, the Chongqing model relies on a much more centralized economic authority, the city's municipal government, which retains strong control over fiscal revenues, local resources and economic activities. This control has allowed Chongqing to implement massive infrastructure projects to attract investment and, at the same time, disburse relatively equalized subsidies to the public to prevent social instability. Adopting the Chongqing model in other regions of China would require strong fiscal health and centralized support. That strong centralized command leaves the model vulnerable to misallocation of resources and wealth by those in power.

Meanwhile, despite the model engendering higher domestic consumption, the economy still is driven by massive government investment, which has resulted in large fiscal deficit and a government debt of up to 800 billion yuan ($126 billion), according to some estimates. This kind of investment has provided the city an interim economic boost, but it is unsustainable in the long term, posing financial risks and endangering development (in much the same way China's massive stimulus efforts in 2008-09 are continuing to affect the country). In addition, government-dominated investment activities are generally made via large business deals with powerful enterprises, which carry a higher risk of government-business relationships that could lead to corruption and the squeezing out of smaller private entities.

From a political view, the prominence of the Chongqing model comes from innovative local governance based on regional variance. But, as the government navigates through a leadership transition set for this year, the Chongqing model may also be an example that local politicians consider for the short term. The economic and social problems it has the potential to create must be addressed before it can become a viable, nationwide alternative to China's current economic model.

Rural Unrest Presents Dilemma for Beijing

January 26, 2012

A few hundred people, evidenced through video, gathered Jan. 19 in the southern Chinese village of Wanggang, a suburb of the city of Guangzhou in Guangdong province, to protest corruption by village officials. Villagers are accusing the local Communist Party of China (CPC) secretary, an unelected official ostensibly appointed by upper levels of the Party, of collaborating with local organized criminal elements to make more than 400 million yuan ($63 million) through land seizures and other activities. In addition to demanding adequate compensation for land taken from them, protesters are calling for the removal of Wanggang's Communist Party of China (CPC) secretary.

The Wanggang protesters are citing as inspiration similar protests in Wukan, Guangdong province, which ended Jan. 15 after four months with the ousting of the village committee and the installation of one of the protest's leaders as its new CPC secretary and with promises to organize an elected village committee. Wukan also has inspired a protest in Jinjiang, Fujian province, where hundreds of residents from the village of Xibian decried land seizures while holding a banner reading, "We're learning from Wukan." While these instances of unrest were triggered by land seizures, the growing popularity of Wukan-style protests and the rhetoric of the Wukan model lies in that village's successful efforts to get the central government to allow some measure of self-governance. With the growing concern of legitimacy in rural areas, Beijing is concerned protests could spread further and carry out similar goals.

The concept of the CPC allowing more autonomy at the village level in rural areas is not a new one. After the economic reforms, which began in 1978, liberalized the rural labor force and invigorated family-based agricultural economy, came a series of supplementary political initiatives throughout the 1980s aimed at keeping the central government abreast of this liberalization. These included abolishing the previous rural administrative bodies, called people's communes, in favor of establishing governance at the county and township levels (though not in individual villages).

However, these changes did little to improve governance at the local level amid a significant economic boom for rural areas. Especially at the village level, tensions between local CPC officials and residents were high, exacerbated by misallocation of land and financial resources, and local officials' continued tight economic and political control over village affairs and day-to-day life. This friction was the subject of an intense policy debate among CPC officials. Introducing some autonomy to rural areas would appease social tensions and increase government responsiveness and accountability, thereby enhancing legitimacy at the rural level, but Beijing did not want the autonomy to go so far out of CPC control that an unregulated body could promote grassroots activities not easily managed by Beijing or that could threaten the party's authority.

The agreed-upon solution was the establishment of village committees — governing bodies elected by residents that existed parallel to unelected local CPC officials, first trailed in 1982, and made into law in the late 1980s. A given committee, and especially the chairperson, held significant powers at the local level, ranging from distributing or leasing village land to controlling financial resources and mediating rural disputes. At the same time, however, Beijing implemented several levers for control over the committees. These included the establishment of CPC-appointed election oversight bodies for each village; rules that allowed the CPC to intervene in the nomination, balloting and voting processes of village committees; and openly encouraging residents to vote for their local CPC secretaries for committee chair, leading to 60 to 80 percent of villages that currently have one person in both positions.

The implementation of village committees did stabilize rural areas and achieve some degree of self-governance, but as the latest unrest shows, the CPC's power over village affairs through unelected officials is a source of lingering tensions.

Politically focused rural unrest is still rare in China — most current and recent protests continue to be over residents' economic security, and even in Wukan's case, the political claim came after months of unresolved economic protests — but the government's conciliatory response thus far has highlighted its dilemma. Beijing is forced to respond to these protests for fear that they could further promote concern over its legitimacy in rural areas. If Wukan-style protests spread, the CPC will need to rethink its strategy for holding authority over rural areas: Tighter Party controls have only further encouraged unrest thus far, but a strategy of appeasement runs the risk of emboldening potential protesters elsewhere. Alternatively, too strict a response could turn protesters' focus from their local officials toward the central government. Stratfor will thus continue to watch for the rise of protesting with goals similar to Wukan in Guangdong and elsewhere.

China's Need for Continued Economic Growth

March 6, 2012

Chinese Premier Wen Jiabao spoke at the opening of the Fifth Session of the 11th National People's Congress (NPC) regarding his administration's annual work report for 2012. The report maintained the previous year's tone with respect to the need to rebalance the economy and placed stable economic development and boosting consumer demand at the top of the administration's list of nine priorities. Detailed measures to substantially increase consumption include the creation of 9 million new jobs, increasing coverage and payouts for social benefits, the continued construction of affordable housing and assistance for rural dwellers. Most significantly, Wen spelled out government aims for economic growth of 7.5 percent, down from the 8 percent target for the preceding eight years.

The reduction has more to do with shaping perceptions than an actual effort to dampen growth, however. Particularly amid a weakening external economy, Beijing will remain supportive of growth greater than 8 percent to ease China's leadership transition and to keep from fueling social unrest.

While growth targets are largely symbolic — China always surpasses them by as much as 1-3 percent — the lowered target will still shape perceptions. It represents Beijing's acknowledgement of an inevitable slowing in growth and shows Beijing working to face the slowdown, particularly under the upcoming generation of leadership, with a greater emphasis on balanced and sustainable socio-economic development.

Beijing has relied on China's growth boom of the past decades to support its immense population and to accumulate large amounts of capital. Such extraordinary economic growth has helped legitimize Party rule, but Beijing's growth plan has seen wealth centralized, benefiting a small group of elites. Negative consequences, including class frustrations originating from the wealth disparity and other social imbalances, increasingly have begun tarnishing China's economic miracle.

After 2008, the weakening global economy damaged China's export-oriented model. Beijing already knew the importance of shifting away from its gross domestic product (GDP) growth-oriented economy, but events since 2008 have reinforced the urgency of such a shift. Beijing accordingly has had to speed up its efforts to restructure toward a more domestic consumption-based economy and toward greater social equity, something it had mulled for years but had not had an impetus to act on. In 2011, numerous senior economic planners called for a greater emphasis on wealth redistribution and on the need to rebalance the economy. In its 12th Five-Year Plan, Beijing set a target of 7 percent for average annual growth over the next five years, a strong indication of Beijing's acceptance of a gradual yet inevitable economic slowdown.

A greater willingness to regulate local government behavior has accompanied Beijing's willingness to accept a modest slowdown. Even before the 2011 annual session of the NPC and the Chinese People's Political Consultative Conference, the National Development and Reform Commission — Beijing's top economic planner — had warned local governments to reduce their individual GDP targets and pointed out problems with the pursuit of GDP growth. Local government officials have long had an incentive to pursue higher GDP numbers to promote their political careers. Attaining higher office frequently has depended upon the ability to point to strong GDP growth, but such behavior now threatens to undermine Beijing's new emphasis on balanced, albeit smaller, growth.

Ultimately, however, Beijing understands that China cannot afford to slow growth substantially, because a slowdown in growth would create even greater social, political or economic hardship.

PART 5: SOUTH AFRICA

The Geopolitics of South Africa: Securing Labor, Ports and Mineral Wealth

May 8, 2009

South Africa, located at the southern tip of the African continent, is a country of significant wealth, from arable land to minerals to human capital. Its history is one of competition between and cohabitation of foreign and domestic interests seeking to control that wealth. Its imperatives are to maintain a free flow of capital and labor within the country and in the southern African region in order to exploit the region's vast mineral riches and to be able to project a security capability in southern Africa in order to prevent the emergence of a rival power.

