

# Will NAFTA Be Fixed?

**WASHINGTON** – It is not a bad idea to look at ways to improve NAFTA, the Free Trade Agreement linking Canada, the U.S.A. and Mexico that came into force in 1994. Back then, we had a different world. The Internet was just beginning to blossom; the on line giant Amazon did not exist, and Apple's future was uncertain. Energy production and possible new cross border investments within North America did not even remotely resemble what we have now. Think of the incredible shale oil and gas revolution in the U.S., large scale oil extracted in Canada from oil sands in Alberta, and then exported to the United States, and the recent liberalization of the energy sector decided upon by Mexico, simply because they are shipped from Mexico.

## **Make it better?**

What is not entirely clear at this early stage in the process is the spirit animating the American negotiators. As a presidential candidate, Donald Trump argued that NAFTA is a horrible arrangement that hurt the U.S. economy and workers, a key item within a long list of fatally flawed trade agreements.

So here is the question. Is the goal here to improve NAFTA or to try to kill it? We shall soon find out.

## **Key issues**

Among the many issues that will be addressed by the U.S., Mexican and Canadian negotiators, "rules of origin", "dispute resolution" and "government procurement" stand out.

## **Rules of origin**

In order to qualify for the NAFTA free trade preference, (this means no customs duties within the free trade area), goods

coming into the United States –say from Mexico– must qualify as “made in Mexico”. For example, they cannot be sneakers or T-shirts made in China, exported to Mexico and then re-exported tariff free to the U.S.A., pretending that they are made in Mexico.

However, in this global economy sustained by global supply chains, how does one establish clear rules aimed at determining the origin of complex products? Think for a moment of automobiles assembled in Mexico. Almost by definition they contain many foreign made parts –parts not originating from other NAFTA countries.

Well, here is the question. What is the limit of foreign (non NAFTA) made components (in terms of value of the components, and in terms of overall percentage of parts) beyond which the car assembled in Mexico no longer qualifies as “originating in Mexico” and therefore not qualifying for the NAFTA preference?

### **How strict?**

How high do you set the bar? Is a car with 30% non NAFTA components still qualifying for tariff-free NAFTA status? Or can the NAFTA negotiators be more lenient and set the bar at 40%? This is a big deal.

More or less stringent rules of origin will affect established trade relations with a global web of suppliers. No wonder the Japanese are following the NAFTA renegotiation issue very closely. The Japanese brands assemble cars in Mexico. Ostensibly those cars are “made in Mexico” and so they can be exported to America customs free, as they benefit from the NAFTA trade preference.

### **Components made in Japan**

But here is the thing. Everybody knows that these cars contain a large amount of components made in Japan. If adopted by the three partners, more stringent NAFTA rules of origin will

inevitably disrupt established supply chains created by the Japanese brands to export components that end up in cars that until today met the minimum NAFTA origin criteria to be considered as “made in Mexico”.

So, here is the issue that will affect the negotiations. America wants much stricter rules of origin, because it does not want what the U.S. considers to be essentially Japanese cars, disguised as “made in Mexico”, to come into the USA tariff free, (because of the NAFTA preference),

Can a compromise be reached regarding what percentage of a finished product must be made of components made in Mexico, Canada or the U.S.A. in order to give this product “NAFTA origin”?

### **Dispute resolution provisions**

The Americans also do not like the “dispute resolution” mechanism included in the original NAFTA Treaty. Many in the U.S. look at it as a binding arbitration process which amounts to an infringement of US sovereignty. Americans do not like to be bound by a process whereby non-U.S. judicial bodies decide the outcome of trade disputes. The other two NAFTA countries would like to preserve it this dispute resolution mechanism. Is compromise possible?

### **Public procurement**

Public procurement is another sticky issue. The three countries would like to have free and equal access to public procurement bids (think of government contracts which may include IT services, or infrastructure projects) put out by their NAFTA partners. Except when they do not.

Especially with President Trump pushing for an “America First” general approach on all trade and non trade issues, when it comes to public procurement, Washington wants to privilege U.S. companies through “Buy American” policies.

And this would include all or most government contracts. This is obviously against the spirit of wide open procurement with a bidding process open to all firms within NAFTA.

### **Uncertain outcome**

In the final analysis, all these are very complex and technical issues –on a good day. If the parties are willing to compromise, there is an opportunity to improve NAFTA.

But if there is a negative bias against NAFTA, it is relatively easy to tear apart this free trade area linking the 3 economies of North America.

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## **America Cut Funds to Syrian Rebels**

**WASHINGTON** – After the fall of Aleppo, I concluded that the Syrian opposition to Assad had been essentially defeated. Sure, some resistance still exists. But the chances of overthrowing Assad via military actions is a dream. Americans (half-hearted, in my view) efforts to force regime change in Damascus by supporting the domestic Syrian opposition through military assistance have failed.

