

# America's Energy Future

**WASHINGTON** – The good news is that America is now among the top three world fossil fuels producers. The bad news is that increased US fossil fuels production will create a disincentive in exploring and then deploying needed alternatives to fossil fuels.

## **The real challenge**

The energy policy challenge for the US –both the government and the private sector–is to look at reliance on abundant domestic oil and gas as a “necessary evil”. Indeed, these are energy sources that we badly need right now. However, as we take advantage of the fossil fuels bonanza, we must be steadfast and relentless in the all out pursuit of emissions free energy alternatives. If we do not want to cook up the planet, our long term future has to be with clean energy sources.

## **The fracking revolution**

That said, if you did not know anything about the immense threat represented by man-made global warming and therefore you had no reason to doubt that fossil fuels are the best answer to America's massive energy needs, then you would be reassured by recent trends. Indeed, thanks to abundant domestic oil and gas, this is a great season for the American economy and for the US fossil fuels industry.

Thanks to hydraulic fracturing technologies, (better known as “fracking”), and horizontal drilling scores of US energy companies, large and small, in the last decade managed to tap into vast energy resources, (located mostly in Texas, Oklahoma, North Dakota, Louisiana, and Pennsylvania), until recently deemed to be uneconomic because of the technical challenges represented by drilling into shale formations in order to free up the hydrocarbons trapped in shale.

Well, thanks to old-fashioned Yankee ingenuity, the technical challenges were overcome –with spectacular results. Thanks to fracking, US oil and natural gas production jumped, this way transforming not just the American energy market, but the entire dynamics of global energy markets.

## **US is ahead**

Let's take stock. America is now the number one world producer of natural gas, and poised to surpass Russia as the biggest oil producer in 2019, having already overtaken Saudi Arabia. (This forecast may change, of course, because both Russia and Saudi Arabia have spare capacity that could be easily tapped, this way increasing their production).

A mere decade ago, the idea of a massive scale US fossil fuels renaissance would have been labeled a silly fantasy. Any reliable forecast would have pointed out that the US had used most of its known fossil fuels reserves.

In 2008 the consensus was that, going forward, America could have powered itself only via massive additional energy imports, (both oil for transportation and natural gas for power generation). This unpleasant assessment created unease in many quarters, given the enormous cost involved in importing most of the hydrocarbons needed to power America, the second largest energy consumer, (after China), and given the negative national security implications of utter dependence on foreign suppliers for such vital commodities.

## **The impact of fracking**

Well, today we have a completely different scenario. While America continues to rely on some oil imports, the percentage has shrunk substantially. Furthermore, today the national security concerns are far less significant, because our oil imports come mostly from our close neighbors: Canada and Mexico, therefore these supplies are relatively secure. Which is to say that America is now close to achieving what the

experts call “Hemispheric Energy Independence”. Indeed, as most of our additional energy needs come from the immediate neighborhood, we no longer rely on a significant scale on distant and potentially unreliable suppliers.

And it gets better. In fact, while we still import some oil, now we also export oil, and growing amounts of oil products. And the quantities of our exports are growing.

### **The real challenge is to develop emissions free energy sources**

That said, this positive energy outlook is deceptive. This fossil fuels renaissance is not the end of the story when it comes to energy sources and their impact on the environment. We know that continued reliance –on a massive scale– on burning fossil fuels will contribute to additional greenhouse gases emissions and therefore to the exacerbation of global warming.

Of course, we know that many companies and scientists are busy trying to find workable –that is technologically viable and cost-effective– alternatives to reliance on hydrocarbons. But this is not easy.

### **Bad policies will not help**

And it seems that policy-makers are approaching the problem in the wrong way. The prevailing policy choice is to “force” the adoption of currently available renewable energy solutions –today– by creating mandates for renewable energy usage, and tax subsidies for wind, solar and electric vehicles. In my view, while these policies of mandates and subsidies may be well intentioned, they will not succeed.

***The fact is that new forms of energy production and new types of vehicles will be spontaneously adopted on a massive scale only once they prove to be cost-effective, without the distorting incentives of mandates and tax subsidies.***

## **Fund more R&D**

Public policy can help not via subsidies but by providing significantly more funding for additional research in alternative, emissions free, fuels. We simply do not know what the future ideal new energy mix will be. It is too early to say.

Electric vehicles look very promising. And yet manufacturers still need to find ways to make cheaper, more energy-efficient, and lighter batteries. The cost of wind and solar has gone down significantly. But we still do not have ways to store the electricity they produce so that it can be used when the wind is not blowing and the sun is not shining.

In other words, still plenty of work to do before we can reliably move away from hydrocarbons for both power generation and transportation.

## **Fast track the development of clean energy sources**

So, here is the challenge for America. By all means, let's take advantage of the incredible fossil fuels renaissance, simply because today there is no reliable alternative technology that could be deployed on a massive scale.