Geography

South Africa has been the dominant power in the southern half of Africa for more than a century. During the colonial era, British authorities established control over the territory's primary ports at Cape Town and Durban and secondary ports at Port Elizabeth and East London in order to protect the sea-lanes rounding the Cape of Good Hope and to control access to the interior of southern Africa. Ports located north in German or Portuguese territories (such as

Walvis Bay in South West Africa/Namibia, Luanda in Angola or Delagoa Bay in Mozambique) were either too dangerous for regular shipping or had environments too malaria-ridden to support a settler population. Without habitable conditions in the region, rival European powers could not easily assemble sufficient numbers of soldiers and settlers to invade and occupy the interior of southern Africa.

Much of South Africa's territory is a hot and semi-arid savannah. A chain of low mountains just inland (peaking at 11,424 feet in the Drakensberg range bordering Lesotho) stretches almost uninterrupted from the country's southwestern corner at Cape Town to the country's northeastern border with Mozambique and Zimbabwe (these mountains continue farther, essentially an extension of the Great Rift Valley's eastern edge). A narrow band of fertile land, ranging from 50 to 100 miles in width, lies between the mountain chain and the Indian Ocean, supporting significant population centers such as Cape Town and Durban. This band also supports much of South Africa's fruit and sugarcane farming and some grain cultivation.

On the interior side of the mountain range is a region consisting of two broad ecological zones, dividing the area into western and eastern halves. The land area is a basin that slopes downward from east to west, bounded on the south and east by mountains, the northwest by the Kalahari Desert and the west by the Atlantic Ocean. The hot and arid western half gives way in the north to the Kalahari, which extends into neighboring Botswana, and reaches west to the Atlantic Ocean. There is relatively little human population found in much of the western zone and little economic activity apart from some grazing, farming and mining, including diamond mining along the Atlantic coast.

The eastern half is the economic heart of South Africa. It includes a higher elevated savannah that is hot and semi-arid and home to much of the country's grain belt, thanks to two river systems, the Vaal and the Orange, which are controlled for irrigation and power purposes. At the western fringe of the eastern half are South Africa's rich diamond veins, centered around the city of Kimberley. To the east is South Africa's gold mining area, with Johannesburg at its heart.

A wealth of other minerals, from chromium to copper to platinum to coal, is also found in this area, which is known as the "Highveld."

The narrow band of fertile land along South Africa's southern and eastern coastal region — from Cape Town through its northern border with Mozambique — was the natural place to support sizeable populations. Abundant water and fertile soil attracted various populations, which inevitably led to competition over a relatively scarce amount of supportable land.

South Africa is the only country in Africa in which there is, for the most part, no risk of malaria. This is because the country is far enough south and high enough in elevation that its subtropical and Mediterranean climate cannot support mosquitoes. The lack of malaria enabled South Africa to support a European-settler population, which in turn enabled the development of industrial-level economic activity. Long-term investments in the country could be made, knowing that its population would not die out in the short term. Neighboring coastal countries such as Mozambique and the northern part of Angola largely consist of lowland tropical marshes that prevent large-scale settler populations from being established. Although Namibia to the northwest also has a low risk of malaria, the country is essentially a desert (interspersed with mountains). That, coupled with a dangerous coastline called the "Skeleton Coast" because of the many shipwrecks that have occurred there, made Namibia profoundly unattractive to colonial Europeans who relied on shipping for communication and commerce.

South Africa's geography is much more useful economically than that of any other country on the continent, and it is also more defensible. The country's disease-free and arable highlands have supported stable population growth and the development of mineral wealth in the interior. Although now led by a democratically elected government, South Africa must maintain a liberal economic regime that permits the free flow of labor and capital to and from a dozen other countries in southern Africa, a region that extends north to the equator, as well as maintain a superior security capability that can be projected in the region.

MALARIA RISK AREAS OF SOUTHERN AFRICA

Early Colonial History

The creation of what would become the Republic of South Africa began with the founding of Cape Town as a resupply station by the Dutch East India Company (VOC, in Dutch) in 1652. Ships traveling between Europe and the Far East all travelled around the Cape of Good Hope, which was about halfway between the riches of the Orient and markets in Europe and therefore of strategic value to maritime trade.

The Dutch were not interested in territorial conquest in the interior of southern Africa. They simply needed land to grow food and ports to service their ships. However, VOC personnel and resources in the immediate vicinity of Cape Town were insufficient to meet the company's needs. In the 17th and 18th centuries, the VOC was driven to expand its territorial control to greater swaths of agricultural areas, establishing the towns of Stellenbosch (about 30 miles east from Cape Town), Swellendam (about 125 miles east) and Graaff-Reinet (about 500 miles east-northeast of Cape Town).

Acquiring greater agricultural-producing lands required the VOC to recruit a greater supply of labor. These two factors — needing more land and more labor — put the VOC on a collision course with the indigenous Khoisan population, which inhabited the Cape area. Competition over grazing land, made scarce by the area's limited rainfall, led to clashes between Cape settlers and the Khoisan beginning in 1659 and ultimately to the defeat and subjugation of the Khoisan by 1713.

The VOC administered the Cape Colony essentially without foreign opposition until the end of the 1700s, when Napoleonic wars in Europe forced Britain to capture control of the Cape Town outpost. Strategically located at the confluence of two oceans, the Atlantic and the Indian, Cape Town put whoever controlled it in position to protect or interdict maritime commerce rounding Africa (this was before the creation of the Suez Canal, which established a maritime link between the Mediterranean Sea and the Indian Ocean in 1869). Britain calculated that if France were able to gain control over the

COLONIAL POWERS IN AFRICA, 1914

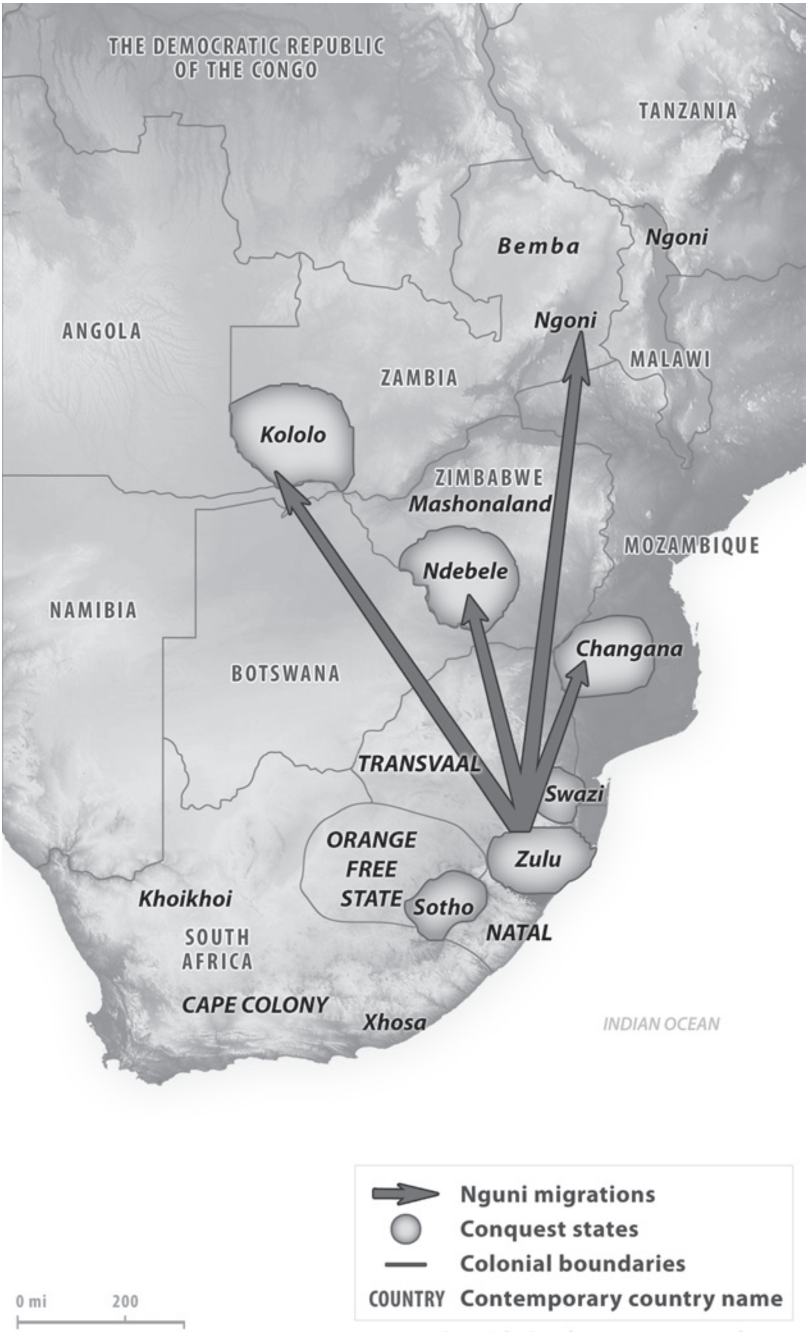
Cape, then British interests in India would be threatened by the French, whose island possessions in the Indian Ocean could interdict British traffic once it had rounded the southern tip of Africa. The British wrested tenuous control of Cape Town from the Dutch in 1795 and gained full control of it in 1806 (though peace negotiations that included sovereign title were not concluded until 1814).