### **No more US aid to the opposition**

Now we learn that the Trump administration

about a month ago decided to stop helping the Syrian rebels via a CIA operation code-named "Timber Sycamore". I call this cutting one's losses and moving on.

Of course, some analysts immediately argued that cutting off the rebels is a big Trump favor to Russian President Putin. A big favor without getting anything in return. They argue that arming the Syrian rebels was smart policy, because it created a pressure point against the Assad regime that could have been used at a later date as a bargaining chip during negotiations about a future settlement of the conflict in Syria.

### **It did not work**

May be so. But, while the details about how much money was spent and how cost-effective this operation has been are not publicly available, the truth is that the Syrian opposition aided by the US and several Arab countries was never very effective; and now it has been essentially beaten. Not completely destroyed. Still, after the fall of Aleppo, it lost any chance of overthrowing the Damascus regime, or even inflicting serious damages to it.

### **Accept defeat**

The Trump administration seems to have accepted this; while it is keen on focusing on the ongoing fight against the Islamic State, or ISIL. Therefore: *"Let's cut or losses, concentrate our efforts on beating ISIL, and stop throwing good money after bad"*.

### **New consensus**

There seems to be a new consensus within the US Government that removing Assad from power is no longer a priority. (Obama instead repeatedly declared that Assad "had to go", because of his violations of human rights and other crimes against the Syrian people). Secretary of State Rex Tillerson and others

actually said publicly that the removal of President Assad is no longer a precondition for any serious talks about the future of Syria.

### **Waste of money**

Given all this, continuing a CIA funded operation aimed at arming a few Syrian rebels who do not have any realistic chances to achieve much against regular pro-Assad forces backed by Russia, Iran and Hezbollah, seems like a waste of time and money.

### **Betrayed**

Of course, if you were part of a Syrian rebels group that had been included in this CIA funded program and you were counting on continuing American military and financial support, you have every right of feeling betrayed. But this would not be the first time in which allies of America have been dropped by Washington, on account of larger strategic considerations.

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## **Emerging Markets Crisis Dragging Down The Global Economy**

**WASHINGTON** – Will emerging markets in crisis drag down the global economy? Probably not. But they have added and will continue to add to the negatives.

### **Enormous debt**

Consider this. According to the WSJ, “foreign banks have lent \$ 3.6 trillion to companies in emerging markets, and foreign investors hold, on average, 25% of local debt in developing economies”.

Now, a lot of these credits were used to finance added production capacity in key commodities producing industries. But we know what happened. China, after its fantastic, multi-year buying spree simply stopped buying. China cannot absorb more.

And therefore commodities collapsed, dragging down all the investors, and those banks that financed them.

### **Ripple effects**

That said, it is important to note that this negative trend is not confined to the companies operating in the sectors directly hit. It also affected other unrelated sectors that were hoping to ride the wave of economic growth fueled by the extra revenue created by sky-high commodities prices.

For instance, the WSJ points out that “Indonesian telecom PT Trikomsel Oke Tbk. nearly doubled its debt from 2012 to 2015, as it rushed to open hundreds of retail stores across the country. But the firm’s revenue collapsed after growth in South-east Asia’s largest economy fell to six-year lows” . Now the company cannot pay back its bonds, “and already defaulted on \$ 460 million of its debt”, according to the same WSJ story.

Well, this means that there are huge ripple effects, not limited to Indonesia. Indeed, Japan’s Softbank Group, an investor in PT Trikomsel, is now taking losses on account of this failed growth strategy.

### **Widespread damage**

And this is not an isolated case. The outlook is equally grim

for Brazil, South Africa and Australia. So, here we go: bad debt, financial losses, bankruptcies, lower revenue, growing unemployment. Is this mix deadly? Probably not. But it is bad both for the countries affected and for the world.

Emerging countries now account for a larger percentage of the global economy. Much was said about how a new, self-confident middle class capable and willing to spend on more cars, and more consumer goods would help boost the global economy. Well, this will have to wait. These countries are in serious trouble. Amid crises and depreciated currencies, the new middle class is a lot poorer, these days.

So, what does this mean for the global economy? It means another wet blanket on growth. The commodities producing countries and their lenders are in trouble because of lack of demand. This means that they will buy less from the West. Lack of demand in China and elsewhere means lower growth in Brazil. A poorer Brazil will buy less from Europe or America.

### **China drags down all its foreign suppliers**

By itself this would be bad, but not catastrophic. But here is the thing. China financed its gigantic investment spree with astronomic levels of new debt. This debt will never be recovered, simply because the investment-driven bubble burst.

So, what does this mean? Well, China sits on enormous cash reserves, so it can weather the storm. Still, this capital will be used to plug holes rather than fund productive investments. As China slows down, its under performing economy drags down all the Asian countries that have become an integral part of China-centered supply chains. Think South Korea, Taiwan, Thailand, and also Japan. Their exports to China are down.

