

THE NEW MIDDLE EAST

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In this engaging presentation, Peter Zeihan discusses the changes in global perspective: The United States' need for the Middle East has changed; Russia sees the Middle East as a means to other ends; and a new contest is shaping up between a rapidly normalizing Iran and a Saudi Arabia that is terrified of this new Iran. Zeihan also speaks on global stability and the future of terrorism: A global energy crisis will soon draw many countries into the Middle East, and a simultaneous political crisis will erode local state authorities, unleashing violence and terrorism. "It is both far worse and far better than it sounds."

John Authers: Well, thank you very much indeed for that introduction. I would like to thank the CFA Institute for giving me the honor of chairing the final session of this conference. And I'd like to thank all of you for not going to the airports just yet.

Now this is actually the second time I've been lucky enough to chair the final session of a CFA annual conference. The last time I was in Edinburgh five years ago. And that time, we actually had — for the only time I've ever seen this — a standing ovation for one of our speakers. So I'm hoping that we might well get something similar this morning.

Now first of all, I'd like to introduce our first speaker, who is Peter Zeihan. Now Peter Zeihan is president and founder of the firm Zeihan on Geopolitics, where he examines how the concept of place affects financial, economic, cultural, political, and military developments. Before that, he was Stratfor's vice president of analysis. And before Stratfor, he worked at the US embassy in Canberra, Australia.

He's also served as Susan Eisenhower's office coordinator at the Center for Political and Strategic Studies. And he's the author of a book, *The Accidental Superpower*. He's been featured in and cited by numerous newspapers and broadcasts around the world, including the *Wall Street Journal*,

Forbes, the AP, Bloomberg, CNN, and the *New York Times*. Ladies and gentlemen, please welcome Peter Zeihan.

[APPLAUSE]

Peter Zeihan: Good morning, everyone. About two months ago I was in Phoenix for an ag conference, all India and Indiana. And I butted heads with their conference director, a woman named Lindsay. She had the audacity to demand that my slides get in a week ahead of time. And I like to show up, saunter in with my keynote five minutes before, plug in my Iron Man zip drive, and just go.

But she kept bugging me, day after day, after day, after day. So finally, I sent it in. I was like, OK, just take it and leave me alone now. And two minutes later, my computer caught on fire.

Consider my relationship with Lindsay. I hadn't changed, she hadn't changed, but the environment in which we related to each other had.

The point of this presentation is to explain to you that the environment that we're all operating in is about to go through the greatest transformation in at least the last three generations, quite possibly the biggest one in a couple of centuries. With that understanding, let's get started with where we came from.

Before the world that we know today, the global system was imperial. The French traded with their colonies, the navy protected that trade. The British did the same, the Japanese did the same, and so on. It was a sequestered imperial system.

You tried to avoid trading with your neighbors because you never knew when some moron on the other side of the planet would throw a war. And even if you weren't a target, you could lose access to the resource, the trade lane, the market that you thought was so important. You kept everything in house. And if you saw something you needed, you would go out and you would colonize it, you would militarize it, you would confiscate it, and you'd fold it into your own sequestered system.

These systems competed for resources, for markets, for trade access. Those competitions turned into wars. And at the end, those wars culminated into World War II, which brought the whole system crashing down.

Now at the end of the war, the Americans brought their allies together for a conference at a place called Bretton Woods. And what do you do at a conference? You bribe everybody with golf and then you lock them into a windowless room. We've all been there.

At Bretton Woods, the Americans explain to their allies that the global system was going to work differently when the war ended. Instead of everybody having their own separate network, all global assets would be pooled. Everyone in the network would trade with each other.

In addition, the United States promised to open up its markets to allow everyone to trade into the American market, which at the time was greater than the combined markets of everyone else in the room. There was a catch. You had to allow the Americans to fight the Cold War their way.

This is the root of NATO. This is the root of the Japanese, the Korean, and the Taiwanese alliances. The idea that everybody is on the same page militarily and economically. And the economics were the bribe to make this happen.

It worked. The Soviets eventually fell, global GDP expanded by a factor of 10, the global population tripled, the alliance was expanded to country after country, ultimately culminating in communist China, to the greatest economic and military strategic network in human history. And then one day it was all over. And the Americans had no idea what to do next.

So free trade was allowed to linger on. It became the de facto way that the world worked. But the security trade-off that had driven the Americans to do that in the first place was dropped.

As time moved on, things changed. China became the number one manufacturing power. Brazil started challenging the United States in agriculture. Russia showed that you didn't have to be American to throw your weight around on the international stage.

But you've got to remember a few things. First, all those countries that the Americans aren't sure about are able to do the things that make them the countries that America is not sure about because of Bretton Woods. What is Russia without international energy markets? What is Brazil without credit? What is China without trade access?

Second, the United States has never used Bretton Woods for its economic purposes. As a percentage of GDP, the US is the least involved economy in the world. In 2015, only 8% of GDP came from merchandise exports, most of that to NAFTA, not global.

And so when you hear people like Donald Trump say that they would forcibly renegotiate every free trade deal on the books, or folks like Secretary Clinton saying that she is opposed to every FTA that has been negotiated in the past 25 years — including the ones that she personally negotiated — this isn't rhetoric. This is not the fringe. This is the American political center groping for a replacement for a policy that's now 25 years out of date.

Third, when the United States finally does walk away from the table, it will still have these suckers. One American carrier battle group has more offensive capability than the combined navies of the

rest of the planet. And the US has 10 of these. The United States is transforming into a country with a global reach but no global interests. And for the 4 billion people on this planet that are utterly dependent upon global trade for their well-being, that is quite possibly the worst possible outcome.

