

ELECTIONS, ANGER, AND WAR: FORECASTING 2008

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December 5-6, 2007

Nearly a century ago, President Theodore Roosevelt said, “We have, as a nation, to exercise foresight...and if we do not exercise that foresight, dark will be the future.”

Let me now try to exercise forethought.

2008 will be notable in several regards. It will be a year of war. U.S. troops will still be at war in Iraq and Afghanistan. The U.S. will be at war with al-Qa’ida.

2008 will be a year of heightened political risk. Some of the increased perception of risk will come from the fact that 2008 will be another election year. An election year inevitably means poor public policy as politicians focus on keeping their jobs by buying off the electorate. The U.S., of course, will hold elections but so will Russia, Pakistan, Armenia, Angola, Bhutan, Cuba, Malaysia, Bolivia, Zimbabwe, Georgia, Serbia, Taiwan, Cyprus, Montenegro, Iran, South Korea, Rwanda, Slovenia, Lithuania, Georgia, Cote D’Ivoire, Azerbaijan, Ghana, Turkmenistan, and perhaps India and Ukraine. Yes, democracy has taken hold across the planet. But its short-term effects are not always positive.

2008 will also be a year of mounting global anger at the U.S. This country continues to be seen as a unilateral, interfering bully. As the most pro-American French President, Nicholas Sarkozy, has put it, “France desires to be a partner of the U.S. but not a subordinate.” Yet the U.S. continues to insist on subordinates and it continues to insist on interfering in the internal politics of countless independent countries. The backlash is building.

And in 2008, international tensions will refuse to subside. No peace will be realized between Israel and the Palestinians, despite the Annapolis meeting. Accommodation between the U.S. and Iran or between China and Taiwan or between Russia and Europe or Russia and the former Soviet republics, especially Ukraine and Georgia, will not happen in 2008. Tension between all those pairs will rise.

First to the actual wars.

THE MIDDLE EAST

IRAQ

2007 has seen more deaths of U.S. troops than any year since the war began. But the

overall total masks a significant decline in casualties over the months with the November total dropping precipitously from the number of deaths at the start of the year. As General Petraeus, the U.S. Commander suggested, Iran seems to have drastically cut its military supplies to the Iraqi Shiites. Meanwhile, the U.S. has been widely arming Sunni tribal groups to aid their efforts to eliminate foreign Jihadists from the country and Syria has been restricting the flow of fighters into Iraq. So violence has declined and will continue to decline across Iraq in 2008. It is still too early to know if this marks a turning point in the war. That turning point will depend on the continued decline in violence and, most importantly, as General Petraeus has put it, the fact that "There is no military solution to . . . the insurgency of Iraq, but only a political solution." But as former Iraqi Commander General Ricardo Sanchez put it in October, 2007, "U.S. national leadership continues to believe that victory can be achieved by military power alone...Continued manipulations and adjustments to our military strategy will not achieve victory. The best we can do with this flawed approach is stave off defeat....The result is "a nightmare with no end in sight." What is clear at the end of 2007 is that President Bush has given up on political progress in Iraq, partly because Iraqi leaders are less and less amenable to American suggestions about how they ought to run their country; partly because they seem so incapable of building a central government that brings together all of Iraq's warring groups; and partly because the government of Iraq is mired in corruption and incompetence.

In the face of the elections of 2008, the U.S. will pull out troops from Iraq. General Petraeus has promised that he will withdraw 25,000 troops by July 2008, "conditions permitting." The most salient conditions may very well be the elections at home.

AFGHANISTAN

The wars in Iraq and Afghanistan are unfolding in dramatically different ways. In Afghanistan, the U.S., has also has seen more U.S. combat deaths in 2007 than in any other year since the overthrow of the Taliban. But as the year progressed, the number of deaths did not decrease. They increased. More Afghan civilians died in 2007 than in any previous year of this war – some – 5,700 by November 1. Perversely, NATO forces win every battle they fight and kill more Jihadists than ever. But as the troops move on to new battles, the territory they cleared of the Taliban is reoccupied. In fact, the Taliban now occupy larger swaths of the country than at any time since their overthrow, having expanded their control from the territory in the south around Kandahar towards the north and the west to provinces along the Afghan - Iran border. The recent massive suicide bombing in northern Afghanistan – an area previously safe from the Taliban – may suggest an even greater expansion of Taliban action. The amount of land converted to opium poppy cultivation has also increased. Meanwhile the government of president Karzai is losing whatever limited support it had. The central issue in the failure of U.S. efforts has been the complete lack of any overarching strategic coordination between the military and other U.S. agencies and NATO and the government of president Karzai. So economic development, the strengthening of the Afghan civilian and military

bureaucracies, the construction of new infrastructure is not occurring – Iraq all over again.

In 2008 watch for the war to intensify, for the U.S. to resort to its original policy of arming the warlords against the Taliban – abandoning the goal of building a powerful central government -- and president Karzai to respond to that by beginning negotiations with the Taliban to attempt to incorporate them back into the political system.