### **Is America insulated from all this?**

Where does this leave America? Much has been said about the



fact that the US economy is not so dependent on exports. Many US firms trade domestically, say between Connecticut and Colorado. Not many depend on exports. And US banks are not exposed to Chinese debt.

Still, as the whole world slows down, rather fast, can the US be the only island of growth and prosperity? I doubt it.

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## The West Is Impotent Regarding North Korea

**WASHINGTON** – North Korea is at it again. Apparently dictator Kim Jong Un ordered another atomic test, claiming that this time it was a hydrogen device, and not a simple atomic bomb. On the basis of seismic data, Western observers dispute the claim, but everybody is worried.

### **A dictator with atomic bombs and missiles**

An unpredictable dictatorship armed with atomic (or nuclear) weapons is obviously a source of concern. US military planners concede that soon enough North Korea may be able to launch ballistic missiles that can reach Alaska, Hawaii, and possibly the West Coast of the United States.

### **The world does nothing**

What is most extraordinary in all this is that the entire world, while complaining, does absolutely nothing. Look, I do realize that it is not easy to fix this North Korean problem. This is after all a sizable country of about 25 million people, run by a despot with absolute powers.

### **The China angle**

And there is an additional problem. In some fashion, China still supports the North Koreans. In fact many argue that without Chinese help the regime would probably collapse. Analysts believe that the semi-reformed Chinese would rather have North Korea run by crazy Jim Jong Un as a neighbor than a reunified, pro-Western Korea allied with the United States. For this reason, until China keeps supporting or at least tolerating North Korea, not much that the rest of the world can do.

Still, while allowing that Chinese political concerns have to be taken into account, I find this explanation for inaction close to absurd. Assuming Western unity and determination to get rid of the Kim dynasty in North Korea, there has to be a way to come to an agreement with China on a mutually acceptable future for a reunified, peaceful Korean Peninsula that will not threaten Chinese interests and security.

### **How strong is North Korea?**

That said, how strong is North Korea? How big of a challenge is it? Yes, we do know that they are spending a great deal of resources on their nuclear program and on their military. But what about everything else? Well, here is how the CIA World Fact Book describes the North Korean economy:

*“North Korea, one of the world’s most centrally directed and least open economies, faces chronic economic problems. Industrial capital stock is nearly beyond repair as a result of years of underinvestment, shortages of spare parts, and poor maintenance.*

*Large-scale military spending draws off resources needed for investment and civilian consumption. Industrial and power outputs have stagnated for years at a fraction of pre-1990 levels.*

*Frequent weather-related crop failures aggravated chronic food shortages caused by on-going systemic problems, including a*

*lack of arable land, collective farming practices, poor soil quality, insufficient fertilization, and persistent shortages of tractors and fuel. The mid 1990s were marked by severe famine and widespread starvation. Significant food aid was provided by the international community through 2009. Since that time, food assistance has declined significantly. In the last few years, domestic corn and rice production has been somewhat better, although domestic production does not fully satisfy demand.*

*A large portion of the population continues to suffer from prolonged malnutrition and poor living conditions."*

### **A poor country**

There you have it: **"Industrial capital stock nearly beyond repair", "chronic food shortages", "severe famine", "malnutrition"**. Yes, this is mighty North Korea, the menacing foe that's keeping the entire civilized world on edge. A poor country that cannot feed its people, relying on a decrepit industrial base.

Want more data? North Korea's per capita GDP is US \$ 1,800, one notch *below* super impoverished Haiti, a true basket case.

All in all, I would not call North Korea a formidable foe. This is not exactly Hitler's Germany on the eve of WWII; nor does it look like the mighty Soviet Union of the 1970s.

This is an impoverished, horribly backward country, with no competitive economic sectors.

### **Powerless international community**

And yet, the entire civilized world –The US, Canada, Japan, the European Union, South Korea, Australia, India and other developed countries– cannot come together to deal with this North Korea problem. They seem to be totally powerless when

confronted with the threatening behavior of a third-rate dictatorship.

It is clear that North Korea is not deterred by anybody. For years it has been doing exactly what it pleases with its ongoing nuclear program. The country is obviously in violation, (multiple times), of international UN obligations regarding non proliferation. But, beyond routine protests and condemnations, neither Washington nor anybody else has done anything serious to make North Korea stop this.

### **Western timidity**

*Sadly, this timidity tells us a lot more about the fundamental weakness of the West than about North Korea's strength. We are talking about the combined resources of the largest and most advanced industrial democracies of the world versus puny North Korea; and North Korea essentially wins –every time. It keeps violating major international obligations about non proliferation, and it pays no price.*

### **How others see us**

If this passivity regarding the illegal actions of a dictatorship with a decrepit economy, plagued by chronic malnutrition is the measure of Western resolve against rogue states exhibiting menacing behavior, then no wonder that Vladimir Putin's Russia, the Chinese and the Iranians feel rather relaxed when dealing with Washington or Berlin.