After gaining control of the Cape, the British set about expanding their control, recruiting some 4,000 British farmers as well as Dutch inhabitants of the Cape Town area to settle the eastern frontier of the colony's territory, demarcated by the Great Fish River in the area now known as Eastern Cape province. The settlers were sent into the area as a frontline trip-wire against Xhosa tribal movements. Control over Eastern Cape also afforded the British control over alternative harbors that could provide secure access into the interior.

Around the same time settlers laid claim to the Eastern Cape frontier, compromising Xhosa tribal homelands, another significant tribe in southern Africa was threatened by colonial encroachment. The Zulu tribe in southeastern Africa (northeast of Xhosa lands) was being pushed south and west by Portuguese slavers operating out of their port at Delagoa Bay (known today as Maputo, the capital of Mozambique). Pursued by the slavers, the Zulu fought for control of new lands they were being pushed into, incorporating lesser tribes for pure survival purposes. Rallying the Zulu was their leader Shaka, who enforced strict hierarchical authority and a merit-based warrior culture in order to overcome the tribe's inherent weakness of divided clans and autonomous power bases that could be exploited by the Europeans. In the 1820s, Shaka's tactics also resulted in a population dispersal known as the mfecane (the "crushing" of lesser tribes that resisted) and the difaqane (the "scattering" of lesser tribes that fled). As a result of the difaqane, Zulu-related ethnic and linguistic linkages are still found throughout southern Africa and contribute to contemporary patterns of migration that make South Africa a beacon for immigration from throughout Sub-Saharan Africa.

Meanwhile, Dutch-descended settlers in the Eastern Cape frontier area, known as Boers (the Dutch word for farmer), became

THE ZULU REVOLUTION



increasingly unhappy with British rule, especially restrictions on the use of African labor. In 1836, a group of Boers chose to emigrate rather than comply with British rule and embarked on the "Great Trek" to claim territory in unoccupied lands (at least by Europeans) in other parts of southern Africa. In 1838, they founded the Republic of Natalia, with principal towns of Durban and Pietermaritzburg. An independent-minded settler population controlling a strategic port at Durban was too great a threat to British control in the region, and in 1843, the British annexed the territory and declared it a British colony.

Many of the Boers in Natalia refused to submit and emigrated again, this time toward the interior, where they established two other independent territories: the Orange Free State (comprising present-day east-central South Africa) and the Transvaal (much of what is now northeast South Africa, bordering present-day Zimbabwe and Mozambique). In 1857, feeling there was little to gain by annexing these isolated interior grasslands and preoccupied by coastal concerns, the British granted recognition to both Boer republics.

The British position would change with the discovery of diamonds near Kimberley in 1867, on the border of the Orange Free State. Until then, the interior of southern Africa was attractive to pioneers, missionaries, Boers and indigenous tribes but not to British colonial authorities. The diamond find at Kimberley triggered a great rush that reconfigured contemporary southern Africa and laid the groundwork for South Africa as a nation-state.

Diamonds, Gold and Territorial Consolidation

With the discovery of diamonds on a farm near Kimberley, prospectors poured in to stake their claims and make their fortunes. Thousands of individual claims were made, yet there was no clear ownership of the territory around Kimberley. Cecil Rhodes, then a young British immigrant to the Cape Colony, hoped to make his fortune in the new find. Rhodes began buying up diamond claims, believing the chaos of thousands of diggers and laborers made extracting the diamond wealth unprofitable. Rhodes, together with a few partners, established the De Beers mining company, aiming to establish a monopoly over diamond mining at Kimberley. British capital was secured to finance the takeover of the area's mining operations.

Because of the unclear ownership of the diamond-producing territory as well as competing ownership claims — particularly from the neighboring Boer republics — the area's indigenous Griqua population petitioned the British government for protection, leading to the annexation of the diamond-producing area in 1871. The British named the area Griqualand West.

Despite the Orange Free State's encroachment upon the diamond-producing area and laying claim to Griqualand West, relations between the British in the Cape Colony and the Boers in the Orange Free State remained cordial. Diamond-mining activities became consolidated under Rhodes' management, but while Rhodes was able to quickly establish central control over multiple claims, he had a harder time putting into place a profitable mechanism for extracting the diamonds.

The key to profitable diamond mining was securing an abundant supply of reliable labor. At this point, African labor was deemed unreliable — Africans would travel to Kimberley to work the mines but would return to their homelands for months on end to tend to their cattle and crops. Those who stayed could, and did, command exorbitant prices for their labor. Additionally, migrant labor had to face the considerable inconvenience of traveling through multiple sovereign territories — the Orange Free State, the Transvaal, indigenous tribal homelands — that interrupted a smooth flow of labor for Rhodes through customs procedures, taxation and the raiding and robbing of migrant groups. Essentially, the political geography of the region worked against effective minerals extraction.

"We must find new lands from which we can easily obtain raw materials and at the same time exploit the cheap slave labor that is available from the natives of the colonies," Rhodes said at the time. "The colonies would also provide a dumping ground for the surplus goods produced in our factories."

Rhodes began to engineer a means of ensuring a stable supply of labor — particularly African labor — by constructing labor camps that provided year-round accommodations for male laborers and by hiring labor agents to travel to neighboring territories to recruit Africans for the diamond mines. Rhodes required greater leverage, however, to overcome the political obstacles presented in the Orange Free State, the Transvaal and the independent African homelands. Rhodes ran for a parliamentary seat and was elected representative in 1880 for Barkly West, essentially a suburb of Kimberley.

With the backing of private British capital and his increasing involvement in British government policy in the Cape Colony (he would go on to become the colony's prime minister in 1890), Rhodes devised a political solution to the impediments blocking mineral development in the interior, using state power to change the political geography. The Transvaal was annexed in 1877, followed by Southern Bechuanaland (present-day Botswana), effectively establishing a single labor pool through relaxed immigration and migration laws across much of southern Africa in order to better tap Kimberley's mineral wealth.

With the discovery of gold in the Transvaal in 1886, leading to another rush of prospectors and mining barons, Rhodes replicated his diamond operations in Kimberley in the Witwatersrand, the name of the gold-producing area. Rhodes sought and gained approval in 1889 for a royal charter establishing the British South Africa Company (BSAC), which was authorized to enter into negotiations for territory and mineral extraction and to raise its own police force. With his charter in hand, Rhodes set out to claim territory further north in the interior, fully intending to link up with the Imperial British East Africa Company, which was seeking to seize and consolidate Kenya, Uganda and the source of the Nile River far to the northeast. The cost of this linkup proved daunting, and Rhodes stayed in southern Africa, establishing a BSAC settlement called Salisbury, in the autonomous tribal territory of Mashonaland. In the mid-1890s, these former tribal lands would be divided into Rhodesia and Northern

SOUTH AFRICA'S REGIONAL MINERAL INTERESTS

Rhodesia, both BSAC-administered territories. (They would become official British protectorates in the 1920s.)

By the turn of the 20th century, Britain had consolidated its control over what is known today as South Africa, annexing numerous territories, including the Boer republics after defeating them in war (1899-1902) and Zululand after defeating the Zulus in war (1879-1897). In 1910, the Cape Colony, along with the annexed Boer republics and the Natal Colony, became the Union of South Africa, a self-governing dominion of the British crown. With control over the four primary ports on the southern edge of the African continent — Cape Town, Port Elizabeth, East London and Durban — the union could control access to the continent's southern interior and its mineral wealth.

Since the British conquest of southern Africa and the creation of the Union of South Africa, South African territory has remained constant, as have its mineral interests in the region. The company that Rhodes was instrumental in founding, De Beers, together with a sister company, Anglo American (primarily responsible for gold mining), remains the driving force in southern African economies, with concessions continuing in territories Rhodes sought to control in the 19th century. Those territories, now the independent countries of Zimbabwe, Zambia, Malawi, Namibia and Botswana, are tightly aligned with South Africa, which is the hub of the region's imports and exports and, most important, the first-choice destination for laborers migrating out of southern African countries.

External Rivals

During the colonial era, the territory that would become South Africa believed itself vulnerable only when neighboring states in southern Africa cooperated with one another or with a foreign power against its interests. At the end of the 19th century, the British colony felt threatened by possible German expansion linking up German colonies in what are now Namibia and Tanzania and by possible Portuguese expansion linking up colonies in present-day Angola and

Mozambique. The BSAC drive into central Africa blocked these rival powers from linking up in central Africa and moving southward to mineral-rich and lower-risk malaria areas.