PAKISTAN

The two key opposition leaders, Nawaz Sharif and Benazir Bhutto, are likely to participate in the January 2008, parliamentary elections. President Musharraf 's rapidly diminishing power will make it difficult for him to prevent their campaigning. But the campaign will be marked by a massive rise in violence as the supporters of Sharif and Bhutto turn to violence and the Islamists attempt to disrupt the whole process. For the time being, the President seems unwilling to compromise and will tough it out in the elections hoping he can get enough of his supporters elected without so antagonizing the international community and his own people through blatant election rigging. But Musharraf will be out of office in 2008.

Sharif was the Prime Minister who conducted Pakistan's nuclear tests (funded by Saudi Arabia), who appointed Musharraf as commanding general of the armed forces and who then – in 1999 – was ousted by Musharraf in a coup. The nuclear tests made him a Pakistani hero. But he has never forgiven the general for his ouster. Nor does he consider himself a friend of the U.S. The feelings are mutual as the U.S. sees Musharraf as an Islamic fundamentalist and the Saudi's man. Sharif will be the person to watch in 2008.

What does his rise mean for the war of the U.S. against al-Qa'ida? The Pakistani military will continue to prove incapable of dealing with the Jihadists. based in the North West Frontier Provinces of Pakistan. The military will prove incapable of preventing their expanding throughout those provinces and into more of the rest of Pakistan. The U.S. will respond with a new and more sophisticated effort based on its success with Sunni tribal leaders in Iraq. U.S. Special Forces troops will be sent to arm and finance tribal leaders to conduct their own war against the Jihadists, further weakening the central government.

Watch for the U.S. to be drawn ever more deeply into the morass of Pakistan, which will remain the world's most dangerous state in 2008.

IRAN

Internal politics will drive Iran's foreign policy in 2008. The competition between President Ahmadinejad and ex-President Rafsanjani will heat up. The sitting President continues to make demagogic appeals to the Iranian people through his frequent trips across his country. He focuses on his defense of Iranian nationalism through his boasts of defying "The Great Satan" while driving the continuation of Iran's nuclear enrichment. Rafsanjani, the so-called moderate pragmatist, sees Iran's long-term interests being

eroded by Iran's isolation. The competition between them is not over the support of the Iranian people, however, but for the ear of the Supreme Leader, Ayatollah Khamene'i. He is the real "decider" in Iran and he has been deciding for the strident, tough line of the President. Watch him to temper that support in 2008.

But not enough to end Iran's commitment to mastering nuclear enrichment. Iran sees that technological achievement as assuring its ascent to the world's "great powers" in whose ranks it already considers itself a member. Khamenei's turn to greater pragmatism will mean that the International Atomic Energy Agency, the IAEA, will have greater access to Iran's nuclear facilities in 2008. But President Bush perceives the IAEA's leader, Mohammed el Baradei, to be something of an apologist for Iran and is not likely to accept his word on Iran's program (just as President Bush was unwilling to accept the word of his predecessor, Hans Blix, on Iraq's lack of nuclear progress.)

But the President is more likely to accept the word of the U.S. National Intelligence Estimate to the effect that Iran did have a nuclear weapons program, but abandoned it in 2003.

So do not expect an American bombing campaign in 2008. Iran, simply put, is not on track to build a weapon and, besides, has too many ways to retaliate. It has submarines, fast patrol boats with torpedoes, and Chinese anti-ship silkworm missiles stationed on bases around the Persian Gulf all prepared to disrupt oil shipments and skyrocket oil prices. It has air bases and planes ready to drop bombs on Saudi oil loading docks. It has short-range missiles. It has Revolutionary Guard troops in Iraq. It can mobilize its loyalists in Lebanon and the Gaza. A bombing campaign in Iran would have to cover the country to diminish this retaliatory capacity. But the result would be a state of permanent war between Iran and the U.S. and a renewed commitment by the Iranians to rebuild their nuclear capacity.

A better bet for the U.S. would be to offer Iran some carrots along with the presently offered sticks. This is precisely what the National Intelligence Estimate judged to have led Iran to abandon its pursuit of nuclear weapons in 2003. As the N.I.E. put it:

"Our assessment that Iran halted the program in 2003 primarily in response to international pressure indicates Tehran's decisions are guided by a cost-benefit approach rather than a rush to a weapon irrespective of the political, economic, and military costs. This, in turn, suggests that some combination of threats of intensified international scrutiny and pressures, along with opportunities for Iran to achieve its security, prestige, and goals for regional influence in other ways, might—if perceived by Iran's leaders as credible—prompt Tehran to extend the current halt to its nuclear weapons program."

President Bush will not follow this advice, unless Secretary of State Rice manages to ace Vice President Cheney out of the U.S. policy process. The President has offered to talk

with Iran if it first suspends its nuclear enrichment. Of course, that is what such talks would have to be about. So that idea is dead on arrival, which is precisely the outcome that Mr. Cheney seeks. Why? Because he has convinced the President that the goal of the U.S. in Iran is to alter Iran's nuclear stance through regime change – ousting the clerics.