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## **Saudi Arabia's Oil End Game**

**WASHINGTON** – More than a year ago, when it became obvious that massive increases in US oil production (thanks to shale and

fracking) had created a global glut, Saudi Arabia did not react in the usual manner. It did not work with its OPEC associates to cut the cartel's production in order to diminish supply and support oil prices.

### **No more production cuts**

No, Saudi Arabia stated instead that it would let the market determine a new balance. No supply cuts. From then on supply and prices would be determined by actual global demand.

At that time it was widely believed that the Saudis wanted to kill US shale production. The conventional wisdom was that relatively expensive fracking operations in the US could not survive with oil below \$ 70 per barrel. They just could not. And, in truth, many US shale producers have been hurt badly by the precipitous price fall allowed by Saudi Arabia. Some had to fold.

### **US shale sector very resilient**

However, a significant segment of the US shale oil industry has proven to be remarkably resilient. It streamlined operations, and it has quickly become far more efficient. Some shale oil producers claim to be profitable with oil at \$ 40 or even \$ 30 per barrel.

In other words, the US shale oil industry has been badly wounded by the oil price collapse; but it is still very much alive. This is astonishing. Only a couple of years ago most industry analysts asserted that the shale sector could not survive with oil prices this low.

Did Saudi Arabia miscalculate? Did the Saudis wrongly assume that in just a few months they would have smothered the Americans? Or may be they have some other goal in mind?

### **Saudi Arabia needs high oil prices**

Be that as it may, whatever the Saudis are trying to

accomplish, they need quick results. Indeed, the massive over supply they created with the intent to kill or weaken less competitive rivals did what it was intended to do. It caused a glut and an oil price collapse.

The problem is that rock bottom prices are beginning to hurt the Saudis.

It is no secret that beyond oil Saudi Arabia has no other sources of real revenue. And it is also well-known that the stability of the Kingdom is based almost entirely on the ability of the Saudi Royal Family to keep subsidizing directly or indirectly almost the entire country: that's 29 million people. These subsidies, paid for with oil revenue, buy consensus, social peace and popular support for the Monarchy.

Sharply lower oil revenues, sustained over several years, will translate into growing public deficits, and therefore into a diminished ability to throw cash around as a way to keep the people happy.

Of course, for the moment Saudi Arabia can rely on its significant dollar reserves. But they are beginning to dwindle. The government has also started borrowing in order to finance its growing yearly deficit. At some point, its ability to subsidize the country will be impaired.

## **Unsustainable**

Let's be clear. We are still far from an economic or fiscal emergency. But, assuming no policy changes regarding oil prices, at some point this course will become unsustainable. Soon enough, the Saudi government will need higher oil revenues.

As noted above, American energy producers are hurting. Some are gone, or will be gone pretty soon. Still, the news from America is that the shale oil sector is far more resilient and flexible than anybody thought.

At least some shale producers have become far more efficient. They can start and stop production without creating havoc. Of course, some shale oil plays cannot be profitable with crude below \$ 40 or \$ 30. But many are. If and when OPEC will decide to go back to its old ways –cutting production in order to support prices– expect the US shale sector to start ramping up production.

### **What is the game plan?**

Given all this, assuming that the Saudis must understand what is going on, one wonders what they have in mind. What do they plan to achieve by allowing oil prices to fall more and more? Whom are they trying to squeeze?

***What is the game plan? I believe that the target is Iran. Saudi Arabia sees Iran as its only rival for regional influence, when it comes to politics, military assertiveness (Iraq, Syria, Yemen) and religious activism. Iran is Saudi Arabia's existential threat.***

### **Hit Iran where it hurts**

For this reason the Saudis are trying to hit Iran where it can really hurt: oil revenue; this way hopefully undermining the legitimacy of the government run by the Ayatollahs.

It is clear that if Saudi Arabia needs high oil prices to keep its people happy, so does Iran. Who knows, may be Saudi intelligence has information we do not have about the fragility of the government in Tehran.

If protracted low oil prices end up undermining the Ayatollahs' regime in Tehran, then this semi-suicidal, low oil price strategy pursued by Saudi Arabia all of sudden makes sense.

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# Fight Global Warming With Disruptive Innovation – Not Mandates

**WASHINGTON** – The Paris event on climate change will probably yield nothing really concrete. The fact is that, despite the rhetoric and the contrived “emergency mode”, there is a huge disconnect between the desired result to stop and possibly reverse global warming and the tools available for this enormous undertaking.

## **Impossible targets**

Whatever the environmentalists may preach or demand, it is essentially impossible to put the entire world, or even most of it, on a stringent, low-carbon diet. Western politicians who claim that they have a plan are pandering, posturing, or dreaming. We could do this only if we had viable, truly cost-effective technological alternatives. And we do not have them. At least not yet.