Following the creation of the Union of South Africa in 1910, Dutch-descended settlers, including the Boer farmers, agitated for a greater stake in the government. Although dispossessed of their independent republics, these settlers never lost their sense of identity as Dutch-Africans. Their distinctly anti-British identity mobilized them as a political force, and in 1914 these so-called Afrikaners formed the National Party to represent their political interests. In 1948, the National Party won national elections and would go on to lead the country's government, uninterrupted, until 1994. (The Afrikaner-led government was instrumental in severing ties to the British Commonwealth and creating the Republic of South Africa in 1961). During its rule, the National Party expanded existing legislation and introduced new laws that took a traditional practice of racial discrimination to a new level, called apartheid (Dutch for "separateness"). The system of apartheid officially segregated the country's white population from its black (as well as Indian and "colored," or racially mixed) population and imposed severe restrictions on the latter.

During the era of apartheid, South Africa felt threatened when it was confronted by a combination of neighboring states, including Zimbabwe, Zambia and Mozambique, that came to be known as the "frontline states." These states were also backed by foreign military assistance, mainly from China, Russia and Cuba. South Africa's qualitative superiority in military capability ultimately met its match on the Angolan battlefield in the late 1970s, but only after 50,000 Cuban troops and many Russian fighters and advisers were deployed in support of African National Congress (ANC) fighters who were using rearguard bases and training camps in Angola to try to overthrow the apartheid regime.

Apartheid South Africa believed itself capable of ensuring national security in South Africa proper, but to do so required a rigid military posture. The country's white population was outnumbered 10 to one by the country's black, Indian and colored population. Like Zulu leader Shaka during the mfecane and difaqane of the 1820s, apartheid South Africa could not tolerate dissent in its ranks or it would not survive raids against its people and its interests. Black and white (as well as Indian and colored) dissenters were scattered into exile, and males from neighboring "tribes" — white Rhodesians and the white population of South West Africa — were conscripted to serve in the South African military (as were many blacks). Significant investment in a domestic military industrial complex supported South Africa's military developments, especially when it faced international sanctions in the 1970s and 1980s.

Apartheid ended in South Africa when a combination of forces that had built up during the 1970s and early 1980s proved insurmountable by the end of the 1980s. International sanctions cut off capital and blocked access to South Africa's trading partners. Internal opposition among white South Africans meant Pretoria could no longer deploy draconian methods or it would risk losing its political base as well as its military conscription base to emigration. Frontline states cooperating with foreign militaries threatened to end South Africa's qualitative military advantages. By 1989, the Afrikaner-led government in Pretoria began negotiating with ANC leaders, ultimately agreeing to hold democratic elections in 1994 knowing that it stood no chance of returning to power after that point in any substantial way. Since leaving power in 1994, a few Afrikaner politicians have pursued a more radical agenda, arguing for an independent white African state or scheming to overthrow the ANC government, but most have either joined the ANC or simply retired to the private sector.

Contemporary South Africa continues to rely on a qualitative advantage to maintain its superior military posture in southern Africa. South Africa does not face any immediate threat against its national security, but this has not prevented the South African state under the ANC from acquiring a high-end defense package that is planned to be online by 2012. This package includes 28 Saab JAS-39 C/D Gripen fighter jets from Sweden, three Type-209 German submarines, four German Valour-class frigates and a number of transport aircraft, attack helicopters and jet trainers that can double as attack aircraft.

The new hardware, combined with a total active South African National Defense Force of approximately 62,000 personnel (including some 37,000 army troops), will maintain the country's regional military superiority for the foreseeable future, ensuring that it can project power up along the Atlantic and Indian Ocean coastlines as well as into the interior of southern Africa. Air bases at the northern edge of South Africa (principally at Makhado) put all of Zimbabwe, the southern half of Mozambique (including its ports at Maputo and Beira) and the Zambian capital, Lusaka, within reach of the Gripen, while lily-pad air bases in northern Namibia (at Rundu) and in Zambia (at Mumbwa, Ndola and Mbala) put practically all of South Africa's mineral interests in southern and central Africa within reach.

Geopolitical Imperatives

South Africa's geopolitical imperatives, grounded in a hundred-odd years of expansion and conquest during the 19th century, continue to drive the country's internal behavior and its relations with neighboring and more distant foreign states.

- Establish control of the highlands, or the eastern half of the country's interior. Effective control also requires holding sufficient portions of the southern and southeastern coasts to ensure access to the port facilities necessary for international trade. While the highlands are not where the modern country of South Africa got its start — which was in Cape Town — they are nevertheless the country's core.
- Extend the state's reach east, south and west to the sea in order to gain control over the entire tip of the South African peninsula, along with the ports this territory provides. (Historically, "South Africa" achieved this aim before it achieved control over the highlands, but this was during colonial times when an

outside power with different interests was using the territory for its own benefit.)

- Utilize state power to remove political restrictions on using the regional labor pool in order to better tap the Kimberley and Johannesburg region's mineral wealth. This includes such strategies as granting economic incentives, relaxing immigration and migration laws and militarily intimidating neighboring states.
- Seek out international economic partners both to serve as markets for the country's mineral wealth and as sources of finance.
- Take advantage of the lack of alternate port facilities and local financing sources throughout southern Africa to extend the labor policy (including the economic incentives and military intimidations that go with it) north. This provides the state with economic opportunities, deep influence with local rivals and a buffer against potential foes farther afield.

Grand Strategy

Following its transition from apartheid to democracy, South Africa has remained the dominant power in the southern half of Africa. It will still flex its muscles when its interests are threatened, but South Africa's behavior is more akin to that during colonialism than during apartheid.

In the short to medium term, South Africa does not in face a threat on its borders. Frontline states such as Namibia, Botswana, Zimbabwe, Mozambique, Lesotho and Swaziland may fare well or poorly in political and economic spheres, but the point for South Africa is that these states are no longer rearguard areas for revolutionary freedom fighters training and equipping themselves to overthrow the South African government. The ANC is the South African government, not some partially exiled revolutionary movement. And with domestic political opposition in no position to threaten the

ANC's hegemony over the black South African voter, it will continue to be the government for the foreseeable future.

Since the ANC came to power, keeping up relations with neighboring states that harbored and armed it during the struggle against apartheid has caused it to rein in some government behavior, such as carrying out destabilizing security operations that would have been instinctive during apartheid. Instead, South Africa has relied on "carrots" (such as trade and customs incentives) and the strength and attraction of its relatively hefty economy to influence neighboring states. This is not to say South Africa lacks or is unwilling to use the "sticks" option (it did so in 1999 when a near-civil war in Lesotho threatened to disrupt critical water and electricity supplies on which South Africa's capital region relies).

During the colonial era, authorities in the Cape Colony sought to expand the colony's control across the entire peninsula. It aimed to gain control over southern African lands, including ports and harbors that could support a European settler population and deny those lands to rival powers. It aimed, successfully, to acquire control over the interior, in order to exploit the region's mineral wealth. It used state power to annex rival territories in order to reduce barriers to labor migration and capital flows, in order to effectively develop the region's mineral wealth. The capacity for the Cape Colony's neighbors to resist during colonialism was relatively long-lasting, and in each case — with the Xhosa, the Zulu and the Boer republics — it took the British decades (in fact, much of the 19th century) to consolidate their control over the entire territory that would become South Africa. Once its control was formally consolidated in 1910, the Union of South Africa relied on tools of economic statecraft to maintain its dominant influence in southern Africa.

South Africa during apartheid sought to maintain the country's superior military and economic posture vis-à-vis its neighbors while it aimed to establish paramount Afrikaner influence over sources of public and private power in the country. Financing the development of Afrikaner-led industry, placing Afrikaners in charge of state and semi-public institutions and promoting legislation in favor of

Afrikaners were its tactics. The apartheid regime developed an indigenous military industrial complex and maintained a heightened military posture internally and externally in order to safeguard Afrikaner and South African supremacy when it faced internal and external threats. South Africa's neighbors were sorely tested during apartheid in their capacity to resist, and only when virtually all of southern Africa united against South Africa and when those combined states utilized extensive foreign military assistance did they rival South African power.

Since democratization, South Africa has sought to establish black South African influence over its domestic economy. The ANC was confident that its political control was safely consolidated, as long as democratic voting practices continued. It has implemented labor legislation that favors historically disadvantaged populations (black, Indian and colored South Africans) while also pursuing legislation requiring the country's white business sector to sell equity stakes to historically disadvantaged investors. In the regional economy, South Africa has used its extensive human and technical resources to negotiate favorable business and economic deals with African trading partners. The ANC has maintained South Africa's superior military capability relative to its neighbors, but it has not been required to deploy that option. None of South Africa's contemporary neighbors are receiving foreign military assistance of any significance, and those neighbors remain dependent on South Africa for their trade relationships. Their capacity to resist South Africa's economic hegemony is limited, which means South Africa does not need to deploy a security option to reinforce its dominant influence.

