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Echoes of the Arab Spring

On the evening of Sept. 11th, the U.S. consulate in Benghazi, Libya was attacked by a mob. During the rioting, Ambassador Chris Stevens and three other members of his staff were killed and several others were wounded. It appears that the attack on the consulate and the safe house where the staff evacuated to was executed by experienced insurgents. Al Qaeda has claimed responsibility for the attack; however, the group has also claimed other attacks which were, at best, loosely managed by the leadership in Southeast Asia. At this point, it is still unclear who sponsored the assault.

The catalyst for the riots came from an obscure film titled *Innocence of Muslims*. According to media reports, a short trailer (which may be all that was actually filmed) of a low-budget slander on the Prophet Muhammad was posted on YouTube in June. From June 1 until September 12, the video only had 10k hits. However, on September 8, Sheikh Khalid Abdullah, a talk show host in Egypt, devoted his two-hour program to the film. A few days later, the Egyptian media carried reports on the Sheikh's program. At last count, YouTube hits are in the range of 250 million.

After the Sheikh's program, the film clip obviously went viral. As it spread, unrest developed around the Muslim world. Various events ranging from non-violent protests to attacks on U.S. State Department facilities occurred from Nouakchott, Mauritania to Jakarta, Indonesia.

This unrest, though triggered by this movie, is really part of a larger discussion about American policy in the Middle East, Africa and Southeast Asia. In our opinion, U.S. foreign policy, especially in the emerging world, has been muddled since the fall of the Soviet Union. To some extent, the unrest caused by this movie reflects the mixed messages American actions have signaled since the early 1990s.

In this report, we will discuss the issue of American foreign policy, democracy and the emerging world. Our primary focus will be on the Arab states. From there, we will examine the particular issues of democratization and regime change for a few selected nations in the Middle East. As always, we will conclude with potential market ramifications.

American Foreign Policy and Democracy

In theory, U.S. foreign policy supports the spread of democracy. However, as the U.S. emerged as a superpower after WWII, it opted on several occasions to ally with authoritarian governments to win the Cold War. Maintaining friendly relations with distasteful dictators was necessary at times to establish bases of operations against nations allied with the Soviets or to prevent these nations from becoming allies of the Communists. Such decisions were controversial. A classic quote attributed to Franklin D. Roosevelt, describing the Nicaraguan dictator Anastasio Somoza, was, "He's an SOB, but he is our SOB."

Referring to the archetypes of American foreign policy (see WGR, 1/9/12, [The Archetypes of American Foreign Policy](#)), the Hamiltonians were more willing to “hold their noses” and make unpalatable deals. The Wilsonians opposed such measures at all costs, the Jeffersonians believed that we shouldn’t be getting involved anyway and the Jacksonians were okay with such deals as long as the U.S. got the better end of the agreement and the dictator could be a useful tool against an enemy.

For the most part, during the Cold War, Hamiltonians tended to dominate policy. Occasionally, Wilsonians would gain influence (President Carter would be in this archetype) but a morals-driven policy tended to be less effective against a determined enemy like the Soviet Union.

However, after the Cold War ended, the dominance of the realist Hamiltonians began to fade. The lack of a clear enemy in an ideological battle meant that the compromises necessary to conduct a Hamiltonian policy were difficult to justify. Although the George Bush administration was Hamiltonian to the core (Brent Scowcroft would be an almost perfect example of the Hamiltonian position), the Clinton and George W. Bush administrations were decidedly Wilsonian. The Clinton administration, admittedly more interested in domestic rather than foreign policy, earned this description for the war against Serbia. The neo-conservative foreign policy of the Bush administration, with its goal of democratizing the Middle East, puts it solidly in the Wilsonian camp.

President Obama’s foreign policy has been somewhat muddled. It would probably be best characterized as a mix of Hamiltonian and Jeffersonian policy. His reluctance to become militarily involved in Libya and

Syria and his pivot toward Asia are more aligned with the Hamiltonian realist policies, although it would fit with Jeffersonian principles as well. The use of drone attacks, generally speaking, fits into a Hamiltonian paradigm. On the other hand, his unwillingness to support Egyptian President Hosni Mubarak appears Wilsonian; although, it could be argued that the president withdrew support only after Mubarak’s situation was clearly untenable. In contrast, his State Department is heavily tilted toward Wilsonians, including Secretary of State Clinton.

Without the overarching threat of communism, Americans are decidedly uncomfortable with Hamiltonian policy. Most Americans on the left side of the political spectrum are either Jeffersonians or Wilsonians. The former tend to oppose military action at nearly all costs while the latter are more inclined to use military intervention for humanitarian reasons. On the right, virtually all categories are represented, with the rank and file of the GOP being mostly Jacksonians. However, the Paulist libertarians would fall into the Jeffersonian camp. The neo-conservatives are Wilsonians and the traditionalist “country club” Republicans are Hamiltonians.