And then fourth, the Americans are about to be too busy to do anything else. The political system is breaking down.

Now, the reason that the Republican coalition tends to win elections is because it's made up of five independent coalitions that don't undermine each other. So for example, the business folks don't really care what you do with your personal life, whereas the pro-lifers don't want to shut down the Marine Corps. They all show up to vote. It's very easy to have a platform that doesn't contradict itself. They tend to win.

The Democratic side is very different. It's a broader coalition, but it's a much more fractious coalition. The blacks and the gays have very different concepts of what civil rights mean. The socialists and the under-30s tend to be at odds with the greens and the unions. And the greens and the unions disagree on almost everything, especially when it comes to industrial policy.

And then in the middle, you've got the groups that the two sides try to swing to them. They tend to be economically liberal. They tend to be socially conservative. But they're both very squishy. Now this is how it's worked in the United States since the 1930s. What's happening right now in the American political system is a radical departure.

So let me just go down the list here. The business community. Because of campaign finance reform, they have not played this round. They have not had a candidate since the very beginning. The national security conservatives took one look at Trump, especially after he started criticizing John McCain for getting captured in Vietnam, and then they looked to Hillary Clinton, who they actually think did a decent job looking out for their interests while she was Secretary of State. The evangelicals currently are supporting Trump, but as long as he tends to brag about his sexual prowess on live television I would not call that firm support. The pro-lifers and the pro-choicers know that Trump was in favor of abortion rights two years ago. So they're in the wind.

The blacks will not vote for a 60-something white woman the way they voted for a 40-something black man. The gays got everything they wanted last year. They're in the wind. The socialists and the under-30s, who are so firmly supporting Sanders, they're not going to show up.

People have been talking a lot about how the Republicans might have this brokered convention, and the idea being that the senior leadership of the party will impose a candidate. The Democrats handled that 10 months ago. They decided to crown Secretary Clinton. There wasn't supposed to be a single debate. We've now had 16. And so when the move is finally made to pull the rug out from Senator Sanders, don't expect these people to show up at all.

The unions hear Trump's talk on free trade and they're like, hey, this is really interesting. The Hispanics oppose Trump 8 to 1, until you look into the data and realize that if you only look at possible voter citizens — as opposed to immigrants — he's only behind by 5 to 4. And then the Catholics look at both candidates and just want to take a shower.

[LAUGHTER]

Here's where we're going. The party coalitions on both sides are already broken beyond repair. The last time this happened, it was in the 1930s. We had the Great Depression; we moved into World War II; we had the most popular president in American history, FDR. It took us 15 years for the parties to settle into their new form, the form that we know today.

Even if the Americans were convinced that their economic and physical security required international engagement, they are about to step out to lunch. And it's going to be a very, very long lunch. Just as the rest of the world needs the Americans, they're leaving. That's piece one.

Piece two is demography. Now this is a standard demographic profile: children at the bottom, young adults, mature adults, retirees, men on one side, women on the other. Simple mortality makes it a pyramid.

Now you can split this into three relevant chunks. First, you've got your young workers. They're starting out. And it's all about the consumption with these guys, because they start with nothing. So it's buying cars, and buying houses, and going to college, and raising kids, and smoking pot. It's spend, spend, spend, spend, spend. But they're new. Their incomes are low. That don't match their needs. So it's college loans, car loans, house loans. High growth, but high debt.

Then you've got your mature workers, people roughly aged 40 to 65. The kids are moving out, the house is being paid down, they're looking towards retirement. They're saving. They're at the height of their spending, but they're not consuming very much. So all that money is going into the retirement funds. The government sees this as the tax base. High investment, high taxes, low spending.

And then you have your retirees, who can't take the volatility. They step back from the system. Stocks and bonds become T-bills and cash. They can't take the volatility. This is how it normally works.

Here's where we are in Canada. Apparently, back around 1972, all y'all forgot how to have kids. And you now have a baby bust two generations in the making. Now you've got a huge bulge in your 50- to 60-somethings. That means that you have more tax income and more investment dollars than you have ever had in your history. That has allowed Canada to build one of the world's most liberal social welfare models and have enough money left over in the couch in order to fund the entirety of the Athabasca tar sands project, the world's most expensive energy project ever.

But in six years, that bulge moves into majority retirement. And all that money that is coming in will reverse. And instead of contributing to the system of the tax payments, these people will be pulling from the system with pension and health care. Canada will go from one of the most capital-rich countries in human history to one of the most capital-poor in six years.

And that cutout at the bottom, there's no replacement generation. There's no consumption. There hasn't been consumption-led growth in Canada in 20 years. And there won't be for at least another 30. So that's no consumption, that's no investment. That only leaves exports. It's a good thing that there's NAFTA.

Now here's the United States. Where are my baby boomers, people born 1946 to 1965? Don't be shy, come on, come on, come on. Freaking army. You guys are the largest generation in almost all of my presentations. I've given presentations in high schools and you guys have been a large group. It's ridiculous.

Now the problem with your generation — well, one of the problems with your generation — is that there's just too damn many of you. You do everything as a swarm. And when you went into the job market back in the 1970s, you took every single job that was available, and there still weren't enough.

So a lot of you had to take jobs that were well beneath your skill set. You pushed down your own compensation for decades. You've been struggling with that your entire professional careers.

And now that you're nearing retirement, you're doing exactly the same in the investment world. You have supersaturated all available investment products in North America, driving down yields. You're tolerating more risk than you should.

