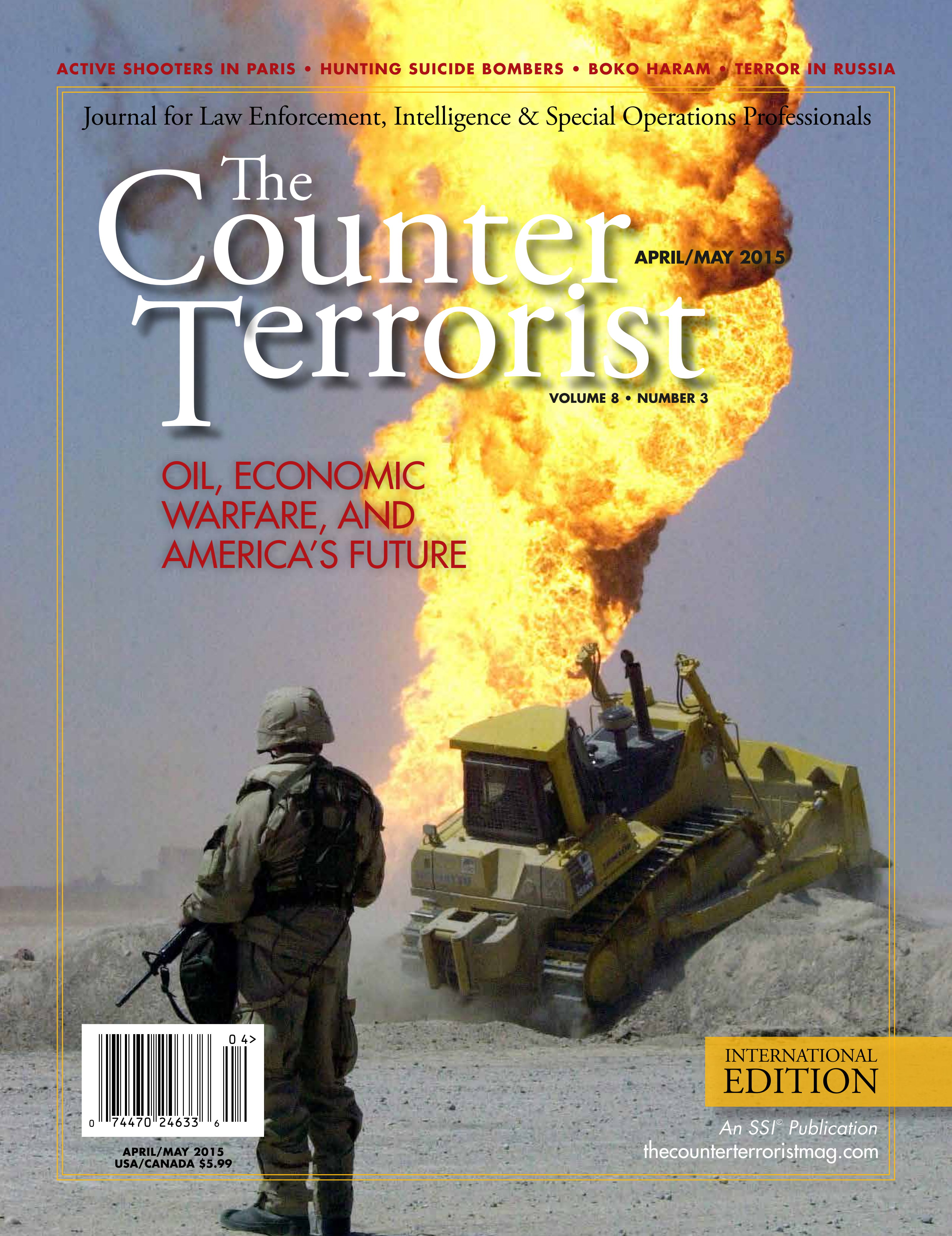

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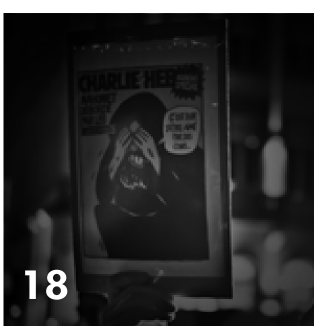