But let's not fool ourselves. Oil and gas are not and should not be looked at as long term energy solutions. The long term solution has to be in emissions free, clean energy sources –whatever they may be. With this goal in mind, let us unleash American ingenuity so that we can get to a reliable, and economically viable post-fossil fuels era as soon as possible.

We all love our planet. Let's do our best to preserve it.

---

# Manafort Indictment Is Just The Beginning

**WASHINGTON** – Russia probe Special Counsel Robert Mueller indicted former Trump insider Paul Manafort and his associate Richard Gates in connection with his broad mandate to investigate alleged efforts on the part of Russian operatives to manipulate the 2016 elections. Mueller's investigation is also supposed to provide conclusive evidence as to whether or not there was any "collusion" between Russian operatives and individuals working for the Trump campaign.

## **No Russia connection**

Well, if you were expecting explosive developments coming out of these indictments, you will be disappointed. Manafort and Gates are accused of several serious financial and other crimes. But there is nothing in the indictment that alleges actions or conspiracies related to possible connections between Russia and the Trump campaign. Zero. Absolutely nothing.

Assuming that the charges can be proven in court, Manafort and Gates are two sleazy and clearly a bit too self-confident "Beltway Bandits" who sold their services to people close to then Ukrainian President Victor Yanucovych. Bear in mind that such an activity is not illegal.

## **Tax fraud and money laundering**

What is illegal is to conceal the profits of such consulting activities, while also concealing the nature and full scope of the work done on behalf of a major foreign client.

In other words, even assuming that Manafort and Gates are guilty, (for the record, both of them pleaded “not guilty” when they appeared in front of a judge on Monday), they would be guilty mostly of tax evasion and money laundering –serious offenses, no doubt; but completely disconnected from the main thrust of Mueller’s investigation about alleged collusion between the Trump Campaign and Russian operatives.

### **What is Mueller up to?**

So, what do we make of this? First of all we should understand that this is by no means the end of Mueller’s investigation. At most, this is the end of the first act. We are still at the beginning of a long process.

If this is indeed so, then the money laundering and tax evasion charges against Manafort and Gates, apparently disconnected from the main thrust of the Russia inquiry, acquire a new flavor. If Special Counsel Mueller has reason to believe that Manafort knows something important about an alleged Trump-Russia collusion, then the indictment against him is in fact a form of heavy psychological pressure.

### **Pit pressure on the small fish**

It is quite common for American prosecutors to go with full force against second or third tier players in a criminal investigation in order to force them to collaborate with them in exchange for leniency. Keep in mind that, if proven guilty, Manafort could go the jail for many years. If he fully cooperates with the authorities, his personal future becomes a lot brighter.

Is this Mueller’s game plan? Yes, it probably is.

### **A major investigative effort cannot end with Manafort**

Indeed, it is most unlikely that Robert Mueller, a tough, seasoned law enforcement official, an experienced lawyer and a

former FBI Director, assembled a large team of important lawyers and prosecutors just to investigate Paul Manafort –a questionable character whose crime seems to be that he tried to hide a few millions of dollars (of legitimate earnings) from the IRS. Therefore, it cannot be that this is the end of the probe. It would be wise to stipulate that with this indictment Mueller is just getting started.

### **Will they find anything?**

That said, this does not guarantee that Mueller, despite a serious effort to determine whether crimes were committed, will find anything. Investigating potential wrongdoing and actually finding any are two different things.

---

## **Will Washington Give Arms To Ukraine?**

**WASHINGTON** – Back in February 2014, right after a popular rebellion ousted pro-Russian President Viktor Yanucovych, this way taking over political control in Kiev, the then Obama administration was long on promises of aid and support; but very short on delivering almost anything of real value to the new supposedly pro-American and pro-European Ukrainian government.

### **Economic basket case**

On the economic front, Ukraine was then (and still is today, by the way) a virtual basket case: an impoverished, non competitive, underperforming economy, poisoned by systemic corruption. On the military side, whatever your political preference on who is to blame for the ongoing fighting between

government forces and pro-Moscow ethnic Russians in Eastern Ukraine, back in 2015 it became obvious that Washington was not going to support the new anti-Russian Kiev government in any meaningful way.

### **Non lethal military aid**

President Obama offered some non lethal equipment, (such as radar, night vision goggles), MREs, (military food rations), blankets, uniforms, and socks, (yes, socks), to the Ukrainian army –but no real weapons.

### **New Trump approach?**

Now, with Trump in the White House, most recently the noises have been changing. It is no accident that U.S. Secretary of Defense Mattis recently made a high-profile visit to Kiev on that country's Independence Day. During public celebrations which included a military parade, Mattis stood at the side of Ukrainian President Petro Poroshenko. Mattis trip to Kiev followed another important visit to Ukraine by Secretary of State Rex Tillerson in July.