And now you've spilled that money out to the wider system. This means that things like Enron are your fault. Subprime is your fault. Disco is your fault. The brick boom is your fault. And in seven — six to seven years on average, when you all enter retirement, all that money has to turn around and come home. We're in an investment boom right now, and the bust is just around the corner.

Now millennials, 1981 to 2000. Hey, it is a treat to have millennials in the audience. It does not happen very often for me, because most of my presentations are before noon.

[LAUGHTER]

Now, the millennials have many of the same challenges as their folks, the boomers. They're the echo boomers. There's too many of them for the jobs that are available. But they have a couple of core advantages that other folks did not have.

First of all, they have a different educational outlook. So in this new Uberized economy, where everybody has a new career every other Tuesday, they're actually fairly well prepared for that. Second,

half of them still live at home. And of the half that have moved out, they've only been able to pay the rent because of continual bank transfers from the financial institutions of mom and dad.

And then we've got the men in the middle, the X-ers, 1965 to 1980. Oh hey, we're all here. We're the smallest generation in history. And the technical term for our financial position is "screwed."

[LAUGHTER]

Because the boomers have decided that we have to pay for the retirement, despite the fact that there are 75 million of them and 11 of us — not 11 million, 11. We have to make up for all the funds that have already been transferred from the boomers to Generation Y. And we will not be able to change the system via the ballot box, because we will not outnumber the boomers until we are in our 70s. Bleh.

Now as much crap as I give Gen Y — they deserve every shovelful — thank god they're there. Three things. One, that bulge right there, that's why the United States is not in recession. That's a consumption-led demographic. That is where the growth is coming from. All that beard cream, all those flip-flops, it adds up.

Second when Gen Y matures — and I use that word in its loosest possible way — they will fill out the ranks of the tax-paying class in a way that Gen X just never has been able to. So in 15 years, Americans finances more or less rectified themselves.

Third, everyone else has the Canada problem. This is the developed world without the United States in 2030. There are no Italian Ys, or German Ys, or Japanese Ys.

We are today in a world where the US is the largest consuming power and the largest financial power because of its demographics. In 15 years, we'll be in a world where the United States is the only financial power and only consuming power because of its demographics, certainly not because of policy. Fifteen years. That's the transition.

Quick around-the-world. Top left, that's the Russian Federation. There was a 60% drop in the birth rate post-Cold War. The Red Army will be less than half the size it is today because in five years, everybody in the army will have been born during the baby bust. If the Russians are going to use military tactics in an attempt to reshape the world, they have to do it now, and so they are.

Bottom left, Italy. This is, in one picture, why the European financial crisis is unsolvable. There is no consumption-led growth in the periphery any longer. They've aged past that. This should be capital rich, but because of the debt, all of the investment has to go to debt servicing.

And as bad as that is, here's Germany. People criticize the Germans for not spending more. They don't have a demographic that can support it. They do have a demographic that is capital rich, that has generated a lot of exports. And that export and investment income can pay for the bailouts of the periphery for another seven years. And at that point, the Europeans will have to figure out how to make Europe work without exports, without consumption, and without money. Ew.

Top right, there's Brazil, the young consuming power base of the future, right? All the data up here is 2015 except for Brazil. Brazil is 1990. Here's Brazil today. They are aging at four times the European rate and six times the American rate. They will be old long before they get rich.

And then you have the People's Republic of China. Twenty-five years after the one-child policy, they're running out of 25-year-olds. People tell me the Chinese are good at math, but it is not in the data. It's actually worse than it sounds. That spike up there, the 25-year-olds, that's 120 million people — that's real consumption. I don't mean to say it's not.

But check this out. That blue fringe is the surplus male population. You take a patriarchal society, you tell people they can only have one child, female infanticide is very common. There's a 10% to 15% sex imbalance based on which province you're in. That's worse than it sounds.

Because when the manufacturers on the coast realized they were facing labor shortages — and they've had labor costs increase by a factor of 10 in the last 15 years — they went inland to find new workers, but they only brought back the women. Why? You can put six chicks into a 300-square-foot apartment. It's reality TV. You do that with six dudes, you have severed limbs in the fridge by week's end. It's a security issue. Men and women of childbearing age are not simply separated by socioeconomic status in China; they're separated by physical province. This is already demography every bit as terminal as what happened in Italy.

Now you may have heard that they dialed back on one child, turn into two child back in November. Well, riddle me this: How long does it take to make a 25-year-old?

[LAUGHTER]

Twenty-five years, nine months, and a bottle of wine.

[LAUGHTER]

First beneficial consumption-led and labor outcomes are a generation away. And China does not have that kind of time.

And then third, just very briefly on energy, what we have here is a price structure chart. The horizontal axis is the volume of output; the vertical axis is the full-cycle breakeven cost. You can

notice that shale is all the way down at the side and all the way high. Back in 2012, shale was not a big deal. But in the last 16 months, a series of technologies started being operationalized and brought together into a best practices suite.

Things like re-fracking and in-drilling, where you can go to an old, decade-old well, bring it back to not just its original output but 10 times the original output. Things like multilateral drilling, which used to allow horizontal connections for one well bore of 150 meters. Now it's 50 kilometers. Things like micro seismic, where you now get a 3D picture of the drill, know exactly where to go and where exactly where to frack, which have dropped input costs by 80%.

The result is a massive change in the cost structure. Here's shale today. The breakeven cost in the American shale patch is now below \$42 a barrel. It will be below \$35 by the end of the year, making it cost-competitive with every energy production zone on the planet not in the Persian Gulf itself. North America, for all practical purposes, has already achieved oil independence. That's where we start.