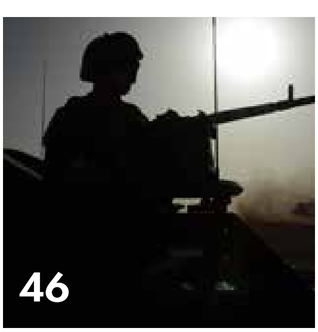

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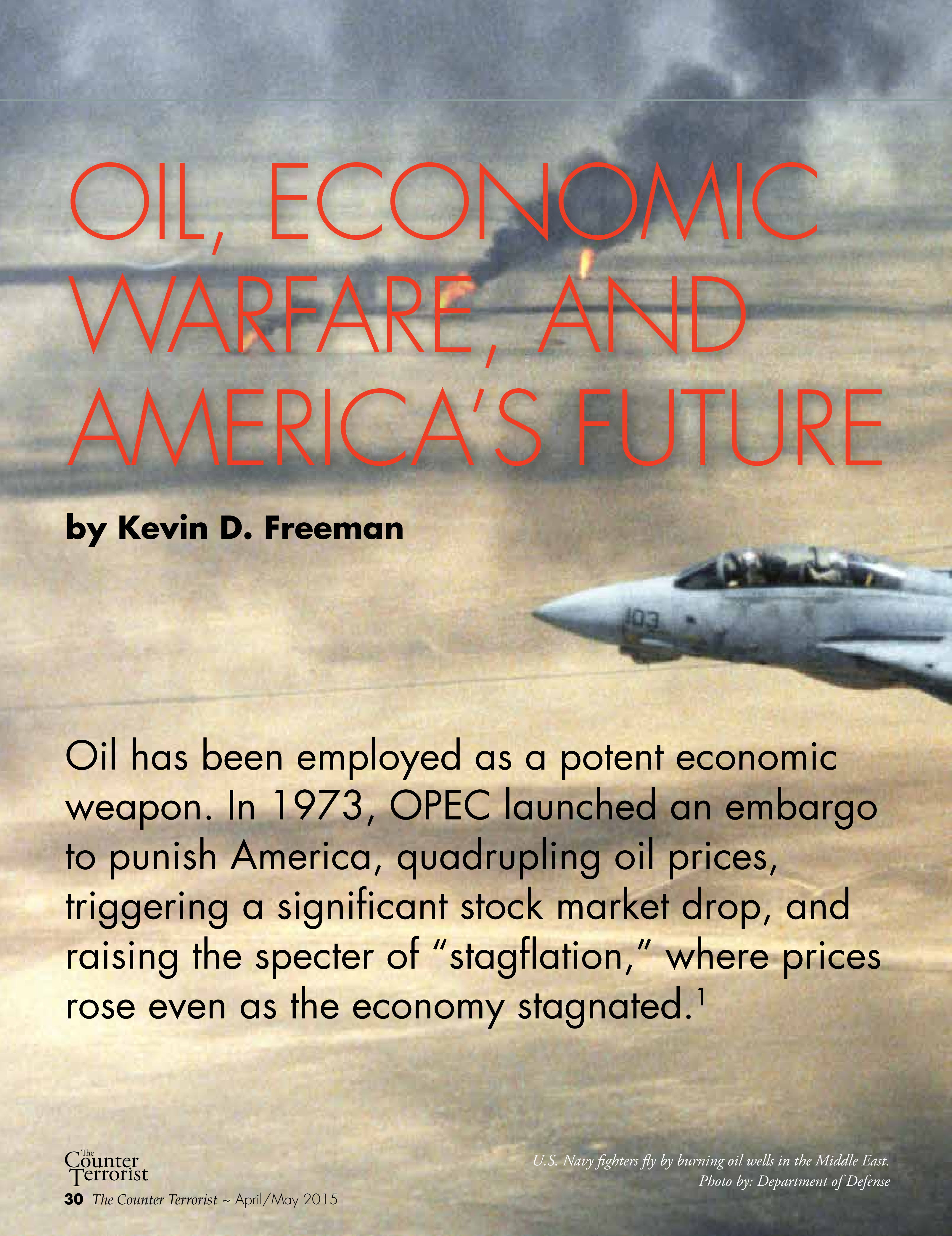
Cover Photo: *A U.S. Army soldier stands guard duty near a burning oil well in the Rumaylah Oil Fields in Southern Iraq. Coalition forces have successfully secured the southern oil fields for the economic future of the Iraqi people and are in the process of extinguishing the burning wells that were set ablaze in the early stages of Operation Iraqi Freedom. Operation Iraqi Freedom is the multi-national coalition effort to liberate the Iraqi people, eliminate Iraq's weapons of mass destruction and end the regime of Saddam Hussein. Photo by: 1st Class Arlo K. Abrahamson*

