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The Solari Report

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The Oil Card - What's Next? **with Jim Norman**





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C. AUSTIN FITTS: Ladies and Gentlemen, it's my privilege to welcome back to The Solari Report a man who needs no introduction, and certainly in this audience, Jim Norman, veteran reporter. Many famous magazines he has written for – *Business Week*, *Forbes*, *Platts Oil* – and someone who commands the most respect from me and our subscribers.

He has been with us many times before. I encourage you to go back and listen to the great interviews we've done.

His first book – and I'm trying to get him to write another one – is called *The Oil Card*, and we're going to revisit it today and then talk about oil and the politics of oil in the events that are happening today.

Jim, welcome to The Solari Report. Thank you so much for coming on.

JIM NORMAN: Hi, Catherine. It's great to be back. I appreciate you having me on again.

C. AUSTIN FITTS: As I always say, if you haven't read *The Oil Card*, you don't understand politics today. Why don't you just, if you could, take us back and recap *The Oil Card* – what it said, how you came to write it, and how it's relevant to what is going on today?

JIM NORMAN: It's especially relevant right now because of the thesis of this book, which came out in 2008. It was a pile of string I'd been collecting through a whole career of covering the oil business. The thesis of it was this: Oil pricing is really not a function of physical supply and demand of crude oil. It's not. It's really a geopolitical function.

In the United States particularly and its allies are able to actually manage oil prices – even a globally fundable commodity like oil. We can do it.



We can pull enough levers and manage things in a way that you can actually move that market out of whack, up or down, for protracted periods of time to either help or hurt other countries.

In particular, the way we broke the Soviet Union was with low oil prices throughout the 1980's. The book details mechanically how Reagan and the Bush administrations did that. All the pieces were there, the levers they were able to pull, and it was so dramatically successful that by 1991 the Soviet Union basically ran out of money, turned out the lights, and went away. It was a bloodless destruction of an empire.

Oil prices were the key strategic weapon in doing that. The way we did it was just a masterful study in economic warfare.

That's history, and it's all well-documented. The pieces are right there. You can go see it. The evidence is right there.

What the book did then was to try to explain why oil prices would be so outrageously high. In 2008 when the book came out, oil prices had risen to like \$140 a barrel from barely \$10 a barrel ten years earlier.

C. AUSTIN FITTS: I just have to put this in context because I remember reading this. What happened to me, Jim, was I went out to dinner and I took your book. I hadn't started it yet. I closed down the restaurant because I couldn't stop reading the book. I was there for the whole evening!

I remember sitting in the candlelight in the restaurant and you had quoted – and I don't remember what year it was – that Exxon's finding cost sometime in and around there was \$4 a barrel. Is that right?

JIM NORMAN: Oh, yes. This is right. I mean, the actual cost for the major oil companies like Exxon Mobil to find, develop, and produce a barrel of oil is ridiculously low. The cost of finding the barrel alone is right now probably less than a dollar a barrel – to find reserves in the ground. To develop them, add another \$10 a barrel. Then to produce it, add maybe another \$5 a barrel. The total cost of getting this stuff out of the ground



– from beginning to end – is still probably less than \$20 a barrel for the big guys.

The basic economic rule for commodities is that commodities tend toward glut, and the price tends to fall to the marginal cost of production. That's why you need cartels to keep the price up on these things in oil and so many other commodities – diamonds and whatever. If you don't have cartels basically restricting production, price tends to just fall to the marginal cost.

“If you don't have cartels basically restricting production, price tends to just fall to the marginal cost.”

If it weren't for a whole bunch of people – entities – trying to keep this lead balloon in the air, oil prices would be far, far lower than they are now. That's why I wrote the book in 2008. There is no good reason why oil has to be trading over \$100 a barrel, let alone \$140 a barrel.

And, lo and behold, in early 2008 – right at the time the book came out – the oil price started to drop and drop big. It fell from \$140 dollars a barrel down to below \$40 a barrel in early 2009 or late 2008. That coincided with Russia's invasion of the country of Georgia. You remember then when Putin moved forces into the Republic of Georgia. He still controls one province there, South Ossetia.

In fact, without any US or NATO intervention, Putin was persuaded to withdraw his forces and leave Georgia there. He got a token prize there, but he didn't get all he wanted. He basically went home with his tail between his legs, and oil prices then came back up. They've hovered in the \$100 range ever since.