Four big challenges hitting the Middle East. First one is terrorism. This is a piece of my global stability map. Countries in blue rule the chaos. They have everything that they need to do in a post-American world. Countries in green, more or less the same situation they're in today. Yellows and browns are where things fall apart.

The yellows have something — a unified population, self-sufficient in food, an ally they can trust — something. They can meet the challenges of the future head-on. They'll lose more often than they win, but they'll be OK; they'll muddle through.

Countries in brown won't. Countries in brown are utterly dependent on the global system in its current form. And they lack the ability to impose an alternative, even in their own neighborhood. As for the reds, if you don't know their names now, don't bother learning them — they're not going to be there in a few years.

Terror groups, trans-continental terror groups, need a very specific social and military environment in which to swim. They want a government that is strong enough to impose a veneer of civilization. Because if you have anarchy, they have to fight for their own backyard. And they don't have the ability to plan and project. But they don't want a government that is too strong, that could come in and wipe them out. Those are the brown countries on this map. Those are the things — those are the places that terror groups can actually function.

And if you cross that with the Islamic population in the world, there are really only four zones where it's even theoretically possible. Three of these are contained. The Western Sahel, that's Nigeria's problem, that's Boko Haram. The Chechens, that's Russia's problem. Kashmir is an India-Pakistani problem. That only leaves western Iraq, the Sunni population of western Iraq, ISIS. That's it.

I don't mean to suggest that there won't be terror attacks. I'm saying that the structure of the world as global trade breaks down will make transport more difficult, will make financial transfers more difficult. And the magic mix of security that terror groups require is very hard to come by in the Arab world. You'll either have national security states that can tramp them out, or you'll have national chaos, like Libya, where they can't function. Very little in between. So that's problem one. Terrorism is coming back. It's a very big problem. But it's a local problem.

Challenge number two is demography. The primary protesting group in any country are men aged 15 to 25 who are unmarried. And if you look at the Arab world, that group is huge, particularly in Egypt and Iraq, which are the top two.

You go down into the Gulf states — they're down in the bottom, Saudi Arabia and the UAE — you'll notice this big bulge in that group. But those aren't locals, those are imported workers. Let me show you what the UAE really looks like here.

[LAUGHTER]

This is not a new problem for the Gulf. They know how to deal with this. They have internal security services to deal with this. They have money to deal with this. So I don't worry about Saudi, I don't worry about the UAE — even though the structure looks pretty bad. I would worry about Bahrain and Oman, the countries that can't afford to maintain social security.

But for the poorer parts of the Arab world, the spring is something that's going to happen over and over and over again. The only country in the world — excuse me, the only country in the region that doesn't have to worry about this is Iran, because there was a baby bust at the end of the Shah's period. Their 15 to 25 is shrinking and shrinking rapidly. That will cause economic problems for them down the road, but from a security point of view, if there was going to be a rebellion in Iran, it was going to happen five years ago, and it didn't. This frees Iran to spark revolutions and not have to worry about its own. So that's challenge two.

Challenge three, what happens when the global system changes? This is a heat map of how the US saw the world back in 1985. Dark blue, that's the family, that's the inner core. Medium blue, those are the chief Bretton Woods allies that fought the Cold War with the Americans. The orange, of course, is the other side. And the light blue is the field of battle. The United States could not afford anything to drop during the Cold War, because if it did, it would threaten the integrity of the entire alliance.

Think about what happened in the Persian Gulf. The reason that the Persian Gulf has been so calm these last 60 years — just marinate in that statement for a moment — is because the United States kept an aircraft carrier battle group on station in the Gulf at all times to prevent the Saudis and the Iranians from going at each other. It's not because we particularly liked either of them, but

it was all about the oil. It's not that the United States was using it very much, but the US needed the oil to flow in order to fuel global trade. It needed global trade in order to fuel the alliance. It needed the alliance in order to guarantee its security.

But now American security is a domestic concern. It doesn't need the alliance. It never used the trade. And because of shale, it no longer even needs the oil. The entire chain of dependencies that kept the United States involved in the Persian Gulf have all broken at the same time.

And that leaves us with this. The US is checking out. It's entering a period of retrenchment — isolationism, if you prefer. It will have a sharply shorter list of values with a sharply shorter list of interests. And if you're not one of those allies and you're not protected by one of those interests, you have to start looking out for your own affairs. And nowhere is that more important than the Saudi–Iranian competition.

What's going on in the region now is a competition at every level — political, cultural, religious, ethnic. And now because shale has removed North America from global energy markets, it's economic too. These two countries are sending exactly the same product, along exactly the same trade lines, to exactly the same customers. It's like we're back in the 1800s all over again with two countries that really don't like each other. I don't care if you were selling Styrofoam that way; that causes strategic competition.

The Iranians aren't quite sure what's going on, but they're excited about their opening. The Saudis, in contrast, are terrified. And they have come up with a two-part plan with the intent of destroying the Iranian state.

Step one is the price war: completely gut Iran's capacity for bringing in money. Income, investment, you name it. If you go from the peak of pre-sanctions to today, it's an 80% drop in Iran's oil income. And the Saudis are now doubling down on that in an attempt to crush any foreign interest in the Iranian oil patch.

Step two is to try to bleed the Iranians economically and physically. They're using their money, their intelligence assets, and whatever weapons they can ship to any group that is willing to go to war with Iran, Iran's allies, or Iran's proxies. There are eight major conflicts in the region, three of which are now open wars.