No sanctions, however, punitive; no bombing campaign, however destructive, will bring about that regime change. The Iranian revolution was made in the name of independence from foreign and, especially, American interference. The more the foreign interference, the more the nationalism and the rallying around the clerics.

A better foreign policy for the U.S. in 2008 would be to recruit an intermediary to intervene in the U.S. – Iran entanglement. Parties to a conflict in Iran do not sit and talk face to face. Rather, a third party intervenes to talk separately with each of the aggrieved to explain why the conflict is useless. That was exactly the way in which the U.S. citizens held captive by Iran in 1979 and 1980 were eventually freed in 1981 – with Algeria serving as a mediator in Algiers without direct U.S. – Iran talks. Algeria would, once again, be an ideal intermediary. But the U.S. will shun that approach in 2008.

ISRAEL-PALESTINE

Israel is planning a gala celebration of its 60th anniversary in May 2008. The celebration will go on without any celebrations over a settlement with the Palestinians or an end to Iran's nuclear program.

The dimensions of a settlement with the Palestinians have been clear since President Clinton's last ditch efforts: an independent Palestinian state on the 22% of the Palestine Mandate left to them on the West Bank and Gaza with land transfers from Israel proper to compensate for settlement blocs around Jerusalem to be incorporated into Israel, the dismantling of most settlements on the West Bank, some sharing of Jerusalem, and compensation of Palestinian refugees denied the right of return.

The dimensions are clear but the political capability of realizing them is not. Neither Prime Minister Olmert nor President Abbas is likely to be able to mobilize the internal support they need to surrender their most hard-line positions. No amount of pushing by the United States nor support from Arab states is likely to accomplish this. Olmert is weak by dint of his shaky coalition and his likely indictment for various crimes. Abbas is essentially kept in power by Israeli arms. Absent Israeli support, Abbas would likely be overthrown by Hamas.

The stalemate will continue with the major price being paid by the hapless, oppressed and impoverished Palestinians. Life has never been worse on the West Bank and Gaza. An Israeli politician once described the Palestinians as “cockroaches trapped in a bottle.” He got that right.

Israel's second grand strategic problem is Iran's nuclearization. A settlement with the Palestinians would go a long way to turning all the Arab states away from Iran and leaving that country isolated. But that will not happen in 2008.

Absent such a settlement, Israeli politicians, from the far right to the far left have said Israel would not tolerate a nuclear Iran. And as one of them put it about the U.S., "the country that did not bomb Auschwitz, will not bomb Iran." So the Israelis believe they are on their own. Their September 2007 raid into Syria was meant as a message to Iran. Whether the Israelis flew into Syria to destroy its nascent nuclear program or whether they flew in and out undetected to demonstrate that they know how to jam the most advanced Russian radar systems – which Iran also deploys – is really beside the point. What is not beside the point is the message to Iran that they are vulnerable and subject to Israeli attack.

The Israelis could not do the job by themselves. But working with Vice-President Cheney, America's most ardent champion of a U.S. air raid on Iran, they may hope to force the U.S. to join in. If that is their hope then they had better start their air strikes in 2008 when the Vice President is still the Vice President.

LEBANON

A lingering residue of Iran's revolutionary fervor is the paralysis of Lebanese politics. Iran has done much to bolster Hezbollah into a powerful Shiite armed force, which not only could withstand Israel's military onslaught in 2006 but also is sufficiently powerful to prevent the formation of a new Lebanese government. The pro-Syrian president, Emile Lahoud, is likely to be replaced by the Chief of Staff of the Lebanese armed forces. But Hezbollah has pulled its Shiite supporters out of the government and parliament depriving that body of the quorum needed to elect a new President. It insists that any new government allows it to retain its weapons for the struggle against Israel. Syria insists that any new President be pro-Syrian. Iran insists that the new Government be dominated by Shiites, fracturing the existing governing arrangements. All these conflicting positions are likely to be resolved and a new, moderately pro-Syrian and pro-Iranian government will be formed. The alternative is Civil War. Fortunately, too many in Lebanon remember the catastrophe of their last Civil War and will compromise to avoid another blood-letting.

TERRORISM

The National Intelligence Estimate, parts of which were made public in July 2007, concluded, "We judge the US Homeland will face a persistent and evolving terrorist threat over the next three years. The main threat comes from Islamic terrorist groups and cells, especially al-Qa'ida, driven by their undiminished intent to attack the Homeland and a continued effort by these terrorist groups to adapt and improve their capabilities..." That forecast is good enough for me. The terrorist threat to the United States remains potent and dangerous. But it is also the case that the real costs to the United States of these threats is less than the costs which have been imposed on American society by our anti-terrorism efforts. We have sacrificed many fundamental American principles in our

anti-terror efforts, in effect helping the terrorists realize at least part of what they seek to achieve.

