



## EG Update

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10 OCTOBER 2016

a dramatic escalation in us-russia relations this week—some thoughts on that and on cyber conflict more broadly. then all these referenda not playing out the way political leaders would have hoped—here's why. some thoughts on iran. and a few words on the greatest show on earth...that is the us election.

### us - russia

i've heard for months now from senior us intelligence and cyber officials that the government had "high confidence" attacks against the democratic national committee were committed by the russian government. barack obama leveled the accusation privately to russian president vladimir putin when they met on the sidelines of the g20 summit last month in hangzhou. he demanded an end to the attacks and warned of retaliation otherwise.

instead activity has continued, both with the continued release of election-relevant emails from wikileaks—many from hillary clinton personally—as well as with an expanding series of attacks against democratic political institutions in addition to state and local election systems. on friday, against the backdrop of the americans ending us-russia talks on syria (more on that momentarily), the us government publicly declared the russian government was behind the cyber attacks and, further, that the explicit intention was to interfere with the election process.

that's a dramatic statement from an obama administration that tries to remain cautious and flexible in most every circumstance when it comes to foreign policy responses—it's more stark than the claims issued against north korea in the sony pictures hack, which led to us sanctions. we're now going to see some form of direct retaliation from the united states, which brings danger of an escalatory spiral.

it's hard for the americans to be "proportional." it's not as if there's much use in the united states attempting to delegitimize russian elections. or, say, publicly divulging information about corruption around the kremlin. it's a similar conundrum with china's industrial espionage—a big part of the challenge is that the difference in political systems makes for differential vulnerabilities. the united states hacks the chinese government continually and effectively, but doesn't have the mechanism or inclination (yet) to provide material information on chinese industrial secrets/strategy to american private sector participants.

additional sanctions to hurt the russian economy are likely, particularly against individuals and companies involved in the hacks...though that would come without support from other countries—either american allies or antagonists—and at a time when existing us-supported sanctions around the ukraine conflict are facing pressure towards reduction. it's also possible we'll see something destructive on the cyber side—attacks to temporarily disrupt or damage some government related areas of the internet. at this point, these are still warning shots, intended to prevent the russians from proceeding as the elections near. but there's no reason to believe that there's an effective deterrent.



two reasons any us response isn't likely to work. first, putin has extremely limited domestic constraint on his rule, while anti-americanism remains popular at home. putin's attempt to delegitimize "democracy" of an exceptionalist united states, whose efforts to promote values on russia's borders and in russia itself are perceived as a direct threat to the russian government, is well aligned with the russian people. second, american officials now consider russia a peer in its offensive cyber capabilities (as opposed to china, which remains considerably less capable). the us government won't want to engage in a seriously damaging "integrity" attack against russian infrastructure that could bring retaliation from an equally-capable moscow. and to the extent that the us has developed new, more advanced cyber capabilities that give them a decisive advantage, the americans won't want to reveal them short of an emergency.

the latest in the syria war surely doesn't help. us secretary of state john kerry won a sharply divided internal administration argument to agree to a us-russia ceasefire and then coordinate attacks against terrorist organizations within syria. it was the biggest rift i've seen on a foreign policy issue in the obama administration, with senior defense department officials privately saying the russians couldn't be trusted on syria...and that they would oppose cooperating with moscow on joint strikes if it came to that. there wasn't even an opportunity to test the claim; the us mistakenly killed over a hundred of assad's forces in a series of strikes, the syrians and russians targeted civilians in attacks after, and "moderates" among syrian rebels were unwilling to split off from al nusra to secure unspecified western support in what surely appeared to be a lose-lose situation for them. kerry's embarrassment with the public policy failure led him to call for a war crimes investigation against russia; the russians immediately responded by pointing to saudi atrocities against yemeni civilians, including the use of phosphorus weapons provided by the united states. or what you'd call an impasse.

the immediate russian response was trademark putin: stationing nuclear capable missiles for military exercises in kaliningrad...posturing but seen as aggressive by poland and the baltic states. beyond that we'll surely see an escalation in harassment of american interests in russia (interestingly, the state department formally complained last week that two diplomats attending russia's major st. petersburg forum last year were drugged), though focused on government officials, journalists and ngo representatives—still not the business community where the general atmosphere remains constructive (though the overall economic relationship will face negative pressure from the tensions). i wouldn't be surprised if we see a withdrawal of the russian ambassador from washington (and vice versa), perhaps even a temporary suspension of diplomatic relations.

one mitigating factor is the lack of international support the russians have in pursuing a destabilizing course in both the middle east and with the americans. the chinese in particular are increasingly unhappy with what they see as an actively revisionist moscow strategy in a world that beijing already sees as far too uncertain for their own national interests. also, russia's recent efforts to paint a number of cyber-attacks as coming from china—a similar strategy that the north koreans have used, albeit less effectively—has caused particular annoyance in beijing. it's worth noting that china decided to abstain on the russia-vetoed un security council vote on syria this weekend...after joining the russian veto on the last four occasions. there are all sorts of tactical reasons for the two countries to show a united political front, but that will show clear limits if russia-us relations signal the potential of looming military confrontation.

without doubt, this is the biggest foreign policy issue where the result of the us elections will have an immediate impact. a trump presidency leads to a quick summit with the russian president and a "deal" over syria, a recognition of crimea as russian, and a climbdown of tensions. under a (more likely) clinton presidency, there's no prospect of a fix, and at the very least an expanded cyber war between the two most powerful players in the field looks increasingly likely.