To me, that was confirmation of the thesis that the US can move oil prices on a very short period of time to affect geopolitical change, and I think that is exactly what you are seeing right now coinciding with the unrest in the Russian interaction in Ukraine. You've seen global oil prices tumble by a third – 30% or more.



C. AUSTIN FITTS: Thirty-percent this summer.

JIM NORMAN: Since June. Right.

C. AUSTIN FITTS: Quite dramatic.

JIM NORMAN: They could go much lower. Crude closed today, Tuesday, on the NYMEX at just \$74 and change. It could go down to \$40 again. There is nothing to stop it. It could go lower than that, too.

People who think that it is miraculously going to stabilize somewhere in between, just out of sheer market forces, are wildly over-optimistic. If we want to drive this price much lower to hurt Putin's regime, we will.

Putin has basically acknowledged that much. He was quoted in Chinese news media this week. Somebody asked him what he thought about the oil prices. He said, "Well, everybody knows it's a political phenomenon. It's a matter of politics."

C. AUSTIN FITTS: Putin said that?

JIM NORMAN: He's quoted as saying that. He said, "Of course, supply and demand have a factor, and global demand is flagging at the moment." I think his quote was something like, "But sometimes we wonder whether the political forces are really in control here rather than market forces," and he's exactly right.

I mean, global oil supply and demand is really in very good balance. In fact, there is no shortage of oil anywhere.

C. AUSTIN FITTS: Right.

JIM NORMAN: You could almost describe it as a glut. I mean, inventories are full all over the globe and there is plenty of production. We're not running out of oil by any means.

OPEC is there kind of tweaking production and trying to slow it down a



little bit so that there's not too much of a glut on the market.

The real determinant of oil prices is the New York Mercantile Exchange – the futures market. There is where prices are really set. The Saudi's really just follow the NYMEX in their pricing strategies and their production strategies. They don't control it.

If you listen to the statements, you kind of realize that. They don't know where oil prices are going; they're just looking at the NYMEX. Now the NYMEX is controlled strictly by flow of funds in and out of it.

When the price was running up, US regulatory activities basically opened the floodgates to an unlimited flow of speculative managed money that went pouring into the oil future's market, pretty much heavily dominated on the long side. In other words, it was buying contracts way out on the forward curve. This is not sound business; it's just pure speculation or market manipulation.

Where that money came from, who knows.

C. AUSTIN FITTS: You know Cameron thinks it comes from the Exchange Stabilization fund.

JIM NORMAN: I think that's part of it, but that may be just a drop in the bucket. Once the government decides it wants to move that market and it starts moving that money, all the smart money can see which way the wind is blowing so they all pile on and it's a free ride. I think exactly the opposite is happening now. You see volume is going down on the NYMEX. Open interest is going down. Clearly money is coming out of there, so you're going to see a stampede of money out of the NYMEX.

Once the price moves up or down, they tend to get amplified significantly. I think you could see much more pressure on crude prices over the near term, which is why I think just about every oil man out there who has built in huge capital spending budgets and built his mansion based on \$100 oil, he's thinking, "Uh-oh. We've got cash flow problems, folks – bigtime."



C. AUSTIN FITTS: To the oil patch this is very uncomfortable.

JIM NORMAN: This is troubling. This is reminiscent of the 1980's. Remember in the 1980's oil patch America went bust. I mean, the ground was littered with bankrupt independent oil companies. It was triage out there.

C. AUSTIN FITTS: Right.

JIM NORMAN: The major oil companies survived because they've got deep pockets. They could cut their budgets. They had other ways they could make it up on their refining business, which does fine in times like this. But the independent oil man – the wild catters – they just got slaughtered.

George H.W. Bush, there is some interesting stuff in Daniel Yergin's famous book *The Prize* about how Bush, when he was running for Vice President, caught tremendous flak from his buddies in the oil patch, "How come you're not doing something about getting these oil prices up?" He couldn't say what was going on, but the fact was this was a government national security initiative to basically drive down the price of oil, even at the expense of a whole slew of independent oil men in the United States. That toppled onto the whole S&L debacle, too, when property values fell. You had S&L's keeling all over the place.

When you monkey with markets this way, there are all kinds of follow-on effects, many of them unanticipated. I think you can see more of that coming down the road now, too. You saw it in 2008.