## **Renewable energy? Not quite here yet**

Of course, there is renewable energy, the miracle cure. We have solar and wind power, and a lot more. But, so far at least, these are not really cost-effective solutions. Otherwise, they would have been already adopted –on a massive scale.

Sure, today we can install solar power plants in Namibia and Arizona or Morocco, and in other countries where there is a lot of sunshine all year round. As prices for this technology are coming down, this is beginning to make economic sense. But



what about Sweden, Siberia, or Belgium? Not much sun there.

### **Mandates are a bad idea**

The worst public policy mistake has been to mandate the adoption of still imperfect renewable energy technologies, so that politicians could show that “we are doing something”. This is a bit like governments, circa 1980, mandating the purchase for every public office of the first generation of PCs running on the first Microsoft operating system. This would have created a rent position for PC manufacturers and for Microsoft, therefore diminishing the incentives to innovate and out-innovate each other.

### **Real innovation, not subsidies**

Indeed, if I know that whatever renewable technology I produce today, it will be adopted for political –rather than cost-effectiveness– reasons, why bother to invest more, refine it, perfect it and make it wonderful, as opposed to barely passable? I know that, because of the mandates, utilities are forced to buy my stuff. I make enough money this way. Then why push the envelope?

### **No real results out of Paris**

So, here is the thing. The big Paris gathering may yield something. But it will not be much. And we can be sure that measures promised eventually will not be implemented, at least not in full.

By the same token, it is obvious that poor countries do not have the luxury to tax carbon, or to subsidize solar.

In fact, guess what, the use of coal –by far the most hated carbon-based fuel– is going up, worldwide. Yes, up.

### **More coal plants in Japan**

Look at Japan, for instance. The Japanese have come up with a

new generation of cleaner burning, lower emissions, coal-fired plants. They are better, for sure. But they still pollute a lot more than comparable gas-fired plants. Let alone zero emission solar.

## **Coal everywhere**

And yet the Japanese are merrily marching ahead. And they are actively marketing their “clean coal” plants in Indonesia, and elsewhere. India depends heavily on coal. And so does China. Ditto for America, even though coal in the US has been gradually displaced by cheaper (and much cleaner) natural gas.

Add to the mix parts of Africa, beginning with South Africa, the number two economy in the Continent, heavily dependent on coal. So, forget about abolishing coal. Right now, it simply cannot be done.

## **The revolution**

Can this change? Of course it can. But we need some truly disruptive innovation in non carbon energy that does not need political coercion for early adoption.

Look, imagine that tomorrow we get state of the art, truly affordable and super efficient solar power. At the same time, Tesla or some other manufacturer comes up with a really cheap electric car that you can drive for 400 miles without recharging. Assuming all this, we are done.

It would take no more than a few minutes for millions and millions of price conscious consumers, and later on the whole world, to switch to the new technologies.

## **The end of coal, gas and oil**

Millions would install cheap and highly efficient solar panels on their roofs, this way making their own electricity, at home. Then they would dump their cars with gasoline engines and buy an electric vehicle that they can charge at home at

almost zero cost. People would make this switch not because they are pious environmentalists, but because they want to save money.

This way, in no time we would have eliminated coal, natural gas (power generation fuels) and oil (transportation fuel) as our key energy sources. Think of that. And we would have achieved the dream of a mostly carbon-free world.

### **Not enough R&D**

This is what we should aim for. Whereas, right now we get little investment in R&D in new energy technologies, and plenty of mandates, regulations, and subsidies for still rudimentary renewable energy solutions.

We should spend real money on “Moon Shot” projects. Bold stuff, out of the box ideas. Of course, most of these efforts will lead to nothing. Lots of money will be burnt on crazy ideas. But this is what happens when you go into uncharted territory.

### **Fantastic energy future?**

Nobody really knows what our main source of energy will be in 50 years. I hope it will be something fantastic, clean and cheap. But if we continue at this pace, chances are that in 50 years we will continue to have debates about “clean coal”, and “lower emission”, gasoline-fired internal combustion engines.

And, if that is so, forget about “solving” global warming.

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# Oil Is King, For Now

**WASHINGTON** – In an interview with FORTUNE magazine, Chevron CEO John Watson argued that, whatever the oil prices wild fluctuations, carbon based fuels are here to stay. Contrary to dire predictions about producers having reached “peak oil” and consequent crude shortages, accompanied by price increases, *“those who follow the energy business in think tanks will tell you that right now about 80% of our energy is coming from fossil fuels”*, argued Watson. *“And if you go out 20 years, about 80% of our energy is going to be coming from fossil fuels”*, he concluded.

## **The age of oil is far from over**

Indeed, there is plenty of oil and gas around the world. Even assuming growing energy demand in emerging markets, it is going to take a long time before we experience significant price increases due to tightening supplies. Translation: the renewable energy golden era may still come, but it is not here yet.

