

For Your Eyes Only – OPEC+

FOR YOUR EYES ONLY

While this report does not contain any actual classified information, we are discussing sensitive topics in this report (the second of three such T-Reports).

- We addressed [Russia's Nuclear Threat](#) on Monday.
- We delve into **OPEC+** today.
- **The Defense of Taiwan** will complete the trilogy.

I have the luxury of working with 17 retired generals and admirals ([Academy's Geopolitical Intelligence Group](#) "GIG"). They have all served their country admirably and apolitically. They offer great insight into the military and the government and have been crucial in helping Academy's clients understand and navigate this treacherous landscape. Many have gone on to serve this country further (in their role as civilians) by shaping transitions, forming policy, and more. They have great knowledge and understanding of how the country's geopolitical apparatus works.

I am relying heavily on the experience, thoughts, wisdom, and views of this amazing resource to craft today's report. To make this report the most interesting, I will push the envelope. We will not only examine the consensus views but also explore some of the outlier views. It is essential for us to think about many alternative narratives and not just what we get from the mainstream media.

By necessity, some parts of today's report might sound political. However, whether it is my views or the views of some of those who I relied on for their insight, the intention here is not to be political.

We need to evaluate the politics, what politicians have done (and might have to do), and the potential consequences. Not everyone on the GIG sees eye to eye with the current/prior policies or how our adversaries will respond. They do have well-formed opinions on why they agree or disagree with what is going on and the consequences of those actions or inactions.

This philosophy permeates the T-Report, but since we really want to push the envelope in this report, considering the dangerous and potentially precarious geopolitical environment we are in, I felt that it was important to lay out the foundation.

The selection of views are mine alone and any misinterpretation, simplification, combination, or omission are solely my responsibility.

OPEC+

OPEC+ has catapulted to the top of the headlines in recent days as they cut production more than expected (by 2 million barrels) and the current administration has admonished Saudi Arabia (in particular) for this action. If it was only so simple.

We will address this outcome through several lenses:

- The steps we've taken that have **pushed Saudi Arabia (and the Middle East) away from us.**
- **The energy related steps that have exposed us to such an action.**
- What can we realistically do from here?

Despite the media headlines (i.e. portraying this as KSA betraying us), the story is much more two-sided. It is the geopolitical framework and the economic landscape that have led us down this path.

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Understanding how we arrived at this juncture is crucial to thinking about the future.

Pushing Saudi Arabia and the Middle East Away

For myself (and for many members of the GIG), this goes back to the campaign trail:

- At the Democratic Debate in November 2019, according to [theintercept.com](https://www.theintercept.com) (more on this in a moment) Candidate Biden said this about the Kingdom of Saudi Arabia “...**make them pay the price, and make them in fact the pariah that they are.**” After about an hour, I gave up searching for a link to a news organization that I've heard of, but both the [NY Times](https://www.nytimes.com) in February 2021 and [CNN](https://www.cnn.com) in March 2021 confirmed either the quote or the gist of the reporting. While my internet search skills are not great, it was surprising (even when narrowing down the data range) how difficult it was to find this quote. **Maybe the U.S. media didn't think it was important?** Without a doubt, the Saudis heard this, and it is not something that they will forget (we wouldn't take it lightly either). There has been a lot of discussion (with little action) about MBS's role or level of complicity in the murder of Jamal Khashoggi. Sadly, in the world of global politics, the truth may have little relevance. Discussing what “may be the truth” is detrimental when pushing an agenda that is unlikely to change behavior.
 - A theme that came up in our Russia report will appear frequently in today's report. This is the topic of “**backdoor channels.**” While public negotiations and communications are important, many things (especially sensitive topics) are often handled via backroom negotiations. Just like a lawyer should never ask a question they don't know the answer to, by the time the big public negotiation is going on, the outcome has already largely been agreed upon. According to the GIG members that I've spoken to on this issue, it is highly unlikely that a candidate would have come to some “agreement” with KSA on this subject. Yes, it is possible (even likely) that a President could negotiate with KSA and argue why he had to make such a bold statement. The message and the response would be done in advance, with both sides engaging in political theater. That sort of quid pro quo does exist, and is a crucial part of politics at the international level, where each country has to appease their own population/electorate as the case may be. It is highly unlikely that this sort of pre-clearance occurred ahead of a debate for the Democratic nomination, which is why it is so important. **We, as a nation, may have learned to ignore campaign promises, but assuming they don't carry weight with those who are threatened is an issue.**
- **Yemen.** Yemen is a frequent topic of conversation in Academy's monthly [Around the World](#) reports. **Yemen is closely associated with Iran's support of the Houthi rebels.** Often the reports include references to attacks on Israel or the ongoing battles with the Saudis. One in particular, from [January 2022](#) caught my eye. **This report discusses the Houthi rebels striking targets in the UAE.** It is a top 10 energy producer which exports about 2/3 of what they produce, making them an important player in OPEC+ and one that supported the cuts. **It is extremely difficult to extricate the people of Yemen from the Iranian supported Houthis, but failure to do so may be hurting our standing in the region.** I do not know what policy is “correct” from a moral, humane, or even economic standpoint, but our policies affect others and these parties will react as they see fit (and not necessarily as we want them to).