In public remarks in Kiev Mattis stated that the Pentagon is reviewing options that could include supplying real weapons to Ukraine; including anti-tank Javelin missiles, and possibly anti-aircraft missiles.

Of course, Mattis insisted that this American hardware –assuming a US Government decision to send it to Kiev– falls under the category of defensive weapons. America's stated goal –again, assuming a green light on this– would be to give Ukraine the tools to defend itself from Russian attempts to unilaterally change borders in the East.

Mattis justified any possible U.S. policy shift regarding weapons sales to Ukraine by pointing out that Russia is not living up to its commitments under the Minsk agreements aimed at solving through peaceful means all issues related to the



future of ethnic Russians in Eastern Ukraine.

## **Policy shift**

Well, should these supplies of U.S. weapons to Ukraine actually take place, this would indicate a major policy shift from the “do nothing” Obama years. For several years, Obama’s deeds (forget his speeches in support of Ukraine) indicated that America would not get involved, even indirectly, in any conflict involving Russia in Eastern Ukraine, a region with deep historic, ethnic and religious ties to the Russian state. With Obama in the White House, Ukrainian President Petro Poroshenko realized that he was on his own.

Now Donald Trump is President. So, a new more muscular approach to Ukraine in Washington vis-a-vis Russia? We shall see. Despite what Secretary Mattis just said in Kiev, I am inclined to believe that the Trump administration does not want America enmeshed, even if indirectly, in yet another, almost impossible and probably endless conflict, far from home.

## **A crowded national security agenda**

Let’s look at the long “to do” list for the U.S. military, when it comes to hot spots. Washington is and will be engaged in the Middle East, (Iraq and to a lesser extent Syria) for quite some time. The President just announced a more muscular and open-ended policy towards Afghanistan, with the stated goals of defeating the Taliban insurrection. And then you have creeping and potentially explosive crises with North Korea, Iran, and may be with China on the South China Sea. Based on recent Washington moves and public pronouncements, we may also have to add Venezuela to this already long and challenging national security agenda.

Does Washington want to add an insoluble conflict in Eastern Ukraine to the headaches list, while cash strapped America has a hard time keeping up with existing and potential

commitments? I do not think so.

---

# OPEC Defeated By US Shale Oil?

**WASHINGTON** – It seems that American shale oil producers, an assorted group of small and medium-sized firms which gained strength in the last decade and are now operating in many states, have become the swing producers in a position to influence global oil prices. How did that happen?

## **Cutting costs**

U.S. shale oil production is relatively new. At the beginning of the “shale revolution” the cost of extracting oil from shale formations was quite high. But now they have come down significantly, mostly because of aggressive cost cutting measures adopted in response to OPEC imposed low prices. (More on this below). On account of this incredibly fast makeover, today a large number of the shale companies, especially those operating in West Texas, are profitable even with oil well below \$ 50 per barrel.

Most interestingly, shale oil producers now have the ability to ramp production up and down with relative ease, this way adjusting to global market conditions, without causing major disruptions to their operations. They can increase output when prices are higher and cut back when prices are too low. Conventional oil producers do not have this option.

With crude around \$ 50 per barrel, it is good news to have a substantial number of U.S. based oil producers supplying the domestic market, while making a profit even in this new era of

low prices. This is a big plus for the American energy sector, and for all American consumers of energy products.

### **OPEC reactions**

With good cause, OPEC saw the spectacular increase of U.S. production caused by the large scale exploitation of abundant shale oil reserves (an additional 4 million barrels a day in just a few years) as a threat to its market dominance.

Hence a very simple strategy aimed at eliminating the American shale oil threat. The plan was to deliberately over produce, this way causing a global glut and consequently falling oil prices. The bet was that a long stretch of low prices would kill the U.S. high cost shale newcomers who –according to all analysts– could not survive with oil below \$ 60 per barrel.

After having eliminated the U.S. menace, OPEC would go back to business as usual, reaffirming its position as the oil cartel which alone has the power to dictate prices by manipulating supply.

### **The strategy failed**

But it did not work out this way. Not by a long shot. And this is because the U.S. shale producers, surprising everybody, managed to quickly adopt major technological improvements which increased well productivity, while aggressively cutting other production costs, this way staying profitable even with oil below \$ 50 per barrel.

All in all, the Saudi/OPEC plan failed. While several marginal U.S. shale producers could not make the adjustments fast enough and went bankrupt, most of the shale sector survived the OPEC imposed squeeze on profits.

### **The high cost of low prices**

In the meantime, the extended period of low prices hurt OPEC producers very badly. They saw their precious oil based

revenue dwindle rather dramatically. It soon became clear that most OPEC countries could not sustain an extended period of low prices.

Therefore, led by Saudi Arabia, the OPEC cartel, (this time working in concert with non OPEC Russia), tried to change strategy and jack up prices by cutting production, this way eliminating the oil glut they had created.