OIL, ECONOMIC WARFARE, AND AMERICA'S FUTURE

by Kevin D. Freeman



Oil has been employed as a potent economic weapon. In 1973, OPEC launched an embargo to punish America, quadrupling oil prices, triggering a significant stock market drop, and raising the specter of "stagflation," where prices rose even as the economy stagnated.[1]

U.S. Navy fighters fly by burning oil wells in the Middle East.
Photo by: Department of Defense

With a single move, the Arab nations seemingly brought a superpower to its knees. Ultimately, the turmoil recorded a bear market loss of 46 percent for the Dow Jones Industrial Average, reordered the global monetary system, increased unemployment by 73.5 percent, caused a 2.6 percent decline in economic activity, and raised the inflation rate to 11 percent.[2] There were, of course, multiple factors at work at the time, but also little doubt that the embargo was not only a trigger but also a significant long-term cause of the worst economic turmoil America had faced since the end of the Great Depression.[3]

Going back a bit further, a U.S.-led oil embargo imposed on the Japanese in 1941 culminated with the Japanese attacking Pearl Harbor.[4] Arab states attempted to use the oil weapon with embargoes in 1956 and 1967. Although less effective, they intended to punish

Gasoline dealers in Oregon displayed signs explaining the flag policy during the fuel crisis in the winter of 1973-74. Photo by: Wikimedia Commons

Oregon gas station dealers had a flag system. Photo by: David falconer

the West through shortages and higher prices.[5] Usama bin Laden was a big proponent of the oil weapon as a form of economic jihad.[6] Reportedly, he called for a price of $144 per barrel in the late 1990s.[7] That level was briefly surpassed in the summer of 2008.[8] This seemed unimaginable when oil prices were $27 per barrel just before al-Qaeda's famous September 11, 2001, attacks.[9] We cannot doubt that enemies of America understand the value of weaponizing oil.

Something altogether different is at work today, but the impact will prove no less potent. Rather than pursuing higher prices and shortages, today's oil weapon is aimed at collapsing prices through surplus production. Why would Saudi Arabia consider such an effort, knowing it would curtail their own revenues while simultaneously boosting the economies of oil-dependent nations? The answer to this question also lies in history.

The concept is called predatory pricing, where one producer offers something below the cost of production to drive others out of the market. A famous oil-related case involved billionaire John D. Rockefeller. More than a century ago, Rockefeller was accused of forcing out competitors so he could later impose substantially higher prices as a monopoly.[10] Although some disagree with the finding, the U.S. government won its case at the Supreme Court and Rockefeller's Standard Oil was broken into thirty-four smaller independent companies, including behemoth heirs that exist today such as ExxonMobil, Chevron, and ConocoPhillips.[11] The concept of accepting losses to hurt competitors became part of the global consciousness. The Reagan administration, in cooperation with the Saudis, reportedly