EUROPE

TURKEY

One question that will continue to be finessed in 2008 is whether Turkey is geographically part of Europe and, therefore, entitled to be a part politically as well. To the extent that Turkey weakens the strict secularism, the legacy of Ataturk, it will be ever less welcome in Europe. That is precisely what will happen in 2008 as Prime Minister Erdogan and President Abdullah Gul will build on their 2007 election win to lift the ban on the headscarf in public places and let graduates of religious-training schools attend state-funded universities. Such moves will trigger protests from the secularists. But they will be welcomed by the vast majority of Turks, and certainly by Erdogan and Gul themselves whose wives wear the headscarf and, as a result, have been banned from attending official government functions.

A more pressing problem for the Turks will be their economy with its relatively high-cost but relatively low-skilled work force. Turkey has benefited from the surge in the value of the euro – both in terms of the expansion in demand for domestically produced goods as well as from increased exports. But if the world economy goes south in 2008, Turkey will be a more troubled country.

Of course with the presence of a PKK enclave in Iraq, Turkey is already a troubled country. The PKK has conducted raids into Turkey, killing members of the Turkish armed forces. Major incursions into Iraq by the Turks are unlikely but the U.S. is on notice to contain the PKK. All this is difficult for the U.S. given that it is supporting a different Kurdish liberation movement – the Party for a Free Life in Kurdistan – called PJAK, which strives for a free state in Iranian Kurdistan.

Because of the US failure to control the PKK in Iraq and a host of other reasons, public opinion in Turkey has turned dramatically against the U.S. According to public opinion polls, a higher percentage of Turks despise the U.S. than do the people of any other country.

EUROPEAN UNION

On January 1, Slovenia – a country of 2 million people -- takes over the EU presidency. Its challenge will be to find common ground among squabbling EU members over the ratification of a new treaty to replace the failed EU “constitution” of 2004. This new treaty was a breakthrough in 2007 made possible by the election of Nicholas Sarkozy. The challenge in 2008 will be to get the parliaments of all EU member states to ratify the new document. Of course the treaty needs to be ratified by parliaments to avoid any repeat of the ugly 2004 spectacle when voters in France and the Netherlands sent the “constitution” to its untimely death. If Slovenia fails to shepherd the treaty through the

parliaments of 27 countries in the first six months of 2008, then France will assume the EU presidency in the second half of the year. Count on Sarkozy to finish the job.

But the main challenge for Slovenia and France will not be the ratification. It will be the selection of two key positions for the 'new' EU. The new treaty specifies that an EU foreign minister be elected with vastly expanded powers. And most importantly, an EU president. The horse-trading will be intense and the nationalism of the EU states will be ever more evident.

The competition will also heighten differences between the richer states of Western Europe and the new members from Central Europe.

Besides its own internal governance problem, the EU will have to face a major external crisis – the likely declaration of independence by the Serbian province of Kosovo. The EU will split over recognizing the newly declared country. The richer states of the west will support the declaration while the poorer southern states, such as Greece, will deny recognition out of solidarity with Serbia while other states such as Spain will deny recognition for fear of their own disintegration. The pressure on the EU will be all the worse because the US supports Kosovar independence while Russia opposes it.

FRANCE

France will celebrate (or mourn) two important anniversaries in 2008: the 50th anniversary of the establishment of the Fifth Republic and the 40th anniversary of the 1968 student uprisings. The tension between these two visions of France – a powerful, nearly autocratic presidency and countervailing power on the streets -- will bedevil the country. President Sarkozy will continue his valiant efforts to diminish the control of the state over the society. But the society fears the competition and fears losing its benefits. The streets will see parades of protesters. But the president will not relent and the confrontation will continue. By the end of 2008, the confrontations will subside as the president modifies the more radical elements of his reform commitments while having achieved victory on the basics.

Sarkozy will also use his presidency of the EU in the second half of 2008 to push for a stronger European defense. Sarkozy does not see a stronger Europe incompatible with his vision of a deeper link of Europe and the U.S. But skeptics abound as to what he is up to, most notably in the UK, Germany, and the U.S. He will set the skeptics to rest by pressing for France's rejoining the NATO's integrated military command, as long as France plays its "rightful" role.

French ties with Germany and the UK will be further tested by Sarkozy's insistence on protecting French national industrial and financial champions and seeking to temper Europe's commitment to competition to increase efficiency and economic growth.

ITALY

The most pathetic state in Europe. And considering the talents and achievements of its people, doubly pathetic. Italy continues to decline relative to other rich countries and its decline will accelerate in 2008. Its public finances are ugly. Its education system, in decay. Its economy, one of the lowest to grow in Europe.