But this new approach is also failing. As oil prices go up on account of OPEC/Russia production cuts, the U.S. shale companies ramped up production, this way offsetting the OPEC/Russia cuts. As OPEC imposes cuts on its members, the U.S. shale sector produces more, while Saudi Arabia is denied the revenue gains that should have resulted from production cuts. So, the OPEC strategy aimed at eliminating the U.S. shale threat to its market dominance did not work.

### **Loss of precious revenue**

That said, the sustained "attack" against US shale has been horribly expensive for the OPEC cartel members. Years of low prices hurt major Middle Eastern oil producers, (not to mention Nigeria and Venezuela, and non OPEC Russia, among others), in a significant way.

Most of these countries rely heavily on oil revenues to finance all or most public spending. Many of them had adopted national spending programs and budgets which assumed oil prices at \$ 90, or \$ 80 per barrel.

This means that all of them are facing fiscal problems or outright crises. Lacking oil revenue in the expected amounts, they have to cut spending and borrow more in international financial markets. But this is not an easy adjustment.

For example, in Saudi Arabia major spending cuts caused by declining oil revenue could lead to unprecedented political problems down the line. Almost the entire Saudi population

depends one way or the other on direct or indirect government subsidies funded entirely via the oil revenue.

### **Reforms will take time**

We know that the Saudi Monarchy is now openly committed to a major economic and fiscal transformation which will (hopefully) reduce and eventually eliminate all state subsidies, while promoting plans aimed at diversifying the economy. But, even in the best of circumstances, this is going to be a long journey. Cutting government largesse too much too soon could be politically dangerous.

Bottom line; U.S. shale wins; OPEC cartel and its new allies lose.

---

## **US Enacted Sanctions Against Russia**

**WASHINGTON** – It should not come as a surprise that Russian President Vladimir Putin decided to retaliate in kind, after the US Congress passed a bill (subsequently signed into law by President Trump) that includes tough economic sanctions against Russia, as retribution for Russia's alleged interference in the US 2016 elections, and for unrelated issues pertaining to its meddling in Ukraine and more.

### **Punish Russia**

Back in 2016, then US President Barack Obama ordered punitive

measures against Russian diplomats stationed in the USA based on US intelligence findings that Russia had actively attempted to interfere in the U.S. elections via hacking and other cyber attacks. The sanctions included the expulsion of a number of Russian diplomats. These sanctions were included in a presidential directive issued by Obama. As such they could have been rescinded by the new president. But now the tougher sanctions have been enacted by the Congress and therefore President Trump will not be able to eliminate them or modify them unilaterally.

### **Putin's reaction**

After the US Congress passed this law containing sanctions, by a huge margin in both houses, Putin decided to get even, as he realized that these are "veto proof" majorities. In other words, even if he wanted to, a more conciliatory President Trump could not have blocked this legislation.

Putin's objective seems to get even. In order to bring the number of US diplomatic personnel in Russia down to the same level of what Russia is allowed to have in the United States, (455), 755 American diplomats will have to leave Russia. This is a major cut.

### **Impact**

Will this move affect Washington Moscow based diplomats' ability to engage Russia in a meaningful way? Probably yes, even though it is not clear at this time which sectors of the bilateral relationship will be mostly affected by these significant cuts.

Most of all, this sequence of tough actions and counter actions indicates that US – Russia relations are in very bad shape, without any signs of improvements.

### **No Ambassador**

To make things worse, keep in mind that the U.S. currently has no Ambassador in Moscow. Former Utah Governor and now Chairman of the Atlantic Council Jon Huntsman has been nominated by President Trump to fill that post, but he has not yet been confirmed by the Senate.

Once confirmed, will Huntsman, an astute businessman who also served as U.S. Ambassador to China, be able to help turn things around? There are at least some areas in which Washington and Moscow can find common ground. At some point, there will have to be some kind of agreement on the future of Syria. There is also an opportunity to convince Russia that it is not to its ultimate advantage to be on the same side of Iran in the Middle East.

### **Common front on North Korea?**

And finally there is the looming threat of North Korea's long-range ballistic missiles, soon to be armed with nuclear warheads. North Korea's threat is clearly aimed at the USA and its allies, South Korea and Japan. But Russia cannot be too happy with the idea of an unstable regime capable of launching nuclear armed Intercontinental Ballistic Missiles, (ICBMs) at its door step.

### **The Russia probe cloud**

That said, for the bilateral relations climate to improve, the whole "Russia probe" now led by former FBI Director Robert Mueller must be concluded in Washington. Indeed, whatever the outcome of Mueller's investigations, only after he is done it will be possible to go back to a "normal" dialogue between Moscow and Washington.