U.S Secretary of State John Kerry meets with Saudi King Abdullah bin Abdulaziz Al-Saud in Jeddah, Saudia Arabia on September 11, 2014. Photo by: U.S. Department of State from United States

fired this very weapon at the Soviet Union in the 1980s.[12] The result? The decades-long Cold War was won and Mr. Gorbachev's wall was torn down.[13]

Fast-forward a quarter century. Once again oil prices, under the leadership of the Saudis, target Russia. Only this time, the weapon is also pointed at the United States. The logic of aiming at Russia is simple. From the Saudi perspective, Russia supports Syria and Iran, serious geopolitical rivals and militant threats.[14] In fact, lower oil prices seriously impact Iran directly as well. Iran may require as much as $140 per barrel to balance its budget.[15] Any shortfall will foment unrest, possibly leading to the toppling of the regime.[16] Given the economic war already underway between Russia and the United States over the Ukraine, Saudi Arabia can demonstrate support of American policy while achieving their own objectives.[17] At the same time, the Saudis hope to reestablish monopoly control by knocking out American energy production.[18] This isn't just a theory. It has been openly discussed at a variety of levels.[19] From a November 28, 2014 Reuters news report:

"Saudi Arabia's oil minister told fellow OPEC members they must combat the U.S. shale oil boom, arguing against cutting crude output in order to depress prices and undermine the profitability of North American producers."[20]

THE SHALE REVOLUTION

Something that was totally unimaginable a few years ago happened last year. The United States became the world's largest producer of both oil and natural gas, passing Saudi Arabia and Russia.[21] This capped a dramatic turnaround after several decades of decline, thanks to enhanced extraction technologies such as horizontal drilling and hydraulic fracking from tight shale formations.[22] It also shifted the price curve in some amazing ways. The International Energy Agency estimated that without American shale production, the price of oil would be $150 per barrel.[23] With 90+ million barrels of oil sold every day globally, the difference between $50 per barrel and $150 is of great significance.[24] For Russia and OPEC, the combined difference amounts to nearly $1.5 trillion per year (based on their combined production of over 40 million barrels per day).[25] Stop for a moment and consider how significant an additional $1.5 trillion annual transfer would be for OPEC and Russia, largely funded by the United States and the West. No wonder economic analysts such as Ron Insana declare, "The fracking revolution must be protected at all costs..."[26]

The domestic shale industry has some unique attributes, however, making it vulnerable to external price pressures. For one thing, the effort is relatively capital-intensive.[27] It has blossomed in a low-interest-rate environment.[28] Without access to inexpensive capital, however, oil drilling would stall.[29]

The second issue is that hydraulic fracking readily stirs up environmental objections.[30] This creates the risk that public opinion could turn against the industry. In addition, shale oil production declines rather quickly compared to conventional extraction methods. While a traditional oil well might produce steadily for twenty years or more, a shale-play well provides strong production for about two years before a quick decline. Conventional wells might decline 2 percent per year while shale production can drop by more than 70 percent in the first year alone.[31] This forces continual drilling to maintain production. So, even though the forecast has been for America to become fully energy independent in the near future, a price decline dramatically alters those hopes.[32]

Estimates are that, at present, our domestic shale industry needs about $70 per barrel to remain healthy.[33] Of course, some fields are less costly than others.[34] Current production will continue well below this price but drilling activity will plummet. We are seeing that already as rig counts have dropped. Operators are already stressed and many could enter bankruptcy. If prices are suppressed for two years, all the recent production gains would be lost. The last time low prices hit a boom like the one we had been experiencing was in the 1980s. It took decades for a recovery, even when prices ultimately rebounded.[35]

POLITICAL COLLUSION?