South Africa still depends on an abundant and freely flowing supply of labor migrating from neighboring states to service its labor requirements. South African technical and financial assistance are still critical components behind many mining activities throughout southern and central Africa (and increasingly beyond). The ANC government will therefore keep its borders open to regional migration, despite calls from ANC supporters inside South Africa that economic immigrants are taking jobs away from South Africans. It will maintain extensive diplomatic relations in Africa, help to portray South African interests on the continent as friendly and establish economic and cultural conduits to expand South African influence.

South Africa is entering a new phase of regional influence. The ANC — now the South African government — is no longer supporting the border states as it did when it was a movement of freedom fighters and anti-apartheid activists. The border states are weaker now and more divided than they were during the apartheid era, with landlocked Botswana ravaged by AIDS and famine-plagued Zimbabwe on the verge of economic collapse. This makes it easier for South Africa to dominate the region, as it did during the colonial era, through sheer economic might. It retains the threat of force, if needed but not preferred, to ensure its dominant position.

At the same time, South Africa is moving into a new phase of government. For all practical purposes, former President Thabo Mbeki, who led South Africa from 1999 to 2008, was a transitional leader as the country exited the old apartheid regime. South Africa, under Jacob Zuma, who will be inaugurated president on May 9, will have its first truly post-apartheid leader who can run South Africa like the dominant regional power that it is, unrestrained by the legacy of apartheid.

South Africa, China: The Limits of Cooperation

August 24, 2010

South African President Jacob Zuma announced a "comprehensive strategic partnership" with China on Aug. 24 during his three-day state visit to the country. Pretoria is courting China and the other BRIC countries — Brazil, Russia and India, all of which Zuma has recently visited — as a way to position itself not merely as a leading emerging economy but as a global geopolitical actor representing a developing region.

Since the end of apartheid in 1994, South Africa has been focused on internal reconciliation, including efforts to avoid capital flight, mass emigration of the white elite, and the possibility of a protracted civil war. It is only since Zuma's 2009 election that South Africa has emerged from this inward focus. The BRIC countries, foremost among them China, have a great deal of technical expertise and investment capital they can offer Pretoria and that Pretoria intends to seek. However, a number of domestic challenges, including labor disputes, unemployment and poverty, must be addressed before South Africa is able to lay claim to its regional and global ambitions, and some of the potential avenues for cooperation with China may even exacerbate these problems if pursued.

The BRIC countries are a loose confederation often viewed in terms of their rapidly growing economies, but more significant, recognized for their regional and global political influence. Likewise, South Africa has long seen itself as not only the natural leader of Africa, but also as a country that should spread its influence globally. During the Cold War, South Africa positioned itself essentially as a Western European ally that happened to be in Africa, acting as a bulwark against Communist expansion on the continent (especially in the southern African region) and as a crucial source of natural resources, as well as informally monitoring military activity in the South Atlantic for NATO.

Reaching out to the BRIC countries is one way for the South Africans to acquire the investment and other skill sets they seek, such as Brazilian energy technology, Russian mining technology, Indian information technology and Chinese capital. The Chinese are already South Africa's largest trading partner both in terms of exports and imports. Recent Chinese deals in South Africa have included major mining and banking sector investments, and during Zuma's ongoing visit, a railway infrastructure deal was discussed and a telecommunications deal was signed.

These will be necessary inputs to help South Africa boost its global footprint, but by themselves will not overcome domestic and regional constraints facing Pretoria. While a strategic partnership with China may facilitate heavy investment, and Beijing may speak up for South Africa on global interests held in common, Beijing's primary interests are obtaining natural resources and providing major infrastructure projects for its state-owned companies. It is not interested in helping South Africa in intra-regional spats with other African countries in which China also holds economic interests. For example, Angola, which is attempting to emerge as a rival to Pretoria for African leadership, is now China's largest crude supplier, and Zimbabwe is home to a number of Chinese mines; China would not want to risk alienating these trade partners. Brazil is also unlikely to jeopardize its growing relationship with Angola, with which it hopes to jointly explore for ultra-deep crude oil in the Atlantic Basin stretching between the two countries.

At home, Pretoria will be careful to manage its burgeoning BRIC dealings so as to not upset its relations, particularly with its labor allies, the Congress of South African Trade Unions. Currently embroiled in a public sector strike over a pay and working condition dispute involving at least 1 million workers, the Zuma government cannot afford a deepening of unemployment (the official unemployment rate is 25 percent, while unofficially the rate is believed to be closer to 40 percent). In addition, China often sends Chinese workers abroad with its investment capital to work on joint infrastructure projects. This potential influx of Chinese laborers displacing their South African counterparts, as has been the case elsewhere in Africa, would compound Pretoria's existing employment problems. South Africa has recently dealt with violent threats against Zimbabwean and Somali immigrants perceived to be stealing South African jobs and absorbing what limited supply of social services there are in South Africa, and anti-Chinese violence could also take hold.

Globally, Pretoria has positioned itself for a stronger international role, and it is taking incremental steps to achieve this — aligning with BRIC countries, representing Africa at G-8 and G-20 summits, and aiming for a non-permanent seat starting in 2011 on the U.N. Security Council (and perhaps using that seat to eventually petition for permanent council membership).

These efforts are not without significance, and the prospect of increased economic cooperation, investment and strategic partnership with China, however it manifests itself, holds promise for Pretoria. However, until South Africa makes headway on some of its fundamental economic challenges, its ability to join the BRIC countries as a player on the global stage will be constrained.

Cooperation and Competition in Angola-South Africa Relations

December 6, 2010

Angolan President Jose Eduardo dos Santos is expected to make a state visit to South Africa before the end of 2010. Originally expected in October, this would be his second state visit to South Africa since Jacob Zuma became president of the latter country in April 2009. Dos Santos is not particularly fond of travel, a fact that made his failure to show in October unsurprising (and a fact that would make his absence from the forthcoming meeting likewise unsurprising). However, over the past few weeks both Angolan state media and South African government ministers have confirmed that the visit is expected before the end of the year. Stratfor sources report that the visit is likely to take place Dec. 14-15.

While the issue of Angola's Lobito refinery project will probably be the focus of the agenda, there are also a variety of other items the two sides will want to discuss, namely trade and visa issues. The larger significance of the trip, though, lies in how it fits into the budding relationship between two rising powers in southern Africa that may be simultaneously cooperative and competitive.

South Africa and Angola differ in many ways, from their colonial history to their political structure, language, economic base and level of development. Where they find common ground is in the fact that both are effectively dominated by a single ruling party currently transitioning from a "post-struggle" era focused strictly on internal consolidation to an era of foreign endeavor. For South Africa's African National Congress (ANC), this means moving beyond the Nelson Mandela-Thabo Mbeki period that followed the end of apartheid in 1994. Angola's Popular Movement for the Liberation of Angola (MPLA) may not be as far along in its own process of post-civil war development, but is trying to improve its oil industry so as to expedite the reconstruction process, badly needed just eight years removed from a 27-year civil war. While the two countries may be at different levels in the process, both are starting to set their sights outward, looking around the southern African region to assess where they can best exert influence.

Angolan and South African Cooperation

Regardless of when the two leaders meet, representatives from their countries' respective state-owned oil companies — South Africa's PetroSA and Angola's Sonangol — are currently in discussions over an ambitious project being planned in Angola: the construction of a massive new crude oil refinery in the coastal town of Lobito. MPLA and Sonangol elites selected this as the location for the future Sonaref refinery, which — if it is actually constructed — would cost $9 billion and would produce 200,000 barrels per day (bpd) of refined fuel.

Lobito is far from the MPLA's core of Luanda. It may have been chosen for a variety of factors. Lobito sits on a port capable of handling large numbers of ships, while Luanda, Angola's main port, is notoriously crowded. But the proposed engineering designs envision a single-point mooring system, akin to a floating buoy, connected to the refinery by pipeline — which would render crude tankers' use of the Lobito's berths unnecessary. Still, it is quite normal for governments in developing nations to select locations off the beaten path for projects like this to spur development in undeveloped regions. Alternatively, personal interests involved within the government and/

or Sonangol might have motivated the choice, a plausible scenario in a place like Angola.

Whatever the motive, the Sonaref project has been in the front-end engineering design (FEED) stage since late 2008, meaning ground has not been broken. Financing has been a significant problem, as no one has proved willing to help Sonangol pay. The state-owned China Petroleum & Chemical Corp. (Sinopec) originally agreed to participate, but the deal fell apart in March 2007 after Sinopec insisted that 80 percent of the refined product be reserved for export to foreign markets. At the time, Sonangol chairman Manuel Vicente said "we cannot construct a refinery just to make products for China."

The South Africans could now partner with Angola to help finance the project, though to what extent remains unknown. During a visit to Angola in mid-October, South African Energy Minister Dipuo Peters announced that PetroSA and Sonangol had entered discussions over a joint venture that would engage in deepwater exploration and production in Angolan waters and build and manage refineries. As there are no other refineries in the planning phases in Angola, this could only mean Lobito. The Angolan Oil Ministry issued a follow-up statement confirming the negotiations, showing that the two countries seem to be serious about the talks.