That said, in the end, both sides must know that there is nothing to be gained when the two most important nuclear powers on earth do not engage with each other. Nuclear war between Russia and America is a very, very remote possibility. But such a possibility may be increased by misunderstandings

and misperceptions.

Notwithstanding the sharp differences between the two countries, open lines of communication are an essential tool that will help prevent fatal errors. And both sides should know that they need competent diplomats in each other's capitals to keep those lines open.

---

## **Facing Low Oil Prices Exxon Is Looking For New Strategies**

**WASHINGTON** – Major oil companies are in deep trouble. Too much global supply means lower crude prices. If this continues –and there is every little evidence that it will not– this means that large exploration projects in far away lands that typically require large up front investments may no longer have economic justifications. Simply stated, these projects mean too much money invested now for potentially weak or even negative returns years from now.

### **Move into shale**

Hence the decision just announced by the new Exxon leadership to invest more in the U.S. shale oil sector. This move would require lower up front capital investments, as opposed to the traditional focus huge on large “conventional oil” exploration ventures, many of them off shore operations, which may cost billions over a number of years before they become operational. It is hoped that this move into U.S. shale would create greater operational flexibility, since shale wells do not cost that much and can be “turned on or off” fairly quickly, depending on global demand and supply fluctuation.



This is how *Oil & Energy Insider* (March 3, 2017) describes the move:

*“Exxon goes big on U.S. shale. New ExxonMobil (NYSE: XOM) CEO Darren Woods gave his first presentation to investors this week, where he outlined a strategy to step up investment in U.S. shale. Exxon will allocate a quarter of its 2017 budget to short-cycle shale projects. The move will help the oil major navigate an uncertain market, as cash can be returned to the company much quicker from shale drilling than it can from the major offshore projects that Exxon has long been accustomed to. Still, Exxon will move forward aggressively on its large offshore discovery in Guyana, hoping to bring it online in the next few years. “*

### **Diversify**

So, here is the thing. Exxon is trying to diversify its energy portfolio. It will continue work on existing “conventional oil” projects. But it will try to mitigate the risks associated with large commitments to new expensive projects in a volatile and downward trending crude prices environment by buying more into the less risky U.S. shale sector.

I say smart move. However, it may just not be enough. In part thanks to the U.S. shale oil revolutions that began in earnest about a decade ago, there is just too much crude supply world-wide.

### **It may not work**

Hard to believe that OPEC’s oil price support efforts –its decision to cut production, somewhat– even if aided by similar production cuts enacted by Russia and other non-OPEC producers, will manage to put a real floor on oil prices.

Good luck to Exxon. It really needs it in order to protect its position as an American oil giant.

---

# Trump's Remarks On NATO

**WASHINGTON** – Republican presidential nominee Donald Trump made headlines in Europe when he declared that America would intervene to assist a European NATO member under attack only if this ally has paid its full share of the bill for the common defense. This is unprecedented. No U.S. leader or aspiring leader has ever publicly questioned U.S. determination to intervene on behalf of a NATO member in case of hostile actions against it.

## **NATO's credibility at stake**

NATO's credibility rests mostly on the U.S. unconditional commitment to defend Europe. If future U.S. policy indicates that this blanket commitment is subject to conditions, this may encourage aggression, or at least unfriendly actions on the part of Russia, always keen to exploit divisions between the U.S. and its European allies.

Here is what Article 5 of the NATO Treaty says: *The Parties agree that an armed attack against one or more of them in Europe or North America shall be considered an attack against them all and consequently they agree that, if such an armed attack occurs, each of them, in exercise of the right of individual or collective self-defence recognised by Article 51 of the Charter of the United Nations, will assist the Party or Parties so attacked by taking forthwith, individually and in concert with the other Parties, such action as it deems necessary, including the use of armed force, to restore and maintain the security of the North Atlantic area. [Emphasis added].*

## **Unconditional pledge**

It is clear that the NATO Treaty makes no mention of added conditionalities. It clearly stipulates that an attack against one NATO member shall be considered by all the others as an attack against all. Therefore, technically speaking, Trump's remarks are wrong, and frankly ill-advised. Indeed, Trump's glib remarks about circumstances that he would look at as president before deciding whether or not to come to the help of a European NATO country in peril are most inappropriate. The U.S. is bound to help a fellow NATO member because of a Treaty obligation. There is no gray area.

That said, Trump, while wrong on his interpretation of the Treaty, diplomacy and more, is actually right on substance. Let me explain.

### **Not paying for the common defense**

In his usual inelegant but (sometimes) effective style, Trump pointed out what every U.S. defense official knows but will not say so bluntly, especially in public. It is a well-known fact that Europe is not paying its fair share of the common defense.

Ever since the end of the Cold War, European defense budgets have been (with very few exceptions) in free fall. The official pledge taken by all NATO countries to invest at least 2% of their GDP on defense has been broken by most of the Alliance members. There is no sign that all or at least most Europeans will soon be in compliance. Again, these are undisputed facts.