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- **JCPOA.** The Joint Comprehensive Plan of Action is yet another can of worms in the region. This has been a topic of conversation at Academy Securities (and in our [Around the World](#) reports) since then President Trump pulled the U.S. out of the agreement back in May 2018. I found several [SITREP's](#) on the issue from the time (they pre-date what we've saved to our website). The messaging from the GIG was both mixed and clear at the same time (if that's possible).
 - **JCPOA was ineffective.** The consensus, though not the universal view, was that the JCPOA did not go far enough in terms of monitoring, inspections, regulating non-nuclear activities by Iran (support for their proxy wars), etc. Few if any felt that the JCPOA was as effective as the headlines suggested.
 - **Better to negotiate from the inside rather than the outside.** While doubting the efficacy of the JCPOA, most believed that pulling out:
 - **Hurt our relationship with our allies.** Those remaining in the JCPOA would be slighted by the unilateral action. More consultation and coordination should have been done before pulling out.
 - **It would be easier to work within the terms of the existing agreement to advocate for change** rather than pulling out and trying to strike some other deal.

The distrust sowed with our NATO allies, Iran, and other countries in the region cannot be helping the current negotiations. While the Iranian nuclear program has suffered some setbacks (possibly enabled by Israeli cyber-efforts), **the GIG, collectively, is concerned about the progress Iran is making on their nuclear program.** Iran's nuclear progress isn't the topic of today's report, and hopefully it won't rise to the level of a report like this (though it seems probable that it will), but the overall JCPOA pullout and negotiations don't seem to be garnering the support we want to have in the Middle East.

- **NOPEC.** One of our generals came back from the Middle East earlier this year with a message for the administration from one of the countries he had served in and continues to have a relationship with. That country expressed a desire to work with the U.S. (and they wanted to do more with us). But they were increasingly confused by our behavior towards them and our role in the region. While the [No Oil Producing and Exporting Cartels](#) (NOPEC) Bill wasn't the driving factor behind their concerns, it seems like it added to it. This bill would open oil producing nations (i.e., part of OPEC) to lawsuits. **More lawsuits? More Sanctions?** Maybe we've explained to those countries why this is so important to us, and they are okay with the characterizations and consequences of such a bill, but it seems unlikely that is the case. I am not a lawyer, so I have no idea how enforceable any of this is, but I am a massive skeptic on the effectiveness of sanctions and believe that rather than having the desired result, actions like this tend to create new and bigger problems.

Before we finger point at the Middle East, which has its own share of issues, flaws, and problems, we realistically need to accept the stage we've been a part of setting if we are going to get out of this mess.

The Economic and Energy Conditions That Led to This Decision

I'm going to summarize the last 50 years of energy industry history into a few simplistic bullet points.

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They are very simplistic and we could debate them for days, but it is a quick starting point to discussing what is relevant regarding recent actions.

To some extent, energy policy seems to have two distinct points in time.