The lack of a clear foreign policy in the post-Cold War world for the global superpower is unsettling. A major problem is that the rest of the world isn’t sure how to adapt to American policy. As we will discuss below, for individual nations, the inability to “read” American policy can lead to outcomes detrimental to U.S. interests. In other words, nations may take policy positions that they view as in their best interests given American policy, only to find that their analysis of U.S. policy was inaccurate.

Democracy and U.S. Policy

On its face, the U.S. should support democracy. The American experience with this governmental system has been successful, for the most part. Although it has flaws, America and the democratic West have been able to successfully transfer power to new leaders without bloodshed, and competing and minority interests usually work out accommodations. The recent media turmoil over the apparent “disappearance” of Chinese leader-in-waiting Xi Jinping clearly shows the difficulty authoritarian regimes have when new leadership is installed. In most cases, new leaders in authoritarian regimes either come at a barrel of a gun or by dynastic succession.

However, one of the problems for the U.S. in supporting democracy is that a democratic government may become an opponent of the superpower, simply because the citizenry may oppose the U.S. Western democratic thought has a rather peculiar component. Most of the political philosophy that led to democracy was born of the Enlightenment. Enlightenment philosophers believed that all tenets of thought should be tested by reason, including first principles. A first principle is a starting point for a belief system. These principles can be derived from tradition, religion, observation, etc. What made the Enlightenment philosophers different is that they held that first principles could be derived from reason. This was a historic break for philosophy.

Thus, a first principle, as seen by Enlightenment philosophers, if accepted, is “reasonable.” Thus, when the Declaration of Independence says, “we hold these truths to be self-evident...,” it essentially means that any reasonable person should see that these tenets are based on reason and, by

design, anyone who disagrees with them is obviously unreasonable.

And so, if one assumes that the first principles that underpin the intellectual edifice of democracy are self-evident and reasonable, and assuming the universality of human nature, then democracy should not just be a Western system but a global system. And, anyone who doesn’t adopt this system is clearly being unreasonable.

When Francis Fukuyama wrote his book titled *The End of History and the Last Man*, he argued that with the fall of communism there were clearly no alternatives to democracy, capitalism and globalization. His argument reflects Enlightenment values and has been adopted by the Wilsonians.

However, in intellectual history, it is interesting to note that the idea that first principles could be rationally derived was mostly destroyed by David Hume and the British skeptics. In effect, Hume argued that all first principles could not be derived from reason. They were either equivalent to faith statements, were tautological or derived from induction, which fails the instant a counter example is discovered. The Hamiltonians tend to come from this tradition.

It is worth noting that there have been two primary groups that have opposed the Enlightenment. The first were those who tended to back religion and the crown. They viewed the Enlightenment movement as a dangerous trend that could undermine legitimate and divine societal order. The second group tended to come from traditionalists who took a more jaundiced view of human nature. Although not necessarily theists, they tended to support the established order simply because changing it via revolution could lead to

unintended consequences. Edmund Burke would be in this camp.

For the Wilsonians, who assume that all democratic yearnings spring from a universal human nature, democracy is a better form of government, and if all governments were democratic then U.S. interests would (eventually) be better served. Hamiltonians remain unconvinced.

The other two archetypes tend to avoid such intellectual flights of fancy. For Jeffersonians, the U.S. is a city on a hill and thus should avoid contact and intercourse with the outside world because, in the end, other countries are corrupt and engaging them will only invite the same corruption into America. For Jacksonians, America is special but even more special are the original Scotch-Irish that tend to form this archetype. Although others have joined this group over the years, the Jacksonians have something of a clannish feel to them. As such, they are more interested in defending the interests and honor of this group. What other nations do is their business until they interfere with America's business or honor.

Western thinkers who tend toward the Enlightenment struggle with the possibility that a nation could adopt democracy and engage in "illiberal" policies. For example, what if a nation structured itself as a democracy and decided to mistreat minorities or women? Or, create a democracy which bases its first principles on religion instead of reason? For example, Iran has a mostly functioning democracy; it clearly doesn't meet U.S. standards but turnouts remain high and, in the past, candidates not favored by the clerical class have won elections.

Unless one adopts the position of the universality of humankind, allowing

democracy runs the risk of governments deciding to oppose U.S. interests.

Wilsonians simply don't believe this will occur over the long run. They are willing to accept it might occur in the short run but eventually these wayward states will come on board to Western views. The Hamiltonians are rather uncomfortable with taking the risk of democracy. Both the Jeffersonians and Jacksonians believe we shouldn't care or interfere in the decisions of another state.

Since most U.S. administrations have been Wilsonian since the end of the Cold War, foreign governments have tended to adapt themselves to that model or lean against it. What is worrisome for foreign countries is that a new president could completely change the program and make major adjustments. This issue leads us to the next section of the report.