What we have here is a heat map of who's on whose side. The blues tend to be pro-Iranian; the greens tend to be pro-Saudi. If you go to a year ago, when the atrocities in Syria were getting very serious, that is what it looks like when the Saudis are winning. Careful who you cheer for.

It's probably best to think of this rivalry — it's one of the rivalries for the ages — as very similar to the rivalry between the Maple Leafs and the Habs, just with more guns — OK, a lot more guns.

And like all of the world's great rivalries, eventually fans end up in the wrong bar. Down here, in downtown Toronto.

[LAUGHTER]

We have 2 and 1/2 million religious Shia living in Sunni Saudi Arabia. Iranian intelligence for years has been trying to stoke a rebellion there, not just to cause the Saudis problems. But as you all know, downtown Toronto is where the Ghawar super-field is. It's the world's largest oil-producing asset.

Not to be outdone, up here at Bell Centre, you have three million ethnic Arabs in Persian Iran. Saudi intelligence is trying to return the favor, stoke a rebellion, not just to cause a headache. But this is where 80% of Iran's oil and natural gas is produced. Assuming no one else gets caught in the crossfire, that's 11 million barrels per day of output that faces some degree of threat.

The challenge moving forward is, where does this go? Because eventually, the Iranians are going to understand that the Saudis are not just going for their throat, but they're not going to stop. And the only way that the Iranians know how to fight is to try to close down the Persian Gulf.

The strategy has always been very straightforward. You close the Gulf, you trigger a global energy-induced depression. And the Chinese, the Japanese, the Koreans, the Brits, the Germans, the Italians, and the French all come to Washington and say, "Fix this. It's part of the Bretton Woods deal. You keep the energy flowing." And 10 years ago, it would have worked. But today, the Americans just don't care.

And Saudi will help. Because Saudi Arabia has a bypass pipeline. So if you take the Gulf offline, the Saudis can still get six million barrels per day out. Oil prices will more than double. The Saudis will still be able to get two-thirds of their output out. And if you're Iran, your only remaining option, that is an outright invasion. And how that will go, too many factors in play to tell. But it's a fair fight.

Fourth challenge. New foreign players that don't have Americans' hands-off approach are coming into the region. What we have here is a climate map of the former Soviet Union. North is to the right. Blue is tundra; can't live there. Yellow is desert; can't live there. The hashes are mountains; can't live there. The green area — if you're going to live in Russia, that's where you want to live. It's not so cold that your snot will freeze in April. It's close, but not quite. It's the Russian wheat belt.

You'll notice that there's huge areas of tan around the green zone. Russia's problem is it's unfortifiable. It has 6,000 miles of open, indefensible terrain.

Now the Russian plan since the Czar has been pretty straightforward — go to these barriers and anchor in them. Because if you can occupy all of them, 6,000 miles of indefensible border shrinks down to 1,500 miles of gaps. And those gaps are traditionally where they've been invaded.

The problem is this involves absorbing all or part of 16 countries, 5 of which are members of the EU and NATO. Now with the Americans, this is rapidly fading from relevance. Because the United States has been looking at NATO the last few years and seeing fair-weather allies. And the idea that the United States is going to put tens of thousands of troops on the plains of Europe in order to defeat a demographically desperate Russia with nothing to lose, while all of the countries it's assisting are using more Russian energy in absolute and relative terms than they did at independence — that's a bit of a hard sell.

Doesn't mean it's going to be easy for the Russians. They're going to have simultaneous conflicts with the Scandinavians, the Germans, and the Turks. And the Russians may think very highly of themselves, but they don't think that's a war that they can win. They need a distraction. They need to take some of these players off the board.

And that is ultimately why they're in Syria. The yellow areas are places where ISIS operates. The orange areas are places where ISIS controls. There's only so much control you can have in empty desert where no one lives. This oval is all empty desert, with the exception of that thin strip of the Euphrates, which at its widest point is less than 16 kilometers. The rest of it is utterly useless.

Usually what happens in this region, going back to antiquity, is when a local group starts causing too many problems, the Mesopotamian army, the Anatolian army, or the Syrian army sweeps in, kills a lot of people, burns everything to the ground, and then leaves. They don't even patrol the area normally, because it's not worth their time. There's not enough there that's worth fighting for, so they just do a prairie fire security sweep every once in a while. That hasn't happened yet, because Syria and Iraq are in civil war and the Turks are still on their vacation from history.

This is the part of Syria that matters. This is where it actually rains. This is where you can live. The Aleppo–Homs–Hama corridor is home to 60% of the population and 85% of the food production. This is the picture that the Russians see.

Now pay attention to these two arrows. From 2015, where we are now, the Russians then intervened, and this is how the map changed. Look where ISIS is. They penetrated into the core. That's what generated a million refugees, which had no choice but to go north into Turkey and then beyond into Germany.

The Russian play was to flood the Turks and the Germans with so many refugees that it destroys the bilateral relationship and makes them incapable of taking steps to counter the Russians in Ukraine. And it worked beautifully. Morally, this is the most repugnant thing I've seen in foreign affairs in the last 15 years. Strategically, this is one of the smartest things I have ever seen. And the beauty/horror of it is that the Russians can do this at least another eight times. Something to look forward to.

Finally, there is a whole new series of players that have never had anything to do with the Middle East that are about to come in full bore. Whenever you have an energy disruption in this new world — whether it's in North America, whether it's in Brazil, whether it's in the former Soviet Union — as energy gets used as a political football between the Europeans and the Russians, or of course the Saudi–Iranian fight, four countries have to suck up the entirety of the shortage: China, Japan, Korea, Taiwan. Because they are 7,000 miles from the nearest oil. And everyone else gets to take their share before the tankers get to Northeast Asia.