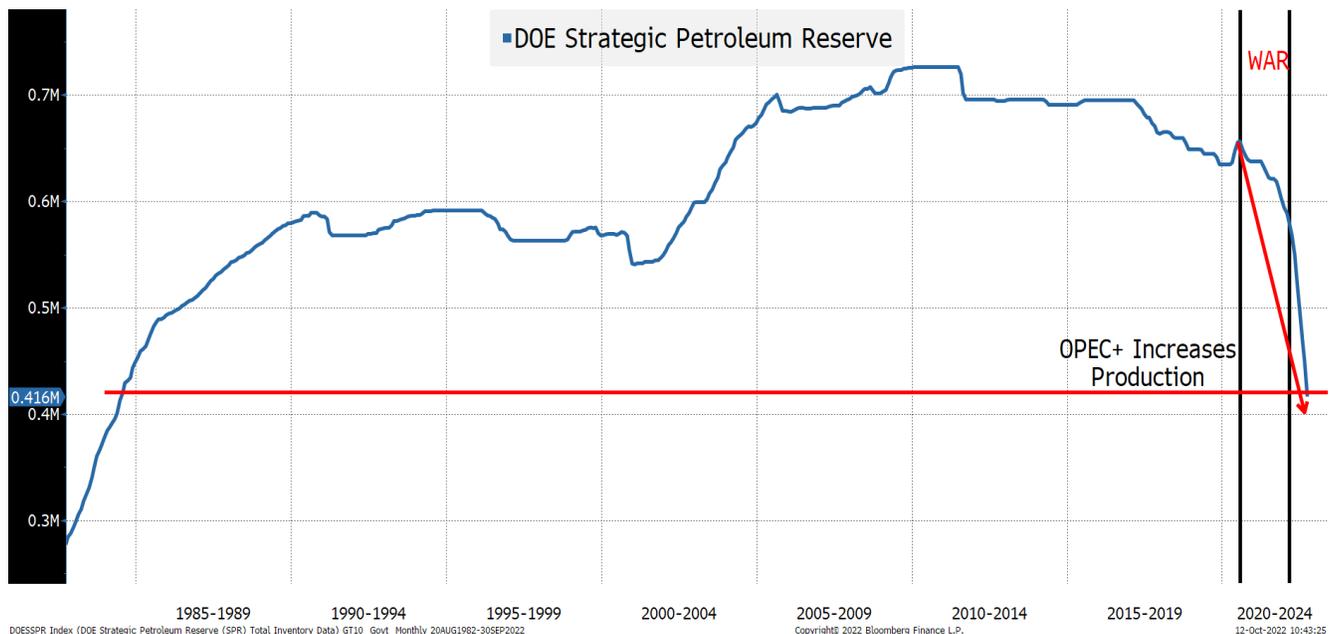
The oil embargo days led to:

- Nuclear plant development (here and particularly in Europe).
- Creation of strategic reserves (which haven't increased meaningfully since the 1970's).
- The development of domestic production AND refining.

The transition to sustainable energy has led to:

- The development of sustainable energy sources, which certainly seems (in hindsight) to have resulted in the underinvestment in traditional energy sources.
- The unintentional (but undeniable) threat to the wealth of many nations as **the West worked diligently towards not being their customers any longer.**

Taking that all with a grain of salt (except for the part where we have been telling oil producing nations for at least a decade that we eventually don't want their oil), let's move to the more recent, easier to prove issues.



This chart highlights several important issues:

- We have been draining our reserves since before the war started. It has accelerated since the war started, but the problem started even before then.
- We have been asking OPEC+ to increase production, which they did starting in the summer of 2021, basically at the same time as we started draining some reserves.
- You ask for a “favor” (or multiple “favors”) and each time the group provides the “favor,” you double down on their action by bringing even more product to the market. That, in all likelihood,

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was explained and agreed upon (I hope), but at some point it seems obvious that the OPEC+ nations may want to stop flooding the market.

- **We now have less petroleum in our strategic reserve than at any time since the early 1980s!** I found one statistic showing gasoline usage in the U.S. has increased by about 30% from 1990 to 2019. If our level of energy consumption has increased (given population growth, the number of automobiles on the road, etc.), then our level of strategic reserves (relative to use) is particularly low. **We drained our reserves and have put ourselves in a position of weakness that allows OPEC+ to take advantage of us** – which may well be in their interest to do! Creating our own weakness, while not understanding the motivations of the people across the table from us, has hurt.