In 2008, the way that year progressed, you started to see some cracks in the mortgage market with housing prices, but everybody was 'whistle and pass the gravy' on that. They thought they'd get by. Then the oil prices cracked in the middle of the year and plummeted down. Soon after that, within a matter of weeks or months, layman failed. Wall Street went into paroxysms of angst, and you began this massive bailout program to try to salvage the financial markets.



China just about went bankrupt. They had to go into massive financial defense mode. So when you see a price drop in oil like this, you've got to wonder when the follow-on affects are coming.

C. AUSTIN FITTS: I want to jump back into the past again. I don't know if you saw David Cameron's speech or article that he published at the end of the G20 meeting in Australia. He's really raising alarm bells. Normally I wouldn't think anything of it, but at the same time you have a series of articles in the British press, including the BBC, announcing new pedophilia scandals.

I don't want to get into that, but the reality is if you look at the way it was done, that is a traditional message that says, "Do what you are told to do or you will be part of the witch hunt here."

The combination of Cameron's article, for someone of that stature to come out and ring alarm bells about the global financial system, that is a little strong. A combination of that and the wagging the witch hunt said to me, "Uh-oh. That is a signal that the squabbling is getting pretty fierce."

With a 30% drop in the oil price and then Cameron doing that, I would say there is reason for concern. Clearly you see a lot of deflationary trends in the global economy.

"With a 30% drop in the oil price and then Cameron doing that, I would say there is reason for concern."

JIM NORMAN: Yes, and the dollar is going up again quite dramatically, which naturally adds to the deflationary pressures all over the place. What you can see happening is every foreign government and every foreign company that has borrowed in dollars all of a sudden is looking at insolvency, including many of Russia's major corporations.

Rosneft borrowed dollars. Now they can't possibly pay them back.

C. AUSTIN FITTS: Right. It's very important. I just want to say this because I know we just had a workshop in California and what I found was that there is still misunderstanding on this issue. As quantitative easing has



gone on for several years, people around the world have borrowed cheap dollars.

There has been this huge carry trade building up in a variety of places. Now with quantitative easing ending, they've got to pay back in dollars. There is a fundamental difference between the United States and everybody else. They have to earn their dollars; we can print them.

JIM NORMAN: Right. This carry trade has gone on all over the globe, and it's a recipe for disaster.

C. AUSTIN FITTS: Right.

JIM NORMAN: Everybody was betting that the dollar would remain cheap and that the US was going to continue to drive it down, which in many regards it needs to do. The US has just become uncompetitive in a manufacturing sense due to its currency overpricing policy. The reason we have zero interest rates in the US is really aimed at trying to lower the value of the currency, but everybody is doing that. The whole world is doing it. It's a global race to the bottom, and it's not working.

C. AUSTIN FITTS: Right.

JIM NORMAN: In fact, history shows currency wars really never work. Nobody can actually get a leg up on anybody else, and what happens is – and this happened before World War II – currency wars ultimately transform themselves directly into trade wars. When currency manipulation doesn't do the job, countries start to impose restrictive trade barriers – non-tariff trade barriers – and then there is retaliation. That is the story behind the whole Smoot-Hawley Tariff thing.

Trade wars lead to real wars, so I would bet you within the next year or so you're going to see on the American political scene an outright realization. People are going to make political hay by talking protectionism, and the public is going to rally to their side. It's a dangerous recipe because it breeds retaliation globally.



I'm not particularly optimistic on that regard.

C. AUSTIN FITTS: Let me jump back and do some more history, and then we'll come back to what is going on currently. One of the things I wanted to mention which I talked to Linda Minor this weekend. One of the things we were discussing was the fact that when we delink the currency from gold, essentially we shift it onto an oil standard. There tends to be a very deep relationship between oil, I think, and the dollar. Would you agree?

JIM NORMAN: I haven't thought that through, but as a de facto matter I think that's right. My take on it is different than most people. Most people think, "The poor United States. We have to wring our hands because we're short on crude oil." No. I don't look at it that way.

My viewpoint is the United States can actually consider itself long on crude and is basically indifferent to where prices are. If you consider us as part of a family – the Canadians, the Mexicans, the Saudi's – we have all the crude that we need. We're not exporters of crude.

If crude prices were low, we would be bailing out those neighbor countries anyway, as we did with the Mexicans and the Saudi's in the 1980's.