Angola has only one mainland refinery currently in operation, a small facility in the greater Luanda area that produces around 40,000 bpd. This refinery is thought to provide about 40 percent of Angola's consumption needs. The Lobito refinery would provide much more than Angola could consume. With its strategic location along the Atlantic Ocean, Lobito could allow Angola to export refined fuel, something unique in Africa. This is likely the root of South Africa's publicly expressed interest in the joint venture with Sonangol, though a chance to try its hand at deepwater oil exploration and production activities might also be tempting it. Still, whether PetroSA would be willing and able to contribute a sizable amount to Sonaref's construction bills depends on numerous factors in South Africa.

South Africa is already planning its fifth crude oil refinery, a massive facility near Port Elizabeth in the Eastern Cape region.

The proposed Mthombo refinery, which will be built in the Coega Industrial Development Zone, would have the largest refining capacity of any refinery in sub-Saharan Africa at 400,000 bpd. This would make it twice as productive as Lobito but still around the same estimated cost of $9 billion-$11 billion. (The reason for the price similarity is unknown, though corruption issues in Luanda are probably a factor.) Mthombo is also still in the FEED stage, but its eventual completion is much more likely than that of Sonaref.

Just how much South Africa would be willing to pay to make the Sonangol joint venture a reality (thereby giving Pretoria access to a stake in Sonaref, and likely a certain portion of the finished product) will say a lot about South Africa's desire to establish a foothold in Angola. Helping Luanda out with such a hefty bill would certainly be seen as a sign of good will from Zuma's government, and could help open doors for other investment opportunities for South African businesses in other lucrative sectors of the Angolan economy. The economics of the Mthombo refinery project appear much more logical, but sometimes strategic factors trump financial ones. One South African Stratfor source describes the Lobito refinery as Luanda's "pet project," indicating Pretoria sees it as important to the MPLA government. This is not to say that a failure to strike a deal would mean South Africa does not factor Angola into its foreign policy, only that Lobito provides an interesting barometer with which to assess relations between the two countries.

Angolan and South African Competition

Dos Santos and Zuma will want to discuss other issues, however. South Africans often complain about the endless bureaucratic structures that make it difficult to operate in Angola. They badly want to get more involved in Angola's reconstruction efforts, among other sectors. (South African companies also have long desired to increase their participation in Angola's rich diamond mining and telecommunications industries.) The leaders therefore probably will discuss the

Investment Promotion and Protection Agreement, signed in 2005, that aims to alleviate such problems.

Moving ahead to enforce the already-negotiated Avoidance of Double Taxation Agreement would also help in this regard. Visa-free travel is also likely to be discussed, the lack of which hinders the ability of businessmen to travel back and forth between the two countries. A Stratfor source in Angola has said these visa difficulties make it easier to organize a South African-Angolan meeting in Namibia than in either Angola or South Africa.

Though the time will come when Angola and South Africa come into conflict as their regional interests start to collide, for now they are likely to be more cooperative than combative.

South Africa's Paramount Role in Zimbabwe

May 1, 2011

Zimbabwe's ruling Zimbabwe African National Union-Patriotic Front (ZANU-PF) is pushing for an early presidential election, possibly as early as the coming months, though no date has been set. ZANU-PF has experienced resistance, however, from the opposition Movement for Democratic Change (MDC), which would like to avoid new elections until at least 2012. The government of President Robert Mugabe, who has ruled Zimbabwe with his ZANU-PF since independence from the United Kingdom in 1980, is not constitutionally required to hold a presidential election until 2013. Determining whether Zimbabwe will hold a presidential election early is currently the subject of an intense political struggle.

South Africa has been involved in mediating Zimbabwe's ongoing political crisis for several years, to the point of brokering negotiations over the formation of Zimbabwe's coalition government after 2008 Zimbabwean elections. This crisis might soon come to a head again if the government of Robert Mugabe and his ruling Zimbabwe

African National Union-Patriotic Front (ZANU-PF) calls an early presidential election.

Regardless of when Zimbabwe holds its presidential election — whether early or as scheduled in 2013 — South Africa will remain the key player in shaping any post-Mugabe government. Other countries in the region will follow South Africa's lead in this regard except for Angola.

While some members of the ZANU-PF elite might be able to circumvent South African economic influence in Zimbabwe — for example, by smuggling diamonds via Angola or using Indian or Chinese traders — South Africa is the economic gatekeeper for the vast majority of Zimbabweans. South Africa facilitates the flow of most Zimbabwean goods and commodities.

In political terms, South African leadership will determine the effectiveness of the response of South African Development Community (SADC), the African Union (AU) and the broader international community to any irregularities in Zimbabwe's next election. South Africa could easily derail any effort by the international community to bypass South Africa and seek to isolate Zimbabwe by going to Mozambique, Namibia or Botswana.

The African National Congress (ANC) government in Pretoria has old ties to Mugabe, who provided substantial support to the ANC's fight against apartheid. Before and after the ANC came to power in 1994, Mugabe facilitated introductions to African leaders and otherwise helped pave the way for South African leadership of sub-Saharan Africa (though Mugabe, who in the 1980s and early 1990s was viewed as a top African powerbroker, did not appreciate losing this influence to South Africa's new leaders like Nelson Mandela). Further cementing these ties, Pretoria sees the Zimbabwean opposition Movement for Democratic Change trade union roots as a threat to continued ANC dominance of the South African government.

Thus, the benefits to South Africa of protecting Mugabe while working to contain matters in Zimbabwe — a policy of "quiet diplomacy" spearheaded during the previous administration of former South African President Thabo Mbeki — so far have outweighed the benefit of actively seeking to remove him. Whether this logic still holds, or whether Mugabe has become too much of a liability, will determine Pretoria's future moves vis-a-vis Zimbabwe. So, too, will South African domestic considerations. While the white minority in South Africa consistently has criticized the ANC's handling of Zimbabwe, the mass influx of Zimbabweans into South Africa over the last decade has made black South Africans favor a definitive solution to Zimbabwe's problems.

The need to engineer a post-Mugabe Zimbabwe that remains beholden to South Africa clearly is in South Africa's interest no matter who rules in Harare. The MDC, however, is not well disposed toward South Africa because of the ANC's continued support for ZANU-PF, but if Pretoria were to decide that the MDC were going to take power, it would doubtless warm to it. South Africa might, however, work to keep a ZANU-PF offshoot in power by speeding up elections.

None of this is not to say it will be easy for South Africa to influence Zimbabwe's politics. The "securocrat" faction of ZANU-PF closest to Mugabe will be particularly reluctant to yield to South African influence. Led by Zimbabwean Defense Minister Emerson Mnangagwa, this faction includes all the top leaders of the country's security forces, who belong to the Joint Operations Command (JOC). The JOC has representatives of all the branches of the armed forces, prison service and intelligence organization. It is the securocrat faction that perhaps has the most to lose in any accounting of possible crimes committed under the Mugabe regime like the one the former Gbagbo regime now faces in Ivory Coast — meaning these leaders will be especially difficult to convince to surrender power.

So far, Pretoria has kept all its options for engaging with Zimbabwe's various factions open in a bid to consolidate its position as the guarantor of Zimbabwe's next government.

Rifts Challenge South Africa's Ruling Party

August 4, 2011

As South Africa's ruling African National Congress (ANC) prepares for the December 2012 leadership convention in Mangaung that will determine the party's next nominee for the presidency, current President Jacob Zuma struggles with a number of intra-party tensions that have threatened the ANC's ability to govern effectively. Strikes for higher wages led by member groups of the Congress of South African Trade Unions (COSATU) have affected business in a number of sectors. Also, calls by the African National Congress Youth League (ANCYL) — another key group under the ANC banner — to nationalize industries and criticize purported efforts to undermine black South African advancement have made potential outside investors in the country wary.

No single allied faction is strong enough to control the party, and the ANC is unlikely to split apart. The party holds a commanding position in South African politics due to its support from the vast majority of black South Africans, who are 80 percent of the country's population, and its three main factions, especially the South African Communist Party (SACP), understand they would have much to lose if the alliance cracked. The faction that holds the upper hand will have a strong influence on whom is chosen to lead the party in 2012, and thus likely the country, when national elections are held in 2014. Despite the increasing tensions, no credible candidate has come forward to challenge Zuma for party leadership, and the president maintains enough support in this diverse group of alliance members that he will likely proceed to re-election and the continuation of an overall centrist policy orientation.