Some things that don't appear in this chart:

- **Russian Oil Production.** The DOE has Russian oil production below where it was ahead of the summer of 2020 collapse in oil prices. Their data is from June. I'm hearing from people plugged into the oil industry that their production is back on the decline. That would not be surprising given that they are mired in a war. Sanctions, at some level, will make it difficult to keep production high, at least until they find new suppliers of parts and equipment. Some percentage of this cut masks a drop in Russian production. Not sure whether that is good or bad, but it is a factor.
- **Lack of Refining Capacity.** What doesn't get enough attention, at least from my perspective, is that much of the SPR that is released has to be shipped elsewhere to be refined. Between our own refineries running at capacity and some issues with refining the quality of crude we have in reserve demonstrates that we are not self-sufficient on this critical front (back to my embargo era rant, which was the last time we seemed to focus on this issue as though our lives depended on it).
- **Global Demand.** OPEC+ specifically mentioned signs that global demand is slowing. That could be a cover and a pretext for the cutbacks (and certainly some part of it is an effort to produce "justifiable" rationale as political aircover). While slower global demand may be just aircover, there could be some element of truth to it. I expect a recession to hit the U.S. sooner (later this year), deeper, and longer than the current consensus which sees a mild/short one sometime next year. Europe could already be in the throes of a recession. Global inventory gluts of products, decreasing costs to ship goods, etc. all point to a global economy that is slowing. China's quadrupling down on their 0 Covid policy fits that narrative too. **While I suspect that slowing demand is not the main reason for the cuts, even with the rhetoric and political aircover, there can be hints of the truth.**
- **Weaponizing Russia's Dollar Reserves.** While probably a stretch in terms of whether it impacted the thoughts of OPEC+ this time around, we have been highlighting that the moment "we" froze Russia's dollar reserves, China (in particular) has been encouraging countries which don't conform to our norms to trade with them and not with us.

These economic conditions, some of which are of our own making and others are conditions beyond our control, have led to this decision by OPEC+.

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It may be nefarious from our viewpoint, but it may be logical for other countries as they develop strategies for themselves (many countries have much longer-term planning than the next election cycle).

Checkers, Chess, and “Wishful” Chess

We often talk about **the difference between playing checkers and chess**. While **checkers** is fun and involves strategy, it pales in comparison to playing chess. **Chess** involves thinking multiple steps in advance and how your opponent will move as well.

“Wishful” Chess is playing chess where you believe that your opponent will fall into every trap you lay. You think you are playing chess (analyzing moves ahead of time), but you are analyzing them as though your opponent is somewhere on the range of stupid, naïve, or even masochistic.

To me, it seems that it should have been obvious as to how we got to OPEC+ cutting production.

Moving Forward

There is much that can be done to move forward. Some things involve international politics, some things involve domestic politics, and some things include eating humble pie as a nation to move on:

- **Lines of communication.** Backdoor channels to create mutually acceptable positions. Possibly less grandstanding **and “dictating” terms**, and instead creating more opportunities to establish paths forward that work for all sides. We spent several pages listing the issues that some countries in the Middle East have with us. We may not agree with their views, but we have to understand them and see if we can come to some compromise. Even if we live quarter to quarter and have had our attention span diminished by social media and the constant barrage of headlines, other countries may have longer memories. And, like many of us, they are likely to remember the slights more than they remember the good actions.
 - **We have to decide if these bridges are worth mending or not.** Maybe some of the issues we've raised over the years are more important than mending bridges. It is possible, but that forces us to think realistically about the direction of our policy elsewhere as we cannot blithely assume that we will have our cake and eat it too.
- **What can we do on the domestic front.** I could go on and on here because as many of you know, I am a big proponent of energy independence and building a strong backbone of traditional energy sources to ensure baseline energy production that meets our needs for at least the next decade. I also believe in building out sustainable energy sources at the same time so we can transition safely and securely. Nuclear is part of both options, as are pipelines (and more). Refining capacity needs to be added. Will we have to take some steps back on current initiatives making us, as a nation, less environmentally friendly? Yes. Would this be inflationary as we build out? Yes. **But will it be worth it because over time, we will be “greener,” get the deflationary benefits of sustainable energy, and be more safe and secure? YES!** This last rant is more of my own opinion (than any member of the GIG's opinion), but there would be agreement on much of this – especially **thinking about energy and other commodities, resources, and products on a national safety and security level.**

Hopefully, this establishes a more comprehensive view of how we got to OPEC+ cutting production by 2 million barrels and helps you manage the risks going forward.

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