The problems focus on its incompetent and paralyzed government and its corrupt society. Its government is not truly incompetent, only incompetent when it is serving the long-term interests of its people. Take its commitment to modernizing Italy's archaic infrastructure. When I first drove between the provinces of Tuscany and Umbria in 1991, a new, divided highway was under construction. I drove the route again in 2007 and the 12-mile road is still under construction – still not finished and still not open for traffic. But when the government is serving its own interests, it is over-the-top competent. Take the Italian presidential palace. Its upkeep costs the Italian people four times the cost of the upkeep of Buckingham Palace.

Two long-time political reporters, Gian Antonio Stella and Sergio Rizzo, published a *The Caste* in 2007, a scathing indictment of Italy's political class. They reported one more outrageous fact after another: Italy's Senate, for example, has 9 full-time barbers on its staff to provide its members with free haircuts. Each barber is paid \$190,000 per year, which is \$36,000 more than the salary of the Lord Chamberlain in the British monarchy. What the authors found most outrageous is that there is a law in Italy according to which tax deductions for contributions to political parties are up to 50 times more generous than contributions to medical research.

The corruption of its society is driven by the incompetence and venality of its government. Taxes are extraordinarily high, as one would expect. But given government incompetence, the people have punished its politicians by ever more novel ways to cheat on taxes. The cycle is vicious.

The problem is the electoral system, which fragments the parliament and requires unwieldy coalition governments to produce a parliamentary majority. The coalition paralyzes decisive government action and prevents the reform of the system. The incentives for reform are, in any case, very low as the life of a politician in Italy is as good as it gets. What will not happen in 2008 is decisive government action to reform its archaic pension and subsidy systems.

Meanwhile, more young, educated Italians will flee abroad in search of the prospects they lack in their own country. There are now five Italians teaching on the faculty of the GSB, much to the great good fortune of our intellectual life but to the impoverishment of Italy's.

UNITED KINGDOM

The extraordinary rise of the UK will continue in 2008. It has become the world's preeminent global city. In 2008, that status will be deepened. Its geographic position

makes it an ideal bridge between the U.S. and Asia. Asian and Middle Eastern Sovereign Wealth Funds see it as a natural focus for their investments. Russian oligarchs do too. They own more of the most expensive houses in London than do the Brits.

RUSSIA

So President Putin got the Duma he wanted – one dominated by his party, United Russia. While the vote last Sunday elected a parliament, everyone in Russia understood that it was actually a referendum on the president. The president got the vote and the parliament he wanted. Now, as the undisputed eminence of Russia, he is likely to leave office in March of 2008 – the two term constitutional limit barring him from a third consecutive term. But he is not likely to leave power. Whatever means he has devised to remain the undisputed eminence -- whether as the next prime minister or some other device – will work. We will have Putin to kick around for 2008.

And he will certainly respond by kicking around Europe and the United States. President Putin has chosen to build his reputation partly on the basis of a xenophobic nationalism. Remember that this is the man who declared the collapse of the Soviet Union as the single greatest catastrophe of the twentieth century. He sees that collapse and the Yeltsin years that followed as a profoundly wounding humiliation that he now seeks to correct. One way he has done that is to attack the “winners” of the Cold War. In 2007, for example, he effectively compared the U.S. to Nazi Germany when he said,

“The number of threats is not decreasing. They are only transforming and changing the guise. As during the Third Reich era, these new threats show the same contempt for human life and claims to world exclusiveness and diktat.”

The internal Russian response to this heightened nationalism will be a demand for ever-greater national unity and conformity to the dictates of the Kremlin. But Russia will not become a model police state mainly because the Russian people will be happy in 2008 to trade democracy and freedom for the improved living conditions which President Putin’s rule has brought them.

The continued prosperity of Russia depends on its ability to supply the world with the natural resources, which it has in such abundance, and on the continued high prices for its commodities, which has driven its prosperity. These conditions are likely to pertain in 2008. The president will use his power to centralize his control and that of his Kremlin cronies ever more tightly over the Russian economy to assure that the country’s wealth flows, in the end, to the power at the top. As a result, foreign investors in what he defines as the central sectors of the economy will be unwelcome and Russia will not develop an entrepreneurial, dynamic economy.

More hostility to the West is in store: under control in 2008 but dangerous if commodity prices begin to fall.

NATO

In April 2008, NATO will hold its annual summit in Bucharest. The location is not random. The U.S. has pushed the expansion of NATO into the former Soviet satellites both to preserve its status in Europe, as the former satellites have joined the EU (of which the U.S. is not a member) and also to intimidate Russia. It has not managed to do that but it has provoked president Putin to strike back. The next move of the U.S. will be to press for the former satellite, Georgia, to be given a green light to begin steps towards eventual NATO accession. The U.S. and Georgia both see this as a means of preventing Russian control. But Russia has an ace in the hole – troops in Georgia in the breakaway Georgian provinces of Ossetia and Abkhazia. Watch for hair curdling rhetoric at the least in the spring.