On September 11th last year, Secretary of State John Kerry met with Saudi King Abdullah at his palace on the Red Sea.[36] While they no doubt discussed Syria, Iran, and Russia, they most likely also discussed global oil prices.[37] Only a day earlier, September 10, it had been reported that the Saudis were slashing their production to keep oil prices over $100 per barrel. But, following the meeting with John Kerry, something seemed to shift. On November 23rd, Secretary Kerry reconnected with the Saudi Foreign Minister in Vienna.[38] This was just four days before OPEC would make a historic announcement, also in Vienna, that they would not defend prices.[39] The sudden shift in position sent prices collapsing. What had been $100 per barrel just weeks earlier quickly slipped under $50 and below $44 by the end of January.[40]

What made the Saudis change their minds so abruptly? They were set to defend prices as they typically had, but soon after meeting with Secretary of State Kerry, they pivoted 180 degrees to focus on maintaining market share, essentially pumping more oil into an already oversupplied market. Everything accelerated in November, immediately after a second discussion with the Secretary of State. It is impossible to imagine that such dramatic changes were not discussed. It appears that these were strategic decisions made with the awareness and consent of the Obama Administration.

Naturally, this raises a few interesting questions. Did the Obama team collude to lower oil prices in the economic war with Russia? The Russians certainly believe so and have reported as much.[41] Equally important, did they do so with full knowledge that such action would hamper American energy entrepreneurs who are primarily Republican supporters?[42] This theory may not be far-fetched. In the 1990s, tobacco companies primarily supported Republican candidates.[43] Senior Democrats demonized tobacco, and launched an organized push to ban its use. These were even called "the tobacco wars."[44] Is it simply that these figures opposed smoking, or was money the higher priority? Given the fact that many of the same key Democrats now support marijuana legalization, the latter appears to be the answer.[45] Consider that three marijuana joints can cause more lung damage than twenty tobacco cigarettes.[46] Clearly, it's also about money, politics and the exercise of power.

The same may be said about energy development and the environment. President Obama clearly stated that he opposed the coal industry and openly promised that his policies would bankrupt coal plants.[47] Having demonstrated antagonism to American hydraulic fracking, is it possible that the Obama administration would support policies that might bankrupt hydraulic fracking as well?[48] If so, collusion with the Saudis becomes a logical consideration. Even as American oil production has risen during President Obama's time in office, federal opposition has dramatically increased.[49]

Ironically, Russia has joined OPEC's initiative to stop the American energy renaissance. Former senior KGB officers reported that they were directed to support environmental activist groups in order to hamper American productivity.[50] Anders Rasmussen, former Secretary General of NATO, stated that former KGB Lieutenant Colonel (and current Russian President) Vladimir Putin has been funding anti-fracking efforts globally.[51] Russian energy companies have likewise been pushing money into the American "green movement" with hopes of undermining energy production.[52] Even the Chinese strategy document *Unrestricted Warfare* advocates "environmental warfare" and "regulatory warfare" to constrain the United States. It's deeply concerning to note that anti-fracking efforts have

Pumpjacks on Lost Hills Oil Field in California on Route 46. Photo by: Arne Hückelheim

prevented energy production in multiple states and even in Denton, Texas.[53] Why do you think the United Arab Emirates funded Matt Damon's anti-fracking movie?[54]

This has created a triangle of sorts. Saudi Arabia targets both American shale production and Russia. Russia targets American shale and threatens the Saudis through Iran. America supports the Saudi effort against Russia, but our domestic energy industry is in competition with OPEC and Russia. The Obama administration supports environmental opposition to domestic energy, making strange bedfellows with the Russians. While complicated, it is clear that oil is the primary weapon in play, and American energy independence is clearly in the crosshairs of many.

A NATIONAL SECURITY ISSUE

Unfortunately, the issue isn't just about money. It is truly a matter of national security. The unnatural collapse of prices threatens continued domestic drilling by making the effort financially unviable.[55] It also provides the opportunity for anti-drilling forces to triumph (in America and Western Europe only, of course) amid public apathy. Are we seeing evidence of this as President Obama proposes banning oil exploration in a large part of Alaska?[56] Without fracking, oil prices would be $150 per barrel, and OPEC projects $200 per barrel before long.[57] The West can't afford the enormous wealth transfer that would ultimately occur to potentially hostile areas. To put this in context, our entire defense budget is about $600 billion per year.[58] Since OPEC and Russia together produce close to 15 billion barrels of oil per year, $200 per barrel would provide them a combined $3 trillion. That does not take into account how losses in our economy will ultimately force military cuts.