U.S. and NATO officials have repeatedly noted (albeit using muffled language) this huge gap between promises and actual defense spending. President Obama himself expressed his distress while contemplating European allies who do not spend even the bare minimum for the common security.

### **Trump said what most defense officials believe**

Given all that, what Trump said is very much in line with what most members of the U.S. national security establishment know and say –but mostly in private meetings. The huge difference is that Trump publicly and bluntly said that America will not come to the rescue of delinquent members. And this is news.

Of course this unprecedented statement by someone who may be the next U.S. Commander in Chief come January 2017 made headlines, especially in the front line NATO countries in Eastern Europe that are directly facing Russia. (Think Latvia, Estonia, Lithuania and Poland). By saying to the Europeans something that amounts to *“First pay up, and then we shall see what I can do for you”* , Trump created nervousness and potentially contributed to enhancing instability in Eastern Europe. Given what he said, will Trump’s America come to the rescue of Estonia in case of an attack? May be not. His statement allowed all sorts of bad conjectures. This is why it was most ill-advised.

### **Pledges should be honored**

That said, on the broader issue of lack of a European serious commitment to the common security, Trump is basically right. Throughout its long history that goes back to 1949, NATO has always been an unequal arrangement, with the U.S. doing the heavy lifting when it comes to defense spending.

But now we are at the point in which many European members of this old security pact contribute little to the common defense, some almost nothing; with the hope that they can get away with routinely unfulfilled pledges. This has to stop. Otherwise this old alliance turns into a joke.

Trump pointed out this huge gap between promises and actions. Again, really wrong on form; but right on substance.

---

# Oil Prices Will Stay Low

**WASHINGTON** – I am not at all surprised to see that the Doha oil talks aimed at finding an agreement about stabilizing output among major producers failed. Saudi Arabia would have liked to freeze production at current levels, which means at the Kingdom's highest level in modern times, (more than 10 million barrels a day).

## **No deal with Iran**

However, it was obvious that Iran could not possibly have agreed to freeze its own production at current levels. Tehran wants to ramp production up to its pre-sanctions peak. And how could anybody have assumed anything else? Of course the Iranians want to increase their oil production and regain lost market share.

Therefore, no deal. As a consequence, oil prices are once again headed lower. There was a time in which low prices were really good news in the West. But now it is a mixed bag, especially in the U.S.A.

## **Oil was good news in America**

And how so? Well, because “unconventional oil” exploration and recovery –we are talking about shale oil– has been one of the brightest spots in the otherwise timid U.S. post 2008 economic recovery. Tens of thousands of new, high paying jobs made things better in many oil-producing states, from North Dakota to Texas.

## **U.S. oil in recession**

But now, lower prices are bad news for a sector composed

primarily of small to medium-sized companies, many of them under capitalized and highly indebted.

For small U.S. energy companies it was easy to get bank loans when oil was at \$ 100 a barrel, and therefore future profitability was not in question. But now it is at \$ 40, possibly headed even lower. And therefore the U.S. oil patch is in a recession. Moody's just downgraded many U.S. energy companies. Tens of thousands of good jobs have already been lost, with more losses to come. This will have a nasty effect in the affected regions, and some negative impact on the overall American economy.

## **Resilience**

Things are not awful across the board. In fact, the shale oil sector has proven to be much more resilient than most analysts had predicted. A combination of aggressive cost cutting and vastly improved production technologies allows at least some shale oil companies to stay profitable even with oil at \$ 40. But this is only about some companies.

The other good news is that shale oil production is relatively flexible. It is not too complicated to shut down wells and then start production again in better times, when prices have recovered. Still, idled wells do not generate any income. Weak producers close down, or go bankrupt. Some may be bought by bigger competitors with deeper pockets.

Sure, at some point this cycle will end. Saudi Arabia cannot afford huge budget deficits for ever. Its bizarre policy of keeping production at these levels, (this way depressing prices), while the Kingdom needs to get into debt in order to fund current government operations (and that includes almost the entire country getting some money from the Royal Family) will end. But it will take a while. In the meantime, hard for U.S. oil workers to find other jobs that will pay so well.

## **Good news for consumers**

That said, depressed oil prices, while they hurt an important sector of the U.S. economy, on balance are positive. America is still a major net oil importer. Lower prices translate into a smaller balance of trade deficit. And for the average consumer cheap oil must be good news. Who can complain when finding lower prices at the pump? For tens of millions of American drivers low gasoline prices are equivalent to a tax cut. More money in their pockets.

## **The future of oil**

That said, going forward, the real challenge for the U.S. oil sector is not Saudi Arabia flooding the global market. The real challenge will be new, non oil-based technologies.