ASIA

CHINA

The coming year will be China's "coming out" party – the year that China hosts the Olympics in August and demonstrates – primarily to its own people – that its repressive government has been able to achieve international status and prestige. The world will come to China. 2008, then, is about the Olympics. Nothing that interferes with the government's goal of achieving that international status will be allowed.

The problem is that China (like Russia) has used nationalism as a substitute ideology for its increasingly irrelevant communism. The Olympics are not about communism but about Chinese nationalism. That nationalism is already obvious. On a recent trip to Shanghai, I was impressed by the topping out of the third tallest building in the world – The Shanghai World Financial Center being built by Mr. Mori of Japan. The upper floors of the building as designed by Kohn Pedersen, Fox was highlighted with a huge circle. When the model was unveiled in the 1990s, Chinese authorities were outraged. They saw the circle as the "Rising Sun" and Mr. Mori as making a statement of Japan's domination of China. For years, the building was held up until he agreed to change the shape of the opening to a trapezoid.

Chinese nationalism is already a brittle but a deep commitment. To the extent that the Olympics are successful, China will take a tougher international stance in defense of what it considers its international interests.

First on that list is Taiwan. Nothing that the Taiwanese or the Americans do will be allowed to change China's basic position that reunification is inevitable. To the extent that the Taiwanese or the Americans contribute to Taiwan's status as an independent state, China will react, Olympics or not.

Taiwan is a constant. What is not a constant are the rising food prices. The favorite protein in China is pork. The Chinese consume some 92 billion pounds of pork per year

and as China has become more prosperous, the demand for pork has skyrocketed. The price in 2007 almost doubled over 2006, driving general inflation higher and leading to various government steps to control prices. China's leaders understand that food price rises in China are often the precursor of political unrest and will work diligently in 2008 to prevent further food price rises.

TAIWAN

2008 will be a year of elections in Taiwan. Elections in Taiwan make Chinese leaders very nervous --- not so much because of the example of a Chinese democracy but because electioneering in Taiwan requires dealing with the unification issue. President Chen is not eligible to run for reelection because of a constitutionally mandated two term limit. But his party, the Democratic Progressive Party, refuses to recognize the 'One State Two Systems' formula and has been the most strident in advancing Taiwan as a separate country. The Kuomintang opposition has accepted the formula and is willing to enter into talks with the PRC.

Public opinion polls show the opposition Kuomintang likely to win in 2008 – implying calmer relations with China.

The wild card in Taiwan's politics, however, is not China but corruption. The candidate for the incumbent party, the DPP, is being investigated on corruption charges. The DPP President, Chen, is immune from indictment but his wife has been indicted on corruption charges and he is likely to be indicted after his term comes to an end. The opposition Kuomintang candidate has already been indicted on similar charges.

Still, watch the opposition Kuomintang to emerge the winner.

NORTH KOREA

We will have Kim Jong Il to kick around in 2008. The master survivor has determined to trade his nuclear weapons program for survival and the world, especially China and the U.S., have grabbed the opportunity. The reality is that no one, and certainly not the South Koreans, wants the brutal regime of the north to collapse. Who would take over? Who could bear the costs? Instead, U.S. teams will dismantle North Korea's nuclear facilities and North Korea should be nuke free by the end of 2008.

INDIA

Prime Minister Singh will hold his fractious coalition together through 2008. He will coax the communists in his coalition to allow him to approve the fabulous nuclear deal offered India by President Bush. He will be less successful in implementing further market oriented reforms, seen by the left-leaning members of the coalition as abandoning India's founding principles.

Nonetheless, India will continue on its path of 8% growth or more. Private investment by Indians and by foreigners will accelerate but still leave India far behind China's staggering rate of capital appreciation.

THE WESTERN HEMISPHERE

THE UNITED STATES

The rage in Washington is palpable – not at Osama or al-Qa'ida. Not at China. Not at Putin. But at President George Bush. The Democrat's rage is not hard to explain. But what is even more startling is the extent to which Republican politicians – Senators, Congressmen and Congresswomen, and those at the state level – have come to despise Bush. Not necessarily because they disagree with his political positions but because he has put their re-elections at risk.

The President is not a lame duck but a mortally wounded one. The principal result will not so much be bad public policy in 2008. But it will be no public policy. The Republicans will join with Democrats to craft legislation meant to please the electorate. The President will veto much of what reaches his desk. Political paralysis will follow.

While many in this audience will welcome this news – for them, the less federal government the better– the reality is far less pleasant. We have no national leadership to address the crucial issues that face this country. Foremost among them is the coming fiscal train wreck. The wreck appears inevitable and is driven by two factors. First, an analysis of the fiscal 2008 federal budget of \$2.9 trillion dollars shows that excluding national defense, national security, Medicare and Medicaid, and Social Security, and the interest on the national debt (some 9 percent of the total budget), only some 15.7 percent or \$455 billion is discretionary. The President and the Congress quibble over some 16% of what the federal government spend every year while some 84% of federal expenditures are built into laws and just roll on.