Low oil prices are beneficial for our economy. Artificially low prices from competitors can destroy our own energy industry. Former Director of Central Intelligence, Jim Woolsey, warns that without aggressive domestic energy production, we will again be "funding both sides of the war on terror."[59] We must be on our guard against the oil weapon targeting us, even when it is manifested in low prices for the short term.

Perhaps the issue was best summarized in an editorial by Ron Insana titled "What the U.S. Should Do to Fight this Oil War."

"The U.S. has lost too many economic wars over the last 50 years, allowing foreign producers to "dump" cheap goods onto world markets to make U.S. energy companies, textile-makers and auto-manufacturers suffer near-death experiences.

The U.S. is on the edge of energy freedom … freedom from nations who use oil money to finance aggression, like Russia … to

finance terror, like many in the Middle East, most recently the Islamic State and freedom from indebtedness that may one day become quite burdensome, if not cataclysmic.

If this is the war to end all oil wars, the U.S. should use every means at its disposal to win…"

HOW DO WE WIN?

First, we need superior economic intelligence. We need to know precisely how long our shale industry can survive with low prices. Equally important, we need to know how long the Russians and Saudis can sustain their budgets with depressed revenues. In addition, the American people need to be educated about the importance of a strong and sustainable energy industry. Political winds can shift quickly and we can't afford to see the promise of energy independence die from the apathy of low prices or contrived environmental activism and regulatory campaigns.

Next, we should support efforts to lower the cost of production domestically. One good example is AERA, the American Energy Renaissance Act sponsored by Congressman Jim Bridenstine of Oklahoma and Senator Ted Cruz of Texas. This legislation would reduce stifling regulation, support the development of pipelines, and adopt other measures that could help domestic producers compete effectively.

Another time-tested solution to predatory pricing is to buy up any essential product that's dumped on the markets below the cost of production if it is also below the long-term expected price. As a nation, we already have a Strategic Petroleum Reserve (SPR) used to store oil for emergencies.[60] We could increase our holdings dramatically through open-market purchases at these depressed prices, issuing 30-year Treasury bonds and backing them with the new oil asset. Assuming that oil prices will at one point exceed the current price plus the interest rate (currently under 2.5 percent) and the cost of long-term storage, such a move would not only stabilize prices but could also prove quite profitable. As an example, the nearly 700 million barrels stored at the SPR cost an average of $29.70 per barrel, demonstrating the economic benefits available.[61] Is there any doubt that oil prices will, at some point in the next thirty years, far exceed the current level?

Another idea would be to open more federal lands for energy production, especially those that can be developed at lower cost. This would ensure that drilling activity remains at high levels for the foreseeable future. It is estimated that the amount of recoverable energy on federal lands is almost 1.2 trillion barrels of oil and over two quadrillion cubic feet of natural gas.[62] Even at $50 per barrel, the oil resources alone would be valued at about $60 trillion, more than three times our current stated national debt.[63] Yet, despite this, the government leases only about 2 percent of federal offshore areas and less than 6 percent of federal onshore lands.[64]

There are multiple solutions and we will likely need to combine several to be effective. Unfortunately, mainstream reporting on the subject is typically superficial and there is general ignorance surrounding the problem. Based on the actions of the Russians and Saudis, however, the conclusion is obvious. Oil is a weapon and this is a matter of national security and long-term survival. ●

ABOUT THE AUTHOR

Mr. Freeman (CFA) is the author of Secret Weapon: How Economic Terrorism Brought Down the U.S. Stock Market and Why It Can Happen Again *(www.secretweapon.org). He has consulted for and briefed members of the U.S. House and Senate, CIA, DIA, FBI, SEC, DOJ, and Homeland Security on the issues of economic warfare and financial terrorism. He authors the blog www.globaleconomicwarfare.com.*

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