The ANC's Divisions

The growing rifts within the party should not come as a surprise. The ANC is better thought of as a coalition of parties than as a single unified group, with the three main blocs, known as the Tripartite

Alliance, being the ANC proper, COSATU and SACP, that latter two fielding candidates through the ANC. Under various names, the ANC has been around for most of South Africa's modern history, formed in 1912 at the beginning of the struggle against racial discrimination (which became known as apartheid under the National Party when it came to power in 1948). During the ensuing decades it possessed a unity of purpose that made it easier to subordinate each constituent group's interests to the larger struggle against white minority rule. Having achieved that objective in 1994, self-interest among these groups has become more difficult to contain in the last decade and a half.

Among the most powerful groups represented within the ANC is COSATU, the country's largest trade union federation, which claims more than 1.8 million members. Recent weeks have seen the beginning of South Africa's so-called strike season, an annual mid-year period when unions enter wage and benefits negotiations with employers that often lead to strikes and other disruptions to business. Factory activity in July fell to its lowest level in two years, and strikes have already taken place in a number of sectors, particularly coal, gold, and diamond mining (one five-day strike by 100,000 gold miners ended by an agreement Aug. 2 cost the companies AngloGold, Gold Fields and Harmony as much as $25 million per day). Strikes have also hit the energy retail sector, with supplies to gasoline stations in the Gauteng capital province being interrupted, as well as manufacturing and chemical industries.

South African workers' wages have struggled to keep pace with the cost of living. Perceived insufficient protections for labor (which is concerned with issues like the increased use of temporary laborers by companies), combined with South Africa's vast wealth disparity, have led to an erosion of support for the ANC among union workers. (The wealth disparity is particularly pronounced between blacks and whites, but is also an issue between blacks and those who have benefited from government empowerment schemes. Critics say the schemes have not translated into widespread socio-economic improvements.)

Organized labor — that is, COSATU — is a key voting bloc and one useful for the party's voter turnout operations. A decline in union backing could be problematic for Zuma's re-election effort, so the president is attempting to reach an accommodation with other parts of the ANC to compensate for any potential loss.

Alternatives for Zuma

One option is the ANCYL, the youth wing of the party. Zuma and his supporters have used the ANCYL to mobilize support since 2007, when it opposed then-President Thabo Mbeki's third-term ambitions. However, this group poses challenges of its own. Its leader, Julius Malema, has been known to issue statements considered reckless, such as calling for the nationalization of mines and industries and for "regime change" in Botswana, or making inflammatory, racially divisive statements, an extremely sensitive issue in South Africa. Despite this, Malema has merely been publicly rebuked by party leadership (such as on Aug. 2, after his description of Botswana as a "puppet regime" and a "footstool of imperialism"), not otherwise disciplined or forced out of office, which has led to speculation that he may have incriminating information on party leaders, perhaps even the president, that makes them reluctant to penalize him. It is unclear who within the ANC backs Malema, though as leader of the ANCYL he retains a great deal of political influence, and Malema clearly wants to use that influence to be a kingmaker within the party.

Malema may yet be disciplined, though. The South African Police Service's Directorate of Priority Crime Investigation, known as the Hawks, has reportedly started a preliminary investigation into Malema for allegations of abuse of a trust fund the Youth League president supervises. The use of corruption investigations has often been a tool by South African politicians to attack their political enemies, and a corruption conviction may be a way to rein in Malema. Malema is not the only one receiving corruption-related attention; the Hawks may also reopen an investigation of corruption surrounding South Africa's arms acquisition package that goes back to the late

1990s. Currently, the focus on this possible investigation is on allegations of payments to Fana Hlongwana, a former adviser to then-Defense Minister Johannes Modise regarding South Africa's National Industrial Participation program intended to generate foreign investment in South African industry to offset South African purchases of European-manufactured arms (such as Saab Gripen fighter jets, BAE Hawk trainer jets, and German frigates and submarines). This arms deal scandal has been widely known for years and no prima facie evidence of a crime was ever proven, but its reopening could be used to undermine Zuma, who was fired from his position as South African deputy president in 2005 by then-President Mbeki because of allegations of Zuma's involvement in the arms deal (though it was widely viewed as Mbeki attempting to remove Zuma as a political rival). It is too early to tell whether these two investigations will lead to any serious consequences in party hierarchy, but their timing and implication involving two of the ANC's most dominant personalities can mean navigating room within the ANC party is opening up.

As president of the country and head of the ANC, Zuma has opted for a strategy of conciliation between the factions in the party, which were united in supporting him against Mbeki in the 2007 party leadership contest. He has been reluctant, however, to align himself too closely with any one faction, in part because he fears rivals emerging from within other factions. This has led to criticism that he has failed to execute a strong policy preference, but Zuma's accommodative approach has led to more pragmatic policies than might be seen under a different leader.

No serious rival to Zuma has emerged yet, but the treads of disunity mean this cannot be ruled out. Zuma sees the fraying within the party and is playing a game for time — maintaining his alliance options so as to ensure he bests any other rival to again win the party's leadership contest in 2012 and thus likely another term as president in the 2014 national elections, continuing the country's overall centrist policy direction. Given the ANC's preponderance in South African politics, the increasing tension between its factions does pose a significant long-term problem. But in the short term, and surely through the 2014 elections, the ANC will maintain its alliance, driven by the self-interest of its partners who know they have much more to lose politically should they break and form independent political parties.

Angola, South Africa Emerge Victorious from Summit

August 22, 2011

Angola hosted the Southern African Development Community (SADC) summit Aug. 16-18, where a couple of significant developments emerged. The first was that Angolan President Jose Eduardo dos Santos, as chair of the summit, said South African President Jacob Zuma would continue to mediate for Zimbabwe's coalition government. Dos Santos also said Zimbabwean elections would only be supported once the country introduced a new constitution and convened a national referendum on the status of the coalition government. The second was that the SADC noted its concern regarding political strife not only in Zimbabwe and Madagascar — another country whose government is receiving SADC mediation — but also in the Democratic Republic of the Congo (DRC).

The most powerful member of the 15-member regional group, South Africa, likely made a trade with Angola at the SADC in which Pretoria ensures its dominance over the Zimbabwean government while Angola retains influence over the government in the DRC.

Putting the Brakes on ZANU-PF

Zuma's role as mediator of Zimbabwe's coalition government has faced some opposition from hard-liners within the ruling Zimbabwe African National Union-Patriotic Front (ZANU-PF). Zuma has held political negotiations with all parties to Zimbabwe's coalition government, including factions of the opposition Movement for Democratic Change (MDC). ZANU-PF hard-liners likely fear that Zuma will interfere with their ability to engineer an elections victory that ignores opposition interests or that foists a faction of ZANU-PF resistant to South African influence.

Those concerns are not unfounded, as South Africa would likely prefer a more pliant government in Zimbabwe that would concede to South African influence. Members of the government of President Robert Mugabe, including Mugabe himself, are antagonistic toward the South Africans. This is partly because they see themselves as the true defenders of the region's liberation struggle against apartheid, while seeing the African National Congress as young upstarts at the least and, on a more subtle level, no different from their apartheid predecessors as a predatory regime intent on ensuring de facto control over Zimbabwe. The SADC, by reaffirming Zuma's position as mediator, has ignored the ZANU-PF's ambitions and given Pretoria the opportunity to pursue its own.

The SADC further applied the brakes on ZANU-PF's elections plans by stating that it would only support elections after a new constitution is passed and a referendum on the coalition government is held. Concerned about the health of 87-year-old President Robert Mugabe, whose five-year term will expire in 2013, ZANU-PF has wanted to hold elections as early as 2011. Another election victory would guarantee another term in office for the ruling party, while it would only be guaranteed the remainder of the current presidential term should Mugabe die in office.

The SADC move does not mean that ZANU-PF is finished atop the Zimbabwean government or that the region is throwing its support behind Prime Minister Morgan Tsvangirai of the MDC. Defense Minister Emmerson Mnangagwa is still the factional leader in the top position to succeed Mugabe, thanks to the death of his top rival within ZANU-PF, Solomon Mujuru. (Mnangagwa will, however, have to moderate his interactions and be less antagonistic with the South Africans should he or his faction want to stay in power for long.) But the move does make it highly unlikely that ZANU-PF will be able to force through early elections; it certainly will not be able to do so in 2011.

Angola and South Africa have competed for Zimbabwe, with its mineral and agricultural wealth, in their quests to extend their regional ambitions and counter one another. By reaffirming Zuma's role as mediator and creating serious obstacles to an early presidential election in Zimbabwe, Angola has given South Africa unencumbered control of the Zimbabwean political process. In return, Angola has received backing to assert strong influence over the Joseph Kabila government in the DRC.

A Warning to the DRC Government

The DRC is less an immediate regional concern than it is a concern for neighboring Angola. Luanda has traditionally seen the DRC, and especially its capital region around the city of Kinshasa, as within Angola's sphere of influence. The countries have a strained history, as both served as proxy battlegrounds against each other during the Cold War.