The coming train wreck is also being driven by the massive fiscal obligations with which the federal government has burdened itself under President Bush. The present value of the unfunded liabilities of the federal government in the year 2000 was \$20 trillion. By the year 2007, the present value of those unfunded liabilities had skyrocketed to \$50 trillion, a burden that the federal government cannot possibly meet.

The falling U.S. dollar is yet another problem. Of course the falling dollar boosts U.S. exports and helps compensate for slowing domestic demand. But exports in 2007 will be slightly less than 12% of U.S. GDP and cannot drive the economy very much. And, of course, a falling dollar will also diminish Americans' appetites to travel abroad and to buy foreign goods, resulting in a decline in the Current Account Deficit. All to the good.

But the dangers of a falling dollar outweigh its benefits. First, some 2/3rds of global foreign exchange reserves are held in dollars. Japan, China, the oil exporters, in

particular, hold dollars. As they see the value of their holdings diminish in relation to their own currencies they will look more seriously for alternatives, threatening a collapse of the dollar.

The collapse of the dollar will bring a fire sale of U.S. assets to those who hold more stable currencies. U.S. trophy real estate properties and trophy companies will be scooped up. Presidential candidates will respond with strident calls for trade protectionism. The failures of Dubai Ports World to buy U.S. ports and of China National Offshore Oil Company to buy Unocal are precursors of an ultimately self-defeating tendency to “protect” Americans from the foreigners.

An even greater danger will be foreigners’ recognition that dollar based financial investments lose much of their appeal when the dollar is falling. Since foreigners hold more than half of all U.S. Treasuries, the risks to the U.S. fiscal and Current Account Deficit are clear and menacing.

Few of the would-be Presidential candidates have addressed these issues and few have been asked how they would address them. My bet, given the failure of Presidential leadership in this country, is that only a crisis will force the country to deal with its burdens. This crisis however will not be evident in 2008, but in the middle of the next decade.

Nor will there be any major foreign policy successes. The Annapolis Forum will not produce peace between the Palestinians and Israelis in 2008. Iraq will remain a political cauldron. NATO will continue to lose its grip on Afghanistan.

As a result, the electorate will be even unhappier in November 2008 than they were in November 2007 public opinion polls. The election results will reflect that anger. The Democrats will strengthen their control of the Senate (remember that the Republicans will be defending 21 seats in the Senate compared with the Democrats’ 12) and the Democrats will strengthen their hold in the House.

The Presidential race is stunningly difficult to predict, for many reasons. This is the first campaign since 1928 with no incumbent entered in the primaries. It is the first campaign with a “Super Tuesday” primary, February 5, when 21 states hold their presidential primaries. Those primaries will determine the commitments of 1,943 convention delegates. (For the Democratic candidate, 2,184 delegates are necessary to win and for the Republican, 2,380.) Moreover, evangelical voters who gave George Bush 50% of his votes in 2004 are unhappy with all three leading Republican candidates. Many of them will sit out the primaries.

Stalemated primaries and a brokered convention are possible for both parties, but more likely is the emergence of the candidates early on. The Republican candidate for President, either Rudy Giuliani or John McCain (and I am betting it will be Giuliani) will

lose to the Democratic candidate. The next President of the United State will be Hyde Park's own and former University of Chicago Law School teacher, Barack Obama.

ENVIRONMENT

Along with health care and immigration, the environment will be a major issue in the 2008 presidential elections. But because of the political paralysis in Washington, the Feds will do little in 2008. The states will pick up the slack but, essentially, the U.S. will remain powerfully irrelevant to global climate change in 2008. So will China. The Chinese are committed to controlling pollution during their Olympics by banning cars from central Beijing and by temporarily shutting down the city's most polluting factories. But meanwhile, China's building boom in coal-fired power plants will continue. Expect a coal powered generating plant to be opened in China every week for the next five years. Whatever carbon emission savings there might be in the rest of the world, China's new carbon emissions will be greater. We are still at square one on dealing with global climate change.

LATIN AMERICA

The economies of most Latin American economies have enjoyed booming economic growth driven overwhelmingly by higher commodity prices. Even the most industrialized states to the south have not managed to become globally competitive exporters of manufactured goods. Take the industrial powerhouse of Brazil. Its commodity exports in 2006 were \$140 billion. Its manufactured exports were less than \$30 billion. As long as the global commodity boom holds up, those states are likely to enjoy a measure of political stability.

But even the stability they have bought with commodity exports is threatened by the failure of the new wealth to "trickle down" and the consequent rise of populism. President Chavez's campaign to become Venezuela's president-for-life failed – in a remarkable triumph for democracy -- but his populism will continue to be an example for others. The presidents of Bolivia, Argentina, Nicaragua, and Ecuador, have turned to populist policies while blaming foreign companies for their domestic troubles. One outcome will be less foreign investment and less technology transfer. Latin American economies will fall further behind.