The Effects of U.S. Policy Uncertainty on Selected Nations

Israel: Since the end of the Cold War, Israeli governments have tended to bask in nearly unconditional support from the U.S. until the Obama administration. The Wilsonians that dominated both the Clinton and Bush administrations tended to view Israel favorably, although there was some discomfort with the treatment of Palestinians. The Bush administration's overthrow of Saddam Hussein, U.S. support for both the 2006 Lebanon conflict and the bombing of the secret Syrian nuclear reactor were all events that aligned U.S. and Israeli interests. There were some misgivings about allowing Palestinian elections and in supporting democratic movements in Egypt, but for the most part Israeli governments were comfortable with their relations with the U.S.

However, relations with the Obama administration have been strained. Obama's Hamiltonian approach is much less aggressive in defending the area's democracies and more interested in reducing tensions. He tried to improve relations with Iran early in his administration, only to be rebuffed by the mullahs. Since then, he has been steadily increasing sanctions on Iran and it's clear the U.S. does not want Iran to develop a nuclear weapon. At the same time, Obama's Jeffersonian streak has made it abundantly evident that the president has little desire to engage the region militarily. As U.S. energy production rises, the incentive to protect oil flows out of the region becomes less of an American concern.

Israel is clearly feeling abandoned. The fall of Mubarak, which may have been unavoidable, has clearly rattled the region. Israel now fears it must defend its southern border; this hasn't been a concern since the 1978 peace accords. Obama's pivot to Asia adds to Israeli worries. *Unfortunately, the more Israel is isolated, the greater the odds that it may take unilateral action to defend its interests.*

Egypt: The U.S. has consistently supported the Mubarak government since the aftermath of the 1973 Yom Kippur War and the assassination of Anwar Sadat. This support was in part due to the Cold War. Egypt had been a Soviet client state under Gamal Nasser but Anwar Sadat had concluded that the Soviets were not reliable partners. His decision to change superpower allegiance, which occurred after the 1973 war, was a significant diplomatic victory for the U.S. The subsequent treaty between Egypt and Israel has been credited with the lack of regional conflicts since the deal was struck.

When the Arab Spring began to spread, it was evident that Egypt would not avoid unrest. As we have detailed before (see WGR, 8/20/12, [The Muslim Brotherhood's Long Grind](#), and 6/25/12, [Counterrevolution in Egypt](#)), the Egyptian military was uncomfortable with Mubarak's attempts at dynastic succession and was looking to oust him. The Arab Spring provided an excuse. Thus, it was less of the U.S. abandoning Mubarak as it was his overstaying his role. However, the subsequent democratization is fraught with risk. Recently, President Obama refused to confirm that Egypt remains a U.S. ally—instead, he suggested the Egyptians were still working that out.

If Egypt falls out of the ally camp, Israel will face a major problem—it will then be forced to defend its southern border. An Egypt no longer aligned with U.S. interests could increase the odds of regional conflict.

Saudi Arabia: The U.S. and Saudi Arabia have had close ties since WWII despite vastly different political systems. Saudi Arabia is a hereditary kingdom. The House of Saud has ruled the country since inception. It is socially conservative and undemocratic. It is also the world's largest oil exporter. During the Cold War, Saudi Arabia was a bulwark against socialism and communism in the region; in fact, it's a classic example of the U.S. allying with a non-democratic regime to further American interests. At the same time, the U.S. became steadily more dependent upon Middle East crude oil and so a symbiotic relationship emerged. The U.S. would protect Saudi Arabia to ensure global oil supplies, and the Saudis would conduct their oil production policies in ways that supported U.S. interests.

The Saudis were clearly uncomfortable with the Bush administration's removal of

Saddam Hussein from Iraq and the clarion call for democratizing the region. Such views were antithetical to the royal family's system of governance. Conditions have been mostly stable under President Obama. The Saudis would like the U.S. to prevent Iran from gaining a nuclear weapon but appear reluctant to openly support a military solution.

America's energy revolution is a direct threat to Saudi Arabia's role in global energy supplies. If the U.S. decides the cost of defending Middle East oil supplies isn't in its interests, the Saudis will need to find a new defender or eventually submit to Iranian dominance.

Ramifications

U.S. foreign policy remains in flux because there is no consensus about America's role as superpower and how it should be

implemented. This lack of consensus remains a major issue—in fact, we believe the current secular bear market in equities is mostly due to this lack of consensus about our superpower role.

There are no specific market recommendations that come from this week's analysis, other than to remain bullish real assets as they stand to benefit from the aforementioned uncertainty. However, if and when the political class develops a working consensus on how (or whether) to manage our superpower status, we would expect a secular bull in equities to emerge.

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