## **direct democracy**

you ask the people what they want...you might not get what you expect. that's less an indictment of popular will than the politics of referenda. there's the obvious point of exactly how the question is posed—ask the same exact question two different ways (one focusing on potential gain, one focusing on avoiding loss, for example—the entire foundation of behavioral psychology) and you'll get dramatically different answers.

but there's also the political science perspective. a referendum isn't just about the issue but also about the political figures that line up on either side. and the more important the issue, the more likely that the decision is even more about popular attitudes towards the politicians who are staking their careers on the outcome.

it's why referenda tend to be close. however popular the issue, however clear the arguments for one side over the other, a critical national referendum almost always becomes a vote about a government's political leadership and therefore the opportunity for the political opposition to remove them. 20 years ago, quebec was within a hair's breadth of becoming its own country (the "no" vote got just over 50%, with an astonishing 94% of the province turning out) while beforehand popular attitudes towards independence tilted significantly more against. to make the point more starkly, a healthy majority of texans oppose the concept of secession (bumper stickers notwithstanding). but put together a referendum on it with a major partisan leader (from either political party) in opposition, and the eventual outcome would likely be much narrower.

brexit followed that pattern. it was far more a vote against the establishment than against the (already fairly weak) european union. colombia looked like an obvious win for a peace deal with the farc, but a popular former president got on the bandwagon against and defeated it. political reform is desperately needed in italy and it's reasonably popular...but the fortunes of italy's prime minister have diminished, and so the passage of the referendum now looks in doubt. it's why most eurozone leaders strongly want to avoid a referendum repeat on the continent. the dutch and french remain strongly pro-eu (relatively-speaking), but if the freedom party or front national were able to force a referendum, the results would likely be closer.

that's not to say these big national votes are always likely to turn out badly. former japan prime minister junichiro koizumi bet his political career on landmark japan post privatization after announcing snap elections and calling on voters to remove members of his own party who opposed him. it proved a historic win. his charismatic leadership and willingness to directly challenge vested interests and their champions in the liberal democratic party didn't hurt. but more often than the pollsters predict, it doesn't turn out that way.

we're likely to see referenda becoming more popular in the future. in political environments where populations are more fragmented and government legitimacy is more open to question, a turn to referendum can look like the best way to secure a popular mandate for a government otherwise stuck on thorny political issues. but looks can be deceiving.

## **iran**

we've seen significant criticism of us-iran relations in the aftermath of this year's nuclear deal. partly that's because the deal isn't as big as it was portrayed. presidents rouhani and obama both saw utility in showing it was a serious breakthrough, classifying it as a big win. the negotiations were certainly hard fought, and they reflect evolving interests on both sides not to view each other as a primary adversary. the united states wants less entanglement in the middle east; the iranian government is achieving greater influence in the region and is happy to set aside the distraction of active us hostility. but that's very different from a fundamental change in us-iran relations.



the iranians delay development and acquisition of a nuclear weapons program for 10 - 15 years. in return the united states unfreezes iranian assets and the international community ends energy sanctions. those steps provide clear, defined benefits to both countries. the challenges remain big. the united states believes iranian ballistic missile tests violate the spirit of a key united nations resolution. there are us sanctions on investment in and finance of iran linked to human rights violations and support for terrorism. they're going to continue. and iran's weak investment climate will continue to deter many investors, an outcome iran will blame on the united states.

geopolitically, the united states and iran remain on polar opposite sides in most conflicts. while the us-saudi relationship is poor (evidenced by the senate quickly overturning that 9/11 bill obama veto—as expected a couple weeks ago), it's still significantly better than us-iran. plus iran's cyber capabilities are a bigger threat to its regional adversaries than its nuclear program.

iran comes out of the deal reasonably stable, with better trajectory than most all of its neighbors in the region (israel and the uae being the only exceptions). supreme leader ali khameini now feels comfortable enough to keep out the hardliners from presidential elections and let hassan rouhani sail to a reasonably smooth second term. but the downside remains significant: we're not going to see sudden or dramatic political reforms in iran any time soon. and opening of the iranian market is going to take longer than many investors had hoped...first, incrementally, from emerging markets, then from europe and japan.