And so if you are Japanese, or Korean, or Chinese, or Taiwanese, you have one thing that you can do. Sail your navy to the Persian Gulf; pick sides in a centuries-old blood feud; physically escort the crude all the way home; and hope that someone else in the quartet doesn't take it from you. If this were anywhere else in the world, I'd say there's trouble coming. But luckily this is in Northeast Asia, and we all know that the Taiwanese, Koreans, Chinese, and Japanese have a centuries-long history of brotherly love and cooperation, and nothing could possibly go wrong.

Four outcomes from this. Number one, all four of these countries will find themselves forced to be involved in the military conflicts of the Persian Gulf. Not an American-style “keep them apart and keep the energy flowing.” A more direct, a more intimate, a more violent, a more visceral involvement that's much more like the imperial age, where you had to physically get the asset, guarantee its shipment, and perhaps sabotage everybody else's. It's a different kind of relationship.

Second, you have an energy price split. On one hand, you've got North America, where small and medium companies produce the crude based on market conditions. It's short-haul transport, mostly via pipeline within two first-world countries: Canada, the United States. It's stable. And it probably has a price ceiling of \$60 to \$70.

And then you have everywhere else, where the major players are giant, state-owned firms that make the production decisions based on strategy as much as economics, where it's long-haul transport measured in the thousands of miles that go through zones they don't control, and where security is a constant issue. The floor in that environment is probably \$150. And then add on a \$50 or so premium for Northeast Asia, where there's simply insufficient volumes and things get interrupted all the time.

Third, manufacturing as we know it is about to end. Pre–Bretton Woods, we had giant industrial complexes — cluster manufacturing is the hot term these days — where you would bring in inputs, they would be developed in that area, turned into finished products, which would then be distributed around the world. One-point production.

Bretton Woods did away with that. Bretton Woods made international trade and transport cheap and safe, reliable. We broke up those industrial conglomerates, relocated plants wherever it made sense. Became first dozens of steps, then hundreds, ultimately thousands of steps in your average supply chain. Containerized shipping.

But the first time that one of these tankers is shot at, or captured, or — God forbid — sunk, that’s it. The cost of transport skyrockets, and half of the world’s supply chains collapse overnight, not to mention anything that involves the Northeast Asian four. We are on the verge of a world where inputs, and production, and consumption do not simply need to be protected, they need to be co-located. And that only happens in North America right now.

And then finally, there’s the capital flight issue. When you have breakdown in trade, when you have breakdown in social stability, when you have a collapse in markets for demographic reasons, when the lights go out because you don’t have enough energy, you’ve got to find a way to stash your cash someplace safe. In ascending order, those places are New Zealand, Australia, Switzerland, Canada, and the United States. That’s the whole list. Oh, crap, United Kingdom — sorry, Brits.

In 2015 alone, that was over \$2 trillion US dollars. And so we’re now in this world where we know for demographic reasons that the overall volume of capital is steadily shrinking, with the real big flip year probably 2021–2022. And while that’s going on, we’ve got these spurts of capital flight driven by geopolitical concerns that sometimes are going to override what’s happening up with demographics. Last year, they certainly did. But they won’t every year.

The result is a world that will fragment. The result is a breakdown in global trade, global commodities trade, different markets, different differentiators, spot markets for things like, well, everything.

I think that’s enough for now. That’s a lot of territory to cover. I want to leave as many questions — or time for questions as we have. I’m going to put this map back up. It’s a good backdrop. You guys laughed at all but one joke. I appreciate that. I will remove it from my deck. Thank you very much.

[APPLAUSE]

John Authers: Well, thank you, Peter. Thank you in the audience for providing these questions that are coming in. There’s still time for you to get questions through for me to pass on.

Let’s start with — this is a financial conference. Various ways of asking this question, but perhaps at its most brutally simple: So, what does this mean for the oil price, then?

Peter Zeihan: In the short term, until the Russian conflict or the Iranian–Saudi conflict really get going, you are looking at an absolute ceiling on prices. One of the fun things that’s going on in shale is that the price structure has dropped so much that there really is a functional ceiling right now of probably \$50. That will continue to drop because we’re seeing the higher-cost production go offline in places like Canada, in places like the US “nodding donkey” fields in western Texas or California. We’ve seen a complete stop of operation, even stop of maintenance in places like Russia and Norway.

And the shale just picks up the slack. They still haven't fallen. We've now had 14 months in a row where the EIA has said that this month is the plateau, and they keep revising it. So output is relatively steady, even rising a little bit. It's not falling. And as long as we don't have those geopolitical shocks, don't expect prices to rise in any appreciable time frame.

As soon as the shocks happen, everything changes. You get a break in the global market, you will see the populist government of the United States — whether it's a Hillary, whether it's a Donald — slap back on the oil price, the oil export ban immediately. Because there is no way that the government that is forming up is going to choose to expose American voters to high prices when there's a way to make sure that that doesn't happen. And so you'll have high prices globally, erratic prices globally, and relatively low and stable prices in North America.

The question is how to profit from that. You can't do it with direct crude trade. You can do it with refined product.

One of the side aspects of the shale revolution is that natural gas in the United States is, in essence, free. And so methane, and ethane, and LPGs are eating into the naphtha feed stock that has normally dominated refining. Because, what can't you do when the feed stock is free? And you're seeing American refining products and petrochem expanding massively, because costs in America are minimal and you can sell them in the international market for a hefty profit.