The US is happy to let prices run up, and happy to let them run down. We're a rich country; we can afford these prices. In fact, high oil prices have actually spurred tremendous economic activity in the United States with all this fracking stuff. We've got wells going everywhere and production is going up.

The United States doesn't have to bankrupt itself to buy oil from abroad. It's quite the contrary. We make everybody else pay through the nose for it.

C. AUSTIN FITTS: One of the things you go into – and we've talked about it – is after what happened in Russia, a real effort was to bring the price up to checkmate the Chinese. There's sort of a dance between busting the



Russians and busting the Chinese and trying to maintain this position.

JIM NORMAN: This is in my book. Washington's national security establishment was so impressed with how effective the oil weapon was in defeating the Russians that they decided: Let's play this in reverse and go after the Chinese. They're big importers. Maybe we can hurt them.

If we can drive up their acquisition costs on oil and other raw materials which they buy in mass, process with cheap labor, and then sell at a loss abroad just to generate our currency, we could bleed these guys white. In fact, that's what we've been doing for about the last ten years.

C. AUSTIN FITTS: Right.

JIM NORMAN: The dirty little secret about China is it really makes no money.

C. AUSTIN FITTS: I would like to point out that before we did that we went into Russia and did a great deal with our allies to assert control and ownership of the Russian oil reserves. Isn't that the case?

JIM NORMAN: Actually, yes, that is true in a sense. If you look at companies like Yukos and some of these other oligarch entities, these guys really got the wind in their sails from the West – from the George Soros kind of people who really got them going, helped them assemble all these vast assets from the dregs of the Soviet Union, and Yukos would have been Russia's biggest oil company.

But when the decision was to move the price up, we had to restrict production. If you're going to push prices up on the NYMEX you don't want extra barrels to slosh around on the market. I've always said Mikhail Khodorkovsky's greatest sin was not threatening to get into politics against Putin. His problem was he wanted to keep increasing production at Yukos and, in fact, build his own pipeline into China. This just did not fit with the program, and the quickest, easiest way to stop that was just to nationalize this company, bust it up, throw all of the head people in jail, and give it to the Russian company.



What everybody ignored was in 2003 the Russians and the Saudi's sat down and signed a market sharing agreement whereby the Russians agreed to limit their exports to half the daily exports of the Saudi's. That has remained ironclad in place ever since 2003. The Russians could be producing and exporting much more oil, but they've limited it to 4.5 million barrels a day, which is half of what the Saudi's do.

C. AUSTIN FITTS: So that deal is still in effect?

JIM NORMAN: Yes it is.

C. AUSTIN FITTS: With all the blustering, it's still in effect.

JIM NORMAN: That's right. Putin's problem is this. If he were to produce more, he would hurt the price of oil. It's very much in his interest to maintain that agreement to keep the Saudi's from overproducing either and keep their agreement in place.

This is why this oil price drop hurts Putin so bad. He's damned if he does and damned if he doesn't. If he tries to compensate by producing more oil, it just drives the price down some more.

“If he tries to compensate by producing more oil, it just drives the price down some more.”

C. AUSTIN FITTS: One of the criticisms I've read of Putin, and I don't know if it's true, is that he didn't diversify the economy. He spent a lot more time trying to assert control of the oil assets than trying to diversify the economy.

JIM NORMAN: I don't know if I would criticize him too hard for that. When you're dealt lemons you make lemonade.

C. AUSTIN FITTS: Right.

JIM NORMAN: What else did he have to work with? I mean, there just isn't a lot else there. I think it was wise to try to maximize his cash flow from oil while he could. He should have put it into more productive stuff, but I



think the whole system there is so corrupt that it all got siphoned off before it went into productive investment. It all went into Swiss bank accounts or London or wherever.

C. AUSTIN FITTS: Cypress.

JIM NORMAN: Yes. It's hard to feel too sorry for Mr. Putin. I mean, he's been presiding over a kleptocracy. The one thing he's still got going for him is his dwindling military might, which I think he is trying to play that card for all it's worth in Ukraine, flying planes around Europe, launching missiles. He's saber-rattling over even nuclear weapons now.

He is exhibiting the behavior of a desperate man, and I think he is. He's not the cocksure Mr. Macho that the media might portray him to be. I think he's got a very weak hand and he's had to go basically hat in hand at the Chinese for financing.