Despite its uncertain beginnings, the electric car sooner or later will become economically viable. Elon Musk of Tesla has bet everything on making affordable, mid-sized electric vehicles, EVs. We are not there yet. Money losing Tesla may be will fail. But even if it does, others will follow. And when someone will hit the sweet spot with easy to recharge, attractive EVs with a good range that the average consumer can afford, it is good-bye to oil.

## **Saying good-bye**

And that will be a real good-bye. It will not be about temporary sector recessions, or fluctuating prices due to Saudi shenanigans. It will be the end of the oil era.

Here in the U.S. at least someone will be prepared for this gigantic transformation. But economies such as Russia, Venezuela and Saudi Arabia which depend entirely on oil revenues to fund "everything" will be in deep, deep trouble.

All told, better to be in America. This society, with all its problems, is still capable of promoting change while embracing it when it comes.

---

# NATO Is Indeed Obsolete

**WASHINGTON** – The Atlantic Alliance, or NATO, is an old security arrangement (founded in 1949) that no longer has a clear purpose. In his habitual blunt style Donald Trump, the leading candidate for the Republican nomination in the upcoming presidential elections, recently said that NATO “is obsolete”. In fact, while Trump is certainly not a leading foreign and defense policy expert, he is mostly right.

## **No mission**

Indeed, what is NATO’s mission today? And, related to that, what means does NATO have at its disposal to execute this mission? On the first question, now that the Soviet Union is gone, the mission of a military alliance created to face it is murky. On the second question, NATO has very few military means, as defense budgets in most members states have been shrinking, year after year. (In the US, despite cuts, the Pentagon’s budget is equal to 3.6% of GDP. Germany’s defense spending is 1.2% of GDP. In Belgium it is 0.9%, in Spain 0.9%, in Italy 1.0%)

## **The old rationale**

The initial rationale for the creation of Atlantic Alliance, the very first peace time integrated military structure, was the Soviet threat against Western Europe at the beginning of the Cold War. Europe’s proximity to the expanded Soviet Bloc, (it included all of Eastern Europe and East Germany), combined with Europe’s economic and military weakness, (due to the lingering effects of the destruction caused by WWII), prompted America to commit itself to the defense of Europe. Hence the creation of NATO in 1949, with tens of thousands of US troops



permanently stationed in West Germany and elsewhere in Europe, with tanks, guns, aircraft, and nuclear weapons.

### **No more Soviet Union**

But then the Berlin Wall came down in 1989, and the Cold War ended because the Soviet Union imploded shortly thereafter. The Warsaw Pact disappeared. The New Russian Federation lost control over all of Eastern Europe. Germany was reunified. Moscow also lost large pieces of the old Soviet Union, including Ukraine, Belarus and the three Baltic States.

### **NATO is still here**

However, NATO was not disbanded in response to the withering away of the old existential threat to Europe's security. Perhaps it was prudent to keep the old institution in place, just in case. And may be it was a good idea to allow the former members of the Soviet Bloc to join NATO, even though the new Russian leaders saw this as an eastward expansion of NATO, and therefore a potential threat to them.

Still, be that as it may, an Alliance's strength is based not on how many members it has, (28 countries), but on its shared purpose and on its ability to deploy the military tools to secure them. And here NATO shows its inherent weakness. No clear purpose, and drastically reduced military forces.

### **A new threat from Russia?**

If we fast forward to today, many will argue that NATO is still quite relevant because Putin's Russia has demonstrated to have aggressive tendencies. in 2008 it went to war with Georgia. More recently it grabbed Crimea, a piece of Ukraine. Many say that, if unchecked by NATO, Russia would keep moving westward into Poland, the Baltic States, and may be beyond.

I believe that Russia is mostly interested in neighboring regions that historically were part of Russia. The idea that

Ukraine is just the appetizer for a famished Russia, while Portugal or at the very least Germany will be the pudding seems quite preposterous.

### **Inadequate military means**

But even if we assume that this unlikely theory of Russian resurgent expansionism were in fact correct, then where is NATO's demonstrable military deterrent to counter it?

Indeed, if NATO is still standing and operational because Russia is a threat to its members, then we should also see robust defense spending aimed at creating a war fighting force that can credibly deter aggression by showing Russia that any threat to NATO members' security would be met by a formidable force.

### **Unfulfilled commitments**

Well, it is not so. Because of economic weaknesses and competing social spending priorities, most European countries have allowed defense spending to go into free fall. In theory, all NATO members are unequivocally committed to spend at least 2% of GDP on defense. In practice, only 5 countries, out of 28 NATO members, have honored this pledge. Most of the others spend around 1% of GDP on their military, or less. This is half of what they promised. If you take the U.S. out, The European members of NATO have only limited air power. Practically no sizable expeditionary forces. No meaningful airlift capabilities.