John Authers: But ultimately, you see a bifurcation. Once the shocks you're predicting happen, we still have stable oil here in North America, and the great split between North America and the rest of the world takes place?

Peter Zeihan: Absolutely.

John Authers: Both geopolitically and in terms of what prices of oil prevail?

Peter Zeihan: Yeah, a complete bifurcation. You're going to have a ceiling here of \$60 to \$70, a floor everywhere else of about \$150. And for countries that have a Western hemispheric security, like Venezuela, this is a wonderful opportunity. Because investment will go — will not go to Venezuela when prices are at \$50, but they will go when it's \$150.

John Authers: Now one topic that has sparked a lot of questions is immigration and its link to demographics, particularly in Europe. Is there any sense in which this huge flow of people into Europe in general, Turkey and Germany in particular — could that actually come to the rescue of Europe's demographic problem? Is there an opportunity there for some of these very ugly demographic pictures to be improved by the flow of people caused by migration?

Peter Zeihan: Well, the short version is no, because of the wrong people that are leaving. About 80% of the flow are men aged 15 to 25 who don't have technical skills, who don't speak the European languages. So they are literally refugees who are looking for low-baseline work. Educating them in order to be a useful labor force, much less a useful consumer base, is a decade-if not two-decade-long process. All of the Syrians who had the skills that were marketable left three years ago. And they didn't go to Germany or Turkey; they went to France, the United Kingdom, Canada, and the United States. And they're not going home.

John Authers: So ultimately, no? All it does is, if anything, exacerbate the problems that were already there?

Peter Zeihan: Right. What you need is skilled labor. And the big problem with global immigration in the new era is not that it's not going to exist — it is. But the cream of the crop, the skilled labor who has a suitcase of cash or a degree, are only going to the countries that are economically stable, not the ones that are necessarily demographically crushed. That's great for Canada, that's great for the United States, that's great for Australia. It's really not good for continental Europe.

John Authers: Now let's talk quickly about — Middle Eastern politics is an issue that comes up. Two particular points. First, do the recent Iranian election results, which suggest some possible long-term reform in terms of the next supreme leader, what will affect — what effect does that have on the IRGC? How do they react? How does that change the picture?

And then, how does Israel fit into all of this? You managed to have a very long talk about the Middle East without even, I think, even once mentioning the word "Israel."

Peter Zeihan: Let's start with Israel, because it's pretty simple. Israel's problem is that it won. Every conflict that they've been involved in that was strategic, they've won. And now every country that they border is either a failed state or militarily incapable of posing a threat.

Now there is another belt of states beyond that that are potentially threatening. And they would certainly appreciate it if the United States would fight those wars for them. US has no interest in that.

But Israel is fine. In fact, they've already even replaced the United States with another ally, the Saudis. There is a nice little deal in place where the Israelis are providing military assistance to the Saudis to teach the Saudis how to use their own weaponry, since it's almost all from the United States. So Israel is absolutely fine. Push comes to shove, they'll be getting Saudi oil.

Iran is a little bit more complicated. Let's assume for the moment that everything goes in the liberal direction and that everything in Iran is built around the reform process. You will see the first meaningful development of a consumer market and an industrial base about five years from now. The Saudis' price war will have destroyed their finances long before that. It's simply too late.

Had this happened 5, 10 years ago, I'd be all on board and looking at it. But it's simply too late in the game. And the IRGC, they have no problem killing a lot of people to get their way. So I'm really not convinced that this reform process is going to go as well as people hope.

John Authers: So that answers the next question I was going to ask you, which is what economic or political benefits do the Saudis expect to get by destroying Iran economically. Does this actually help the Saudi Arabians, other than making them feel happy about the misery, other than creating some *schadenfreude*? Then one other question is, if Ireland can move to becoming a peace area, which it has more or less done, why can't Iran and Saudi Arabia do the same thing?

Peter Zeihan: Why, because they both have I's?

John Authers: They're next to each other in all examples.

Peter Zeihan: Exactly. So Saudi Arabia's goal here is to destroy Iran as a functional economy. If you have Iranian crude go offline, if as part of the conflict output from Iraq and Kuwait is compromised — which is highly likely — Iran is left as the predominant energy player in a newly volatile world with double energy prices, triple energy prices from where they are right now, probably with a partnership with Japan. That's probably how this ends up. The risk is, of course, that they lose the war, in which case all hell breaks loose.

John Authers: Right.

Peter Zeihan: The economic development plan that the Saudis are putting into place is honest, it is real, but it will not bear its first fruit in the next 15 years. Because the first thing they have to do is bring in — oh, let's be kind and call it 50,000 experts to train the local population. The cultural aspect of that alone is a decade-long process.

So don't hold your breath there. I'm not saying that there's not potential. The Saudis are certainly going to splash a lot of cash on this program. But the initial output will be a long time coming.

As for the Ireland comparison, the reason that Ireland was able to pull itself into the modern world is it served as a bridge between American investors in the Eurozone market, using England as the logical linchpin. Because of demographic reasons alone, the financial system alone. European stability is breaking down. The market is breaking down.

Ireland is going to have to find a new model. And if it can't, its past is going to look — its present is going to look a lot more like its past. And that assumes that Brexit doesn't happen, which now is even odds. Because if Britain leaves, the entire Irish plan to be that lily pad dies in a day.

John Authers: And the Scots might also leave Britain and try to open up a rival lily pad in Europe.