Right now the case for renewable energy is mostly based on the desire to abandon fossil fuels on account of their likely impact on global warming and climate change. Most governments buy the renewable energy argument backed by many scientists. Therefore, they mandate the use of renewable energy, not because it makes any economic sense, but because it is the best way to stop global warming.

However, there is a steep price to be paid for being virtuous. Subsidies for renewable energy have to be budgeted. They cost money. In the meantime, all observers agree that even heroic efforts aimed at adopting renewable energy on a much larger scale would produce minimal effects on global world temperatures. Therefore, the case for renewables, (we are talking about currently available technologies), based on

their ability to lower world temperatures across the globe, is inherently weak.

### **The US shale oil boom**

In the US we are experiencing an oil renaissance. However, as Watson point out in the above referenced FORTUNE interview, shale oil wells have a relatively short life span. You have to keep drilling in order to maintain the same level of production.

All this is expensive. Therefore some wonder, with cause, how long this US shale oil boom can last. Is there a lot more shale oil out there? Will energy companies come up with improved drilling techniques that will increase well productivity? There are promising signs indicating that all technologies related to “fracking” are getting better, very rapidly.

Still, whatever the long-term prospects of US oil production, (total US oil reserves are estimated to be at 44 billions of barrels, not a very high number), just in the Western Hemisphere there are other oil producers with enormous reserves.

### **Plenty of oil in the Western Hemisphere**

We know that Venezuela is in a sorry state because of its silly populist regime that has mismanaged everything, starting with oil production. But at some point this may change. And Venezuela has the largest proven oil reserves in the world: 298 billions of barrels. This is more than number two Saudi Arabia, (266 billions of barrels). It is not inconceivable that at some future date Venezuela will get better political leaders who will be able to reorganize its energy industry, something that will have to include foreign investors who will bring in new technologies and know how.

And, if we go north, there is Canada, number three in the

world, (after Saudi Arabia at number 2), with proven reserves at 174 billions of barrels. Add Mexico (10 billions of barrels), and Brazil (13 billions) to the mix and you have a lot of oil, and this is just in the Western Hemisphere.

### **Oil price changes**

Oil prices are volatile. Right now we are experiencing very low prices because OPEC members, (led by Saudi Arabia), contrary to their established policies, decided not to curb production when faced with lower prices due to added global supply, (much of it coming from US shale oil). This OPEC policy, of course, may change. And so, assuming reduced supply, at some point prices will go up again, although we do not know by how much, and for how long.

However, in order to make a solid economic case for non oil-based energy for transportation, (electric vehicles, fuel cells, and more), oil prices would have to go up, and stay up, for a very long time.

### **The moment of renewable energy will come**

Sure enough, in a few years someone will come up with a new form of clean, zero emission energy that will cost less than gasoline.

As a former Saudi Oil Minister said long ago: *"The stone age did not end because we run out of stones"*. Yes, stones were abandoned when humans figured out how to make better utensils and weapons using bronze and then iron.

*Which is to say that oil is king –for now.* That is until something better comes along. Renewable energy had a "politically mandated" false start.

But we can expect that its day will come.

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# NATO Reaffirms Its Unity and Resolve – Yet Defense Budgets Are In Free Fall

WASHINGTON – “[At the forthcoming NATO Summit in Wales] we will send an unmistakable message: Today and in the future, NATO means one for all, all for one”. This is the upbeat conclusion of a [WSJ](#) op-ed piece co-authored by Anders Fogh Rasmussen and by General Philip Breedlove, Secretary General of NATO and Supreme Allied Commander for Europe and Commander of US European Command, (*A NATO for a Dangerous World*, August 18, 2014).

## **We stand united**

The gist of the piece is that NATO stands absolutely united, now as before, while the Alliance has done or is doing all that is necessary to strengthen the political and military cooperation among its 28 members.

While the Cold War is over, the authors argue, there are many potential threats out there, from further deterioration in the Middle East to possible escalation of the crisis in Ukraine.

Well, it is nice to read reassuring words from the top civilian and military authorities of this old Alliance. The trouble is that most of what they say regarding NATO being ready to meet challenges is either grossly exaggerated, or not at all true.

## **Disconnect between commitments and budgets**

The two authors vaguely hint at the enormous disconnect between declared goals and objectives (ambitious) and real defense budgets (ridiculous) when they write that: *“The Wales summit is a key opportunity to reverse the trend of declining defense budgets and to share the responsibilities for security more fairly”*. So, they admit that there is a defense spending problem. But they do not even begin to say how big it is.

### **Defense spending in free fall**

The US is the NATO member that spends the most on defense: about 4% of GDP. No other European NATO member comes even close. Britain leads the pack with defense at 2.4% of GDP. France dropped military spending from 2.5% in 2004 to 1.9% in 2013. Germany is at 1.3%, Italy a bit less with 1.2%. Poland does better with military spending at 2%, while economically challenged Spain went down from 1.2% in 2009 to 0.9 today.