Basically he's done some oil and gas deals with the Chinese where he's basically sold them decades worth of oil and gas into the future in order to get the cash upfront quick. "Pay us the money now, and I promise we'll deliver this oil later." The Chinese are willing to do that.

C. AUSTIN FITTS: This is good for them. It's bringing the price down.

JIM NORMAN: It is, and it is insurance of supply. The two countries have also signed some currency swap agreements. Now that is interesting to me because you've had a lot of these bilateral currency swap agreements. Some of the media wring their hands and say, "That means we're going off a dollar standard for oil, etc."

No. I don't think that's what it means. I think what it means is that all of these countries participating in these things see a currency crisis over the horizon here in which they would not be able to convert their own currencies into dollars. They've got to set up these backstop currency swap agreements so there will at least be some availability of tradable currency for them.



This is where things could get really hairy at some point.

C. AUSTIN FITTS: I think it's pretty hairy right now, Jim.

JIM NORMAN: I don't think that the world is in shape to go into another 2008 kind of disaster.

C. AUSTIN FITTS: If you look at some of what's happening in the recession, I drove from San Francisco over the last week. I drove through Phoenix. I was getting off on one of these big interstates where you get onto the intersection above the ramp. There are like 12 corners because you've got medians in the road and two lanes on each road coming in. There was a beggar on each corner. It cost me \$50 to go through Phoenix. That's how much money I gave out to beggars.

JIM NORMAN: We've got these guys in Phoenix now?

C. AUSTIN FITTS: These were people who were clearly well-educated and attractive and you could see it on their faces that they were scared to death. They had signs like, "I have two kids to support."

These were people who clearly didn't have any family or support, and they were just desperate.

JIM NORMAN: Well, our country has got a whole bunch of problems. The economics is just one of them.

C. AUSTIN FITTS: I think if you look at the numbers, I haven't spent any time in Europe over the last year, but if you look at the numbers on unemployment in some of these countries it's pretty significant.

JIM NORMAN: Right. I think the only game plan that seems available to any of the global leaders and their central banks is to print more money. They'd avoid deflation at any cost. That's fine until currency crisis strikes, and then everything falls apart.

That's why I think that that is a great unknown which you don't hear



anybody really talking about. Nobody can really get their minds around what it would look like if it happened, but it would just happen one day and – boom! We'd all say, "Gosh, why didn't we see that coming?"

Anyway, I think Russia could be in for a lot more hurt on this oil price. It could go down a lot more.

C. AUSTIN FITTS: My sense, and I don't know why, there are two things that I am trying to figure out but I don't have it. One is that it seems to me that Putin is getting help from different factions in North America. Maybe it's relationships with the particular oil companies, but the picture is a little bit more murky than two sovereign nations squabbling. That's part of it.

JIM NORMAN: I think that's true. I don't think we want to destroy the guy; we just want him to come around to our way of thinking on things. We could destroy him, but we don't want to do that because he's useful as a foil against the Chinese. The Chinese are really the ultimate bogeyman here. If not the oil prices, it's going to be other economic means brought to bear against them.

I think the thinking in Washington is that China is going to topple over on its own; it's going to implode. It's a huge bubble economy that at some point is going to run into a brick wall, and its political system is so brittle that the people are just going to rise up with their pitchforks and it will be gone overnight like the Soviet Union was – maybe.

C. AUSTIN FITTS: Really?

JIM NORMAN: I think that's what they're angling for – another 'no guns fired' kind of disappearance of a regime there. The Chinese are certainly not going to willingly go that route if they can avoid it, so they are shucking and jiving and doing everything they can to mollify their populace and try to clean things up and keep the economy going without overheating.

I think they've got problems. You see them resorting to the same kind of military bluster that Putin is, and they're raising military tensions all over



Asia.

C. AUSTIN FITTS: It's an uncomfortable picture because at some point there is a certain kind of squabbling that destroys the economy. You've got a variety of parties engaged in economic warfare, and it sometimes gets very dirty. It certainly can be very expensive.

For the people who are trying to engage in productive trade and productive innovation it can certainly be very harmful and damaging. It's kind of like you are cooperating and competing at the same time. The question is: Is the competition destroying the fruits of the cooperation, or getting in the way of it? That's what it looks like to me.