Peter Zeihan: In the interests of full disclosure, I'm a big supporter of Scottish independence, I'm a big supporter of Brexit, but for the same reason that I was a big supporter of Sanders and Cruz. I make my living communicating and explaining —

John Authers: Shaking things up.

Peter Zeihan: — dysfunction and chaos. And so it would all be personally very good for me.

John Authers: Now this all segues nicely into a bunch of questions, specifically on the impact for Canada. Does the problem in changing Canada's cash position due to demographics mean that it'll have to behave like the States in future and have something like a fact-guessing, taxing internationally? Can Alberta really secede from Canada and join the US, is one question somebody asked. And how would a pipeline to Canada's east or west coast affect the tanker war you were discussing? You've got an access directly across the Pacific.

Peter Zeihan: There is not going to be a pipeline through BC, because BC has basically said that we'll take half of revenues — not half of profits, half of revenues. And so that deal is already dead.

The east pipeline — let's assume for the moment that all of the provinces that have to be crossed, including this one, ultimately come to a deal today and construction starts tomorrow. That's a five-year construction project. Tanker war will be underway before that even considers. And that will be putting the oil in the wrong basin. So I don't consider Alberta to have meaningful alternatives for getting their crude to market that don't involve the United States. Either Keystone will be renewed, or it's not.

But honestly, it's probably already too late. Albertan crude is heavy and sour; shale crude is light and sweet. The goal of Keystone was to mix the two in the center of the country where most of the shale output is, creating a medium-sour blend that all American refineries can use. The American refineries have given up on that now, and they're going ahead and dumbing down the refinery to work with the light, sweet crude.

I call it chicken oil crude, because you wave a white chicken in front of it and you get gasoline. It's very easy to work with. Our refineries in the United States are just too advanced. That's problem one for Alberta, is that their core market has now been destroyed.

Problem two for Alberta is it's the only province in Canada with an American-style demographic, with a Generation Y. Problem three for Alberta is it's the only state — province, excuse me — that is paying into the federal budget now. Everybody else is a net recipient. Problem four is, the Trudeau government has now announced its budget for the next three years. And it calls for enough financial transfers from Alberta to the center to impose a Greek-style depression on Alberta, assuming the energy price recovers, which it probably won't. Problem five, which is more Canadian than Albertan, is that secession is legal here.

John Authers: I don't think we can take too many more problems in the list.

Peter Zeihan: Exactly.

John Authers: I'll ask you another —

Peter Zeihan: Unless Toronto and Montreal start taking Alberta's concerns seriously, there's a viable legal, strategic, and cultural way out for Alberta. And we're now in a world where Canada can't enjoy its standard of living without Alberta, and Alberta can't enjoy their standard of living as long as they're in Canada. Anywhere else in the world, there would already be firearms being exchanged.

John Authers: But this is Canada.

Peter Zeihan: This is Canada. You're so damn polite.

John Authers: Two more questions I'd like to try to squeeze in very quickly. One, there are a number of questions about renewables. Obviously, a lot of excitement in innovation in energy. Is there any possibility that advances in renewable technology could change the kind of strategic questions that you're discussing?

Peter Zeihan: It could actually speed it up quite a bit. The only first-world country that's relatively close to the equator is the United States, which means that the only first-world country that can impose solar en masse is the United States. People talk about lithium batteries being able to maybe square the circle on the intermittency issue, but you just can't get by the fact that the United States gets 12 times the solar radiation of Germany. Storage isn't an issue, because storage works for up to three to six hours, whereas Germany needs to store it for three to six months. That technology breakthrough is not even being considered right now. So the United States can actually achieve a greater level of independence on a decade time scale that's impossible for Japan, or Korea, or Canada, or Europe. So yes, but not in the way you think.

John Authers: Very quick answer, and I'll try to fit in one more question after this: How much does it really matter whether it's Hillary or Donald?

Peter Zeihan: It's an even fight at this point. And it's really hard to answer that question, because we still don't know what Donald stands for. The advantage that he has in this race is the difference between the convention period and the election is the candidates get to reinvent themselves. And Hillary is horrible at that. She sounds like she's just lying through her teeth. Trump has reinvented himself, what, 16 times already? And every —

John Authers: He hasn't changed color yet, but yes?

Peter Zeihan: He says something crazy; he attracts a new audience; then he says something equally crazy over here that contradicts what he earlier said. But the original audience isn't offended. And that, when it comes to a general election, is an amazing trait. So I see this as a flat-even race.

John Authers: So current prices, you might buy Trump futures.

Final, very quick question, because it provides us a bridge to the next speaker. Well somebody asked, what about African demographics? They have the youngest population in the world. Isn't there a future, therefore, in sub-Saharan Africa?

Peter Zeihan: Not really, in my opinion, on the broad scale. Africa is built on a series of plateaus, and the populations are on the top of the plateaus. So getting infrastructure up to them is always hideously difficult.

There are a few exceptions. There are places where you can reach the interior, limited areas — Nigeria; Ivory Coast; Uganda; Kenya; Durban, South Africa; and Luanda in Angola, but that's it, that's all six. Everywhere else, you're seeing the baby boomer bulge. All that extra financing is providing opportunities in the short term that will die as soon as the capital fades away. And that's just a few years off.

John Authers: OK. And on that note, we may — we'll find out more about whether that viewpoint is necessarily agreed with by our last speaker.

Peter Zeihan: Fair enough.

John Authers: I'm afraid time is up. I'm afraid I didn't get to all the questions. But thank you very much indeed, Peter. That was fascinating.

Peter Zeihan: Thank you.

John Authers: Thanks a lot.

[APPLAUSE]