EMERGING MARKETS AND COMMODITIES

Emerging markets in 2008 are likely to grow two to four times faster than the developed economies, further diminishing global inequality. The effects of the great global boom in emerging markets have been stunning. In 2002, 9 of the top 10 wealthiest people in the world were Americans. By 2007, only 3 Americans were among the ten. Bill Gates and Warren Buffett, of course, are the two richest Americans. But very few know the name of the third. He is Sheldon Adelson of the Sands Hotel Corporation. It also appears that two non-Americans may now have outdistanced Bill Gates' fortune to become the richest men in the world – Carlos Slim of Mexico and Mukesh Ambani of India.

For the coming year, the success of the Emerging Markets will depend on their ability to continue to export to the developed economies. That, in turn, depends on the value of the dollar and the state of the developed economies. A decline in either will reduce their exports – both manufacturing exports and commodity exports -- and their prosperity.

Commodity prices, as we all well know, have been on a tear. The number of countries benefiting from the boom in commodity prices is astounding – from Russia to Australia; from Norway to Botswana; from Canada to Chile. Then cycle in commodity prices is likely to continue through 2008, even with diminishing demand from the U.S.

Ultimately, the most significant commodity in 2008 will be oil. Its price is key for the global economy. Given the likelihood of slower growth in the rich countries and slower export growth from the developing countries and the high price of oil, global growth in oil demand will increase but at a slower pace than recent years. In turn, the reduction in demand pressure will moderate oil prices. But the political risk premium and the dollar decline premium will still be in the oil price. Look for \$80 as the average oil price for 2008.

Lower prices could fail to materialize given OPEC's refusal to increase exports. The oil exporters are – to put it mildly – enjoying their oil profits and are mindful that even with \$90 oil, the global economy has failed to collapse. Further, five of the seven countries with the largest proven oil reserves – Saudi Arabia, Russia, Iraq, Iran, and Venezuela are loving every minute of the pain inflicted on the rich countries by their high prices. They are worried that a production increase in the face of a slowing global economy would return them to the catastrophic days of 1986 with its \$10 oil or even in 1999 when oil was still at \$10 per barrel.

Post 2008, watch for higher oil prices. Global economic growth will be more robust. China and India will consume more oil. New sources of oil will be discovered, particularly in the Arctic and Russian Siberia where extraction costs will be huge. We'll have it. But we'll pay for it. The transfer of wealth to the oil exporters will accelerate, as will their investments in developed economies.

Nonetheless, as commodity prices have accelerated, so has political risk. Take the oil exporters. The 15 top oil exporters in the world are Saudi Arabia, Russia, Norway, Iran, the UAE, Venezuela, Kuwait, Nigeria, Algeria, Mexico, Libya, Iraq, Angola, Kazakhstan, and Canada. With the partial exception of Norway, these countries have used their oil revenues to fuel a tremendous boom in internal (and external) consumption and investment. Kuwait, for example has recently announced its intention to build the Burj al Kuwait, the “Kuwait Tower” which will be 1,000 meters high, insuring that it will be as much as 20% higher than the next highest building in the world, the Burj al Dubai, the “Dubai Tower,” now nearing completion. It is well to remember that when small states build tall towers, it is a sure sign that grandiosity is taking hold, rather than

economic rationality. And when oil prices approach 3 digits it is reasonable to become grandiose. But to every upside there is a downside.

DEATH WATCH

Remember. This is not a wish list. As the baseball umpire puts it, "I just calls 'em as I sees 'em." My 2007 predictions of significant world figures to pass from the scene was a failure. The 79-year-old King Bhumibol was near death when he suffered a stroke and paralysis in October 2007. But he has returned to his Palace and allegedly is recovering, although it is difficult to believe any news one hears about kings. King Mahendra of Nepal is neither in exile nor dead. But he is politically dead. The King and Crown Prince of Saudi Arabia are still the King and Crown Prince of Saudi Arabia.

So what are my bets for the coming year?

Fidel Castro, the 81year old Cuban leader will succumb to his illnesses in 2008 and unleash a succession struggle between Raul Castro, Miami exiles, and the Cubans who have withstood the failures of the Cuban economy since Castro's successful revolution.

King Bhumibol is back on my list. The monarch, one of the world's richest men, was actually born at the Mount Auburn Hospital in Cambridge, Mass in 1927. He returned to Thailand as an infant in 1928. (Too bad he did not run for President of the United States.) His many illnesses will catch up with him in 2008 and he will be succeeded either by his son or his daughter - the choice is actually up to him.

Political assassinations have not disappeared from the world. The most likely target in 2008 will be Mahmoud Abbas, Palestine's president.

And I am keeping the King of Saudi Arabia and the Crown Prince on the list. Both are in their mid to upper 80s.

CONCLUSION

The rest of us are lucky to be alive. And we will be especially lucky to be alive in 2008, which will be a fabulous year of war and death, prosperity and poverty, victory and defeat, drama and passion, and – above all – of renewal through the magnificent process of the American elections.

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