If you look at what the sanctions are. If Russia doesn't buy food from Europe and you're a farmer in Europe, that is very painful. It will hurt a lot of people.

JIM NORMAN: It's more painful if you are in Russia and can't get fed and you can't feed your family.

“If Russia doesn't buy food from Europe and you're a farmer in Europe, that is very painful.”

C. AUSTIN FITTS: Right.

JIM NORMAN: I mean, Russian agricultural production has still never recovered from the communist disaster. They still have to import large amounts of meat and grains and all that stuff. That's what finally destroyed the Soviet Union.

What I said in the book was what really killed them was when oil prices dropped and they had to go hand in hand to borrow money from the European banks in order to buy US wheat. That's what ultimately forced Gorbachev to throw in the towel. It was game over for them when they couldn't pay back those loans, and the strings attached basically prevented the Soviets from moving troops into Eastern Europe.

That was the leverage that we had against them. When they lost their



borders, they lost their country.

C. AUSTIN FITTS: Over the last month you had confirmed that you would be willing to do this interview. Over the last month every time someone comes out with an interesting excuse on why the price of oil is going down, I just start laughing and wishing that I was talking to you.

I have to run some of these by you. This just started. The oil card gears up and switches into the next gear. Suddenly we have all sorts of people coming out and saying, “Fossil fuels is bad for the world. We need all the universities to divest oil stocks.”

I don’t know if you saw any of those articles or any of those promotions. They were all campaigns online to get universities and everybody to dump their oil stocks. Somebody needs air cover here. It happened just as the price started to go down this summer.

JIM NORMAN: There are all kinds of excuses. They say, “Oh, it’s all that fracking that’s raising oil production.”

The United States, because it is still largely a free economy, has responded exactly the way you would expect to high oil prices. The United States uses about 20 million barrels a day of oil. Our production had gotten down to like seven or eight million barrels and we were importing the rest from Canada, Mexico, and the Saudi’s.

We’re up to about 15 million barrels a day now between higher oil production, plus with all of these fracking wells we’ve drilled – a lot of it is natural gas, but with the gas you get natural gas and liquid which is almost like oil. So when you combine increased oil production, increased gas liquids production, refinery gains, and other stuff, we only have to import about five million barrels a day anymore. Actually, it may be more than that in crude.

Now we’re exporting liquids as well. That’s where the big controversy is. It would make sense for the US to export more of this stuff because our refineries actually can’t use that much light crude. It’s better to send it to



Canadian refineries on the East Coast because they can use it there better than we can. Other places can, too.

It would be more economically efficient. The highest and best use of those hydrocarbons is to send them abroad. We'd be net gainers.

C. AUSTIN FITTS: Another one was: ISIS is selling oil. Of course, you know me. I have great deep questions about who ISIS really is. I'm figuring they are an affiliate of some defense contract here.

JIM NORMAN: I think so, too. In fact, let's talk about Iraq a little bit because it fits into the picture here.

C. AUSTIN FITTS: Okay.

JIM NORMAN: Part of the way we kept oil prices high until recently was by taking a bunch of OPEC-producing countries off the order of battle. I mean, we had Libya production completely shut down for a while. Iraq was off the board for a long time. It's finally come back on, but Iraq is an interesting case study.

When Saddam was there, he had firm plans that would have been producing as much oil as the Saudi's by this time or before. The Saudi's export ten million barrels a day. He thought he could go from two million barrels a day to ten, and he probably could.

The Maliki government that was running ragged after the US left, they had plans to get up to that level, too. The way they were going to do it was by bringing in foreign investment.

What they decided to do was not to actually sell right to the oil in the ground in the form of equity ownership and production sharing contracts. Instead Iraq auctioned off service contracts.

A service contract basically gives a company maybe a dollar or two a barrel to produce this stuff, but if you want to buy the oil you have to pay the market price for the oil. You really don't get much of a bargain.



Eventually if you can get the production from some field up above a certain level, then they let you recoup some of the proceeds for your cost recovery, but you've got to get the production way up to do that.

Most American companies didn't want to screw around with that so Exxon left. Others sold out. The Chinese came in and took out these contracts. They were happy to get the oil. They thought eventually they'd get their people on the ground and they could make hay.

Well, it turns out the Chinese companies have invested billions upon billions of dollars into these old oil fields to get them up and running in