During the Libya mission, confronted with a third-rate enemy, the French and British air forces run out of smart bombs only a few weeks into the conflict. Even that limited operation could not have been executed without US support in key areas such as air defense jamming and suppression, and overall logistics.

### **Not serious**

Quite frankly, this reluctance to field credible military forces makes NATO into a joke. You cannot say that we have to keep NATO together and strong in order to face an aggressive Russia and then have a virtually disarmed military alliance on account of the fact that nobody wants to spend diminished revenue on defense in economically weak countries.

### **Limited support to US-led operations**

As far as what used to be called “out of area” (that is possible threats outside of Europe) NATO does not have clear objectives and a credible strategy to achieve them. Yes, NATO countries participated in the difficult Afghanistan and Iraq conflicts. NATO countries intervened in Libya. All true. But in all these efforts (Libya is a partial exception) the US was leading, and selected NATO countries followed.

At present, while the US (with little enthusiasm) is leading a military effort against ISIL in Iraq and Syria, some NATO countries are contributing some aircraft to the air war. But there is no clear NATO policy. And certainly no commitment by all NATO members to participate.

### **No clear purpose**

So, here is the thing. With the end of the Cold War, NATO lost its original purpose. What we have now is murky strategic objectives and lack of military means to accomplish even slightly ambitious missions.

The NATO Alliance is now mostly a talking shop with too many members who contribute almost nothing of value. While something may change after the US elections, it is unlikely that anybody will ask the hard questions about purpose, strategy and means.

### **No debate on difficult issues**

Nobody wants to have an open debate within NATO that would

inevitably expose deep political divisions and embarrassing military vulnerabilities. For this reason, I suspect that the old institutional framework will be left as is, even though most analysts recognize that it is obsolete and virtually meaningless when it comes to core military capabilities.

In the future, if we are lucky, the US may be able to create *ad hoc* “coalitions of the willing” and work selectively with the 4 or 5 NATO countries that still have modern armed forces.

---

## **No Deal To Cut Oil Production – Still, Russia And Saudi Arabia Are Talking**

**WASHINGTON** – Saudi Arabia and Russia are the leading world oil producers and exporters. Energy Ministers from both countries met in Qatar to discuss a possible agreement leading to production cuts. They were joined by Qatar and Venezuela.

### **No deal**

But nothing really happened. The only “agreement” reached by the two oil exporting giants, (the other two participants are not very consequential), is to freeze their production at January levels, an all time high. So this does not mean much.

Besides, the agreement is contingent on Iran and Iraq not raising their production beyond this level. And this is almost impossible. Iran wants to ramp up its production to pre-sanctions levels. This translates into *adding* another one million barrels a day beyond the 400,00 it has already added. Iraq desperately needs cash to finance its counter-insurgency

efforts against ISIL in the North West of the country. So, expect no production freezes from these two key OPEC members.

### **Too much oil**

The current oil production glut, intentionally allowed by Saudi Arabia when it refused to cut production when confronted with lower prices in 2014, is hurting both Russia and Saudi Arabia. And, as noted above, the situation is about to get worse. With the lifting of international sanctions, Iran is now free to export more to Europe and elsewhere. We can expect more than 1.4 million barrels of additional Iranian oil to hit already saturated markets in the near future. For sure, this over supply will keep crude prices down. They are around \$ 30 right now, down to just 1/3 of what they used to be before this glut began.

### **Financial pain**

Saudi Arabia can tolerate the financial pain caused by the huge oil revenue loss, for now, but not indefinitely. Likewise, the Russian government has been forced to cut spending, repeatedly, while dipping into a reserve fund to cover the substantial revenue shortfall. Depressed crude prices are really bad for both countries.

While no breakthrough took place in Qatar, may be it is time for the Saudis to get a deal with Russia. The problem is that Saudi Arabia is also concerned with retaining market share. If it cuts production, it will lose some customers. And others who are not cutting may end up benefiting. (Think Iraq and Iran, among others).

### **Can they agree?**

Hence the importance of a deal with Russia, the other giant exporter. The two of them combined control 20 millions barrels of production. Still, is such a deal really possible?

In theory, yes. In practice, we would be entering uncharted territory. This has not been done before. Russia is not an OPEC member. Besides, Russia is not viewed as a friend by the Saudis. Moscow is on good terms with Iran, while it heavily supports Assad in Syria.

### **May be**

Can the two countries go beyond these major political differences, and strike a deal that would benefit both of them financially, in a major way?

As we are getting closer to what begins to look like an emergency situation caused by oil revenue collapse, a production cut agreement between Moscow and Riyadh is just possible.

The meeting in Qatar was inconclusive. Still it counts as an exploratory talk between two critical players that until today had no established venue for bilateral energy talks.

Will there be more meetings? Can the two sides get a real deal, a deal that will cut production, and therefore lift oil prices? I would not rule this out. Both Russia and Saudi Arabia badly need more cash.