Though Angola defeated its Cold War domestic enemy, the opposition National Union for the Total Independence of Angola (UNITA), it remains deeply distrustful of the DRC, which was a staunch backer of UNITA and still holds pro-UNITA elements. Even if the DRC government is not intently involved in undermining the Angolan government, anti-Angolan forces can use DRC territory. Because of this, Luanda is interested in ensuring that the government in Kinshasa is proactive in protecting Angolan interests and not merely relaxed about how Congolese territory might be used by anti-Angolan agents.

Additionally, Angola harbors concerns about illegal Congolese residents in its territory who are involved in alluvial diamond mining and smuggling. This population, the largest foreign population in Angola, is a body the Angolan government instinctively fears, whether or not the Congolese government is active in shaping what that diaspora is doing. Angola and the DRC also have an ongoing and unresolved dispute over their offshore maritime boundary, an area of lucrative crude oil deposits that Kinshasa would like to get control over. Amid these concerns, the ruling People's Movement for the Liberation of Angola (MPLA) wants to ensure that any government in the DRC is under Luanda's thumb, not supporting rebel groups or engaging in activities that threaten Angola's security or economic interests. It appears South Africa, which has significant mining links to the DRC and also could support UNITA — as it did during the Cold War — has granted Angola's wish.

By voicing concerns about the government of DRC President Joseph Kabila — who abruptly left the SADC summit after the opening welcome session — the Angolan government is warning Kabila that his government is vulnerable. The DRC is set to hold national elections in November, and while Kabila might be the favorite right now, political support could shift, and Angola might go so far as to intervene to protect its favored candidate. (The Angolans readied some 10,000 troops to intervene in Kinshasa during the last DRC elections, held in 2006.)

Kabila has been aware of this risk and has been making subtle moves to protect himself in the event he loses his grip on power. (Kabila is surely also mindful on a personal level of what can happen if one crosses Angola, as MPLA agents were likely involved in organizing the 2001 assassination of his father, Laurent Kabila, whom Joseph succeeded.) On Aug. 19, he oversaw the sale of two government stakes in copper mines in the country for $30 million, an amount reported to be worth 3 percent of the mines' free market value. The two mines, one of which, Frontier mine, is the third-highest producing mine in the country, were seized by the government in early 2011. It is possible Kabila is trying to dump government controlling stakes at whatever price he can and then receive money from the deals under the table to be redirected into an offshore bank account for a post-presidency "retirement" account.

The SADC summit concluded with two parties, ZANU-PF hardliners and Kabila, displeased. ZANU-PF will be forced to work with Zuma and the MDC and will need to wait for at least a while before holding new elections. Kabila will have to protect his own position with the threat of ouster by Angola hanging over him. Angola and South Africa, on the other hand, were able to work out an agreement to preserve their influence in countries within their respective spheres.

Shifting Loyalties Within the ANC

January 20, 2012

The loyalties within the group that propelled South African President Jacob Zuma to power are shifting. Although Zuma still has a powerful support base, one group of elites among the Northern Sotho ethnic group who supported Zuma in 2007 are considering their own political ambitions. These elites do not have a support base large enough to challenge Zuma and must form a new alliance to become a credible opposition force. If they fail to forge such an alliance, they likely will back down from political confrontation and content themselves with their current status.

Zuma's Supporters

In 2007, Zuma won the African National Congress (ANC) presidency, a position effectively guaranteeing that he would become South Africa's next president. Several political factions backed Zuma in his rise to power, including the labor movement, the communist party and other ANC networks, such as its military and intelligence wings.

Among Zuma's supporters were several members of the Sotho ethnic group: Kgalema Motlanthe, current deputy president of the ANC and of South Africa; Tokyo Sexwale, former chief of Gauteng province and current minister of human settlements; Julius Malema, suspended president of the African National Congress Youth League (ANCYL); and Mathews Phosa, former Mpumalanga province chief and current ANC treasurer-general. These ambitious politicians gained some success in joining others to support Zuma but were not content with the positions they were given, as they considered them stepping-stones to the highest office in the land. The Sotho elite broke away from Zuma not long after he became ANC president because they wanted to fulfill their own political ambitions of succeeding Zuma after a single term, while Zuma adamantly desired two full terms. Motlanthe and Sexwale both believe they have better presidential credentials than Zuma. However, their current support base is not large enough to challenge Zuma's.

Tribal Interests

Motlanthe, Sexwale, Malema, Phosa and other ANC members believed to be undermining Zuma all hail from the Northern Sotho ethnic group. The Northern Sotho make up about 9 percent of South Africa's population and roughly 11 percent of the ANC membership base; the Southern Sotho constitute 8 percent of South Africa's population and roughly 8 percent of the ANC membership base. Even if the two Sotho subgroups formed an alliance — and even if ethnicity strictly determined South Africans' voting preferences — they would not pose a credible challenge to the political hegemony of the Zulus, who make up 25 percent of both the national population and the ANC membership base. The Sotho elites looking to challenge Zuma would need to incorporate allies from outside their narrow group. The logical strategy would be to incorporate the Xhosa, the second-largest ethnic group in South Africa and the Zulus' main rivals for political power.

The Xhosa constitute 18 percent of South Africa's population and 23 percent of the ANC membership base. This ethnic group produced South Africa's first two democratically elected presidents: Nelson Mandela and Thabo Mbeki. Mbeki was president from 1999 to 2008 and became a controversial leader as he increasingly isolated himself and focused more on retaining power at all costs. Mbeki's power base narrowed in 2007 as he tried to force his way to a third term, and this led to the formation of a broad-based alliance against him. He lost his bid for a third presidential term to Zuma when the alliance now in control of the ANC lost confidence in Mbeki's leadership.

A Stratfor source in the Zuma camp said he does not believe the Sotho are planning an alliance against Zuma. However, if an alliance between the Sotho and the Xhosa is in the works, it would explain Malema's recent attempts to rehabilitate Mbeki's image and position in the ANC. (Mbeki has been virtually absent in domestic affairs since his recall as South African president in September 2008. His minimal presence — he makes only rare appearances at ANC events — is surely orchestrated by the Zuma-led ANC.) Prior to his suspension as ANCYL leader, Malema criticized Zuma's performance, comparing him unfavorably to Mbeki. More recently, Malema has said Mbeki should become more involved in ANC affairs again. A possible alliance would also explain Motlanthe's Jan. 11 visit to the Eastern Cape province, the heartland of the Xhosa, where he met with provincial leaders and promoted popular policy issues such as education advancements.

If the Northern Sotho, Southern Sotho and Xhosa formed an alliance, they could credibly challenge Zulu hegemony if voting along ethnic lines was the ultimate deciding factor in South African elections. But voting in the ANC ultimately depends on power and patronage opportunities. No province — other than possibly Zuma's home province of KwaZulu-Natal, where there is a sentiment that this era is owed to the Zulu since the Xhosa benefited greatly from previous ANC administrations — will vote strongly along ethnic lines. The Sotho and Xhosa cannot count on all voters to choose candidates from their own ethnic groups, particularly since Zuma has some influence among the Sotho and Xhosa communities.

Zuma's Strategy

Zuma's camp in the ANC is taking steps to make sure it retains its advantage when ANC delegates meet in December to elect the party's leadership. Zuma has maintained strong relations with the Congress of South African Trade Unions and the South African

Communist Party, having given their leaders patronage and positions in his Cabinet. Zuma had a falling out with the Malema-led ANCYL (Malema likely was backed by Sexwale, who in turn is likely financing any campaigning for a leadership bid by Motlanthe), but his administration is working to install a Zulu leadership in the youth league to safeguard the agency's involvement in rallying young voters for Zuma. The president is also relying on ANC networks that supported his rise to power, most notably cadres from the ANC's former militant wing and its intelligence apparatus, to discreetly help with his re-election campaign.

Zuma's supporters are also promoting and expanding ANC membership nationwide. This is not only to ensure ANC hegemony among South African voters but also to give Zuma more delegates than any other candidate or alliance. Of the ANC's national membership of approximately 1 million, about 250,000 members are in KwaZulu-Natal. Roughly another 225,000 members are in the Eastern Cape province, and 121,000 are in the Gauteng province. Malema's home province of Limpopo has about 115,000 members, and approximately 99,000 ANC members live in Phosa's Mpumalanga province. The Free State, North West province and the Western Cape province have 76,000, 60,000 and 44,000 members, respectively. Pro-Zuma networks are at work in these provinces to recruit Zuma supporters and win their delegates' votes.

Zuma is waging an aggressive re-election campaign, and his ANC rivals, including Motlanthe, have yet to form a stable and credible counter-alliance. Should the opposition continue to falter, it likely will decide not to challenge Zuma. In that case, the Sotho elites likely would bide their time until the 2017 ANC leadership race and 2019 national presidential election. By that time, Zuma will have customarily stepped down after finishing his second term as party and state president, and a pan-Sotho alliance would have a better chance at fulfilling its ambitions.