And do keep in mind that America is already cutting its military spending, with more cuts coming in the near future.

So, there you go. *We stand united. Our resolve is unshakable, blah, blah, blah.* Unfortunately, this is mostly “feel good” nonsense. The Alliance is there, and so are all the trappings of a peace time integrated military structure. The commitments are there, and nobody says they will not be honored.

### **Modest capabilities**

However, the sad reality is that most European NATO countries cannot field credible armed forces. And even the best do not have that much. For example, shortly after the beginning of the air campaign against Gaddafi’s Libya, led by France and Britain, the Europeans were asking America to give them precision guided ammunition, because they had run out. And this was a small war against Libya, a third-rate military force.



And leaving aside the actual level of spending, if we look closely at the actual military preparedness of the armed forces theoretically fielded by –say– Romania, Estonia or Portugal, we are not going to be impressed.

### **Few synergies**

Related to this, there is the perennial shortcoming resulting from a lack of real “*military integration*” among NATO countries. Which is to say that there is no way to get “*more bang for the buck*” because military spending is highly fragmented.

Indeed, many attempts notwithstanding, the individual European NATO members, plus America and Canada field separate armed forces. There are few if any effective synergies when it comes to procurement of new weapons systems.

Over the years weapons standardization and interoperability have improved some. But we do not have a fully integrated “NATO Army”. Which is to say that the little money that is indeed spent does not buy as much as it could in terms of joint NATO capabilities.

### **When the Soviet Union collapsed**

The truth of the matter is that when the USSR disappeared back in 1991 the real rationale for the NATO Alliance –protecting Europe against a possible Soviet aggression– also disappeared. And so most European countries, whatever their public pronouncements, started cutting defense spending.

Today we have an Alliance which is actually much larger in terms of members, (Poland, the Czech Republic, Hungary, the 3 Baltic countries, and many more joined in recent years), but with minimal military capabilities.

### **Please, tell the whole truth**

The pep talk-editorial authored by Secretary General Rasmussen

and General Breedlove is in fact a disservice, as it hides the stark reality about lack of resources behind NATO-speak verbiage on theoretical commitments, coupled with a routine reassertion about steadfastness and unity.

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## **Newly Elected President Petro Poroshenko Should Recognize That Eastern Ukraine Is Lost**

**WASHINGTON** – Now Ukraine has a legitimate, elected president: Petro Poroshenko. A self-made wealthy industrialist, (chocolate is his sector), Poroshenko is no stranger to politics and policy-making, having served as Foreign Minister after the 2004 Orange Revolution. And (fluent in English) Poroshenko will be more at ease in international fora than all his predecessors.

### **A good first step**

This is a good first step for Ukraine. The country needs a legitimate leadership that can credibly engage the West in the very complicated negotiations aimed at providing financial and economic support, as the nation is trying to emerge from the ugly mess of protracted political upheaval, economic mismanagement and endemic corruption.

### **No way to win in the East**

That said, President Poroshenko, hopefully with the help of a

new parliament, will have to make a bold policy choice on Eastern Ukraine. It is obvious that the Russia-inspired and Russia-funded insurrection cannot be defeated, simply because Ukraine lacks the military means and the funds to fight a protracted civil war in the East. And, even if the Kiev government did have the means, the suffering of the civilian population is likely to be immense, while the probability of eventual victory is practically zero.

### **No help from America or Europe**

Here is the reality. Ukraine on its own cannot win, while it will not get any military help from either America or Europe. And the West, beyond the largely symbolic sanctions imposed on a few individuals in the Russian government, will not do much more.

Which is to say that Putin can continue his undeclared but obvious destabilizing effort in Eastern Ukraine almost with impunity.

### **Russia has all the cards**

As many analysts predict, Russia may very well be a country on a path to demographic and economic decline. But this will take a long time. Right now, when it comes to Eastern Ukraine, Putin has all the tactical and strategic advantages.

Russia can claim to have a humanitarian interest in the welfare of millions of ethnic Russians right across its borders. Moscow can easily insert into Ukraine Russian special forces and other operatives who can easily blend in with the local, mostly Russian, population and be therefore almost unidentifiable. It can supply the local militias with weapons and funds. In other words, at a relatively modest cost and without any direct, open engagement Putin's Russia can make Eastern Ukraine an ungovernable mess for as long as it wants.

### **Outfunded and outnumbered**

And what can President Poroshenko do to put an end to all this? Quite frankly, nothing. Ukraine is outfunded and outnumbered by Russia; while the West, looking at its timid reactions thus far, will do nothing big to force Putin to stop his machinations.

Taking all this into account, for the Kiev government to keep sending east troops and helicopters that get shot down by the insurgents is madness. Ukraine is essentially broke. It is trying to negotiate IMF loans, while begging the EU to help out. Using precious resources to fight an insurrection that can count on Moscow's unlimited support is totally crazy.