### **us elections**

all sorts of october surprises...and we're only one week in. the most significant revelation has been a 10-year old video of donald trump with unprecedented, disparaging and vulgar commentary about women. even in the radically altered context of what's beyond the pale this election cycle, the tape hit a collective nerve, with dozens of republican congress members and governors withdrawing their endorsements, vice presidential nominee mike pence suspending his public schedule for the weekend, the republican party shutting down some campaign support for the trump campaign, and house majority leader paul ryan withdrawing an invitation for a joint campaign event on saturday.

a significant minority of gop leadership have contacted the trump campaign to call for the candidate to step down. it's hard to imagine him doing so at this late stage; a video of trump apologizing focused more on bill and hillary clinton's transgressions and promised attacks along those lines. instead we'll now see republican leadership turning their money and efforts away from the trump campaign and focusing on down ballot races—particularly on moderate incumbent republicans who face the most significant challenges.

it's nearly over for trump. negative sentiment for hillary clinton remains extremely high and as mentioned above, further damaging email leaks now look virtually certain—the weekend's news mostly buried another wikileaks email dump with private emails involving the clinton campaign (including the transcripts of some wall street-friendly banking speeches the campaign had steadfastly refused to release). but a significant clinton win is now a comfortable call, with the senate flipping to democrats and the republicans losing 15 seats or more in the house of representatives. that's not a big plus for governance in the united states—divided government, especially divided partisan government, is always challenging. and that's going to be more true in a house of representatives where it's the moderates who are losing their seats; party loyalty for the majority republicans will be even harder fought.

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i was going to write more about recent conversations with trump's policy team, as well as a sit down with ivanka trump and son-in-law jared kushner. if the race gets closer i'll provide some color on their policies and preferences. but to give you a couple of key takeaways: i was impressed with the intelligence and breadth of knowledge of kushner and daughter trump, as well as just how involved they clearly were in every aspect of the campaign. kushner is clearly the only person calling important campaign shots other than trump himself; most of the listed policy staff have no direct access to the candidate. what also struck me was how doctrinaire they were on a host of key issues—on the role of big business and banks in the us and globally, on trade, and on foreign policy.

i was most taken by how deeply the trump family sees themselves as outsiders, only accepted by powerful players because they buy their way in. that came through viscerally in my meeting. and their experience and related mistrust of erstwhile "peers" colors their policy views more broadly. there aren't any shared values that matter with other countries; instead the united states is being taken for a ride because america refuses to use the wealth and other levers of power (critically including the military) to improve america's terms of engagement. if the united states is the most powerful country in the world—by far—it should be receiving terms that reflect that imbalance. and if trump becomes the most powerful individual in the country, by definition american business, banks, and other players should align themselves with his view of the country's national interest. it came as a sharp rejoinder to those that believe a trump administration's actual policies would be more establishment/pragmatic than the campaign. there's lots in the belief system there that isn't traditional republican. but it's very strongly anti-globalist. and that would be a significant change.

the most relevant point given where we now are in the campaign—i pushed ivanka on whether her father would immediately concede to president-elect clinton if he were to lose the election. she said there was no doubt in her mind, and didn't shift an inch when i brought up his charges of the election being "rigged" and his threat of litigation against ted cruz over delegate strategy during the primaries. ivanka's position was that was all gamesmanship showing strength/not conceding an inch while the elections were on...but that her father was capable of accepting a loss if it came to pass (as it did in iowa, she pointed out), and that he'd make the call to hillary and then take a vacation. i've no idea if that reflects donald trump's own reality. but i did find myself convinced that she believed what she was telling me.

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on **north korea**...interesting to note that the us treasury department leveled sanctions against a chinese firm (dandong hongxiang industrial development) and four chinese executives there for laundering money for a north korean bank involved in funding the country's nuclear and missile development. it's a small company and doesn't hit the chinese government; beijing could plausibly claim lack of knowledge of the transactions and distance itself from the company. but state department officials tell me more companies are presently being scrutinized. this won't become a blow up in the last months of the obama administration. but assuming a hillary clinton victory in a few weeks, the policy trajectory on this issue isn't likely to change. we're heading for significant us-china tensions on this issue.

and some better news, from **india and pakistan**. tensions look to quickly cool despite the military confrontation over kashmir. immediate de-escalatory rhetoric came from both sides: indian officials clearly stated that there would be no additional 'surgical strikes' while pakistani officials continued to deny that anything more serious than regular cross-border firings took place, so no need for a sharp military response. militants in pakistan aren't about to stop targeting—going forward we'll see more attacks on indian facilities, as well as in third countries such as afghanistan; for its part, india will continue to work to isolate pakistan internationally. the real risk will come the next time there is a major terrorist attack within india. having already launched these strikes, indian prime minister modi would need to go further...and then the pakistani military would feel a greater obligation to respond in kind.

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my presentation at the imf annual meeting was a solid kickoff to bringing global politics and economics together (including a fair bit of sparring with angela merkel's chief economic advisor). if you'd like to see it, here's a live-stream: <http://www.imf.org/external/mmedia/view.aspx?vid=5161614552001>.

meanwhile i'm heading to buenos aires for some work with the business community and a bunch of bilaterals with cabinet officials. will also be my first opportunity to sit down and chat with president mauricio macri; quite looking forward to it. shall report back next week...

best,

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