### **Eastern Ukraine is lost**

Unless the West discovers a new bold determination that will compel Putin to stop –and I cannot see a scenario leading to this– Kiev has lost. While admitting this is painful and humiliating, once you know you have lost it is better to adjust to this reality rather than continue a useless fight.

### **Grant independence**

The only endgame I see here is for the Kiev government to grant total autonomy, amounting to *de facto* independence, to Eastern Ukraine. Whether this independence, with subsequent annexation by Russia, would in fact reflect the genuine will of the majority of the ethnic Russians or not, this is unfortunately immaterial.

There is no way to conduct a proper referendum in which the people of Eastern Ukraine, without any pressure or intimidation, would be able to freely express their will.

### **Focus on reconstruction**

Right now the events are driven by the Moscow-armed separatists. They have won. Kiev has lost. Let Eastern Ukraine go and focus on the daunting task of reconstructing the

economy in the rest of the country, while forging meaningful ties with Europe and America.

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## America Shall Not “Pay Any Price” To Protect Ukraine’s Territorial Integrity

**WASHINGTON** – The Moscow-inspired and Moscow supported Ukrainian crisis is slowly morphing into something resembling a civil war. Whether this is the actual direction or not, it is obvious that the Kiev government will be unable to achieve its goal of recreating law and order within Eastern Ukraine.

### **Illegitimate government in Kiev**

The Kiev provisional government is described by Moscow, and now by many if not most ethnic Russians in Ukraine, as illegitimate, (it came into power via the violent overthrow of the properly elected government), and bent on destroying the large Russian minority living in the East. As we all know, it is a government led by neo-Nazis and Russophobes, and so on.

This being the case, the Russians in the East have every right to resist the police and military forces sent by Kiev to kill them. And Moscow has every right to intervene in order to protect its brethren on the other side of the border.

This being the official Russian interpretation of events, add to the mix overwhelming Russian military force now deployed close to the border with Ukraine and compare these well armed

Russians with a small and ill-equipped Ukrainian army.

### **Hopeless situation**

Once you have done this, you can only come up with one conclusion: the situation is hopeless. Kiev cannot and will not prevail in this crisis. Further escalation will simply give Putin a pretext for intervening directly.

It would make sense for Kiev to resist this well-orchestrated, indirect Russian aggression only if the provisional government could have the comfort of a solid, US-led, Western commitment to its security and territorial integrity.

### **In another era, America would have helped**

Yes, there was a time in which the US pledged its unconditional support to all those who were seeking freedom against tyranny.

Yes, there was a time in which America was the defender of freedom:

*"...Let the word go forth from this time and place, to friend and foe alike, that the torch has been passed to a new generation of Americans—born in this century, tempered by war, disciplined by a hard and bitter peace, proud of our ancient heritage—and unwilling to witness or permit the slow undoing of those human rights to which this nation has always been committed, and to which we are committed today at home and around the world.*

***Let every nation know, whether it wishes us well or ill, that we shall pay any price, bear any burden, meet any hardship, support any friend, oppose any foe to assure the survival and the success of liberty.*** [bold added]

*This much we pledge—and more.*

*To those old allies whose cultural and spiritual origins we*

*share, we pledge the loyalty of faithful friends. United there is little we cannot do in a host of cooperative ventures. Divided there is little we can do—for we dare not meet a powerful challenge at odds and split asunder....”*

### **America, the defender of freedom**

No, this is not fiction. This was the most memorable part of John Kennedy’s Inaugural Address delivered on January 20, 1961. Yes, a long time ago, but not so long ago. Kennedy delivered it when America was engaged in the Cold War, a global ideological and geo-political struggle against Soviet communism and Soviet-inspired mischief.

Mercifully, today there is no longer a Soviet Union. But we have a Russian Federation led by Vladimir Putin, a tyrant who wants to make his own rules and impose them on weak neighbors, counting on Western timidity. And Putin’s calculation about Washington’s inaction is most probably correct.

Obama’s America may grumble; but it will not do much. JFK’s pledge to ***“pay any price, bear any burden, meet any hardship, support any friend, oppose any foe to assure the survival and the success of liberty”*** sadly, does not apply any more.

Moscow knows this, and this is why it is not backing off, whatever Obama says it will do in response to Russia’s open support for the separatists in Eastern Ukraine.

### **Kiev should realize it cannot win**

It is high time that the Kiev provisional government realizes this as well. As America will not intervene, its fight against the Russian separatists in the East is hopeless. Kiev cannot win without the active support of powerful and credible allies—and this means Washington. In fact, prolonging a fight against this manufactured insurrection may make matters far worse.

It is time for Kiev to recognize that Eastern Ukraine is lost. No, America is not ready to "*pay any price*" for the "*success of liberty*".

And if America will not protect and support Ukraine, forget about Europe, whose real concerns are about unhindered deliveries of precious Russian gas and business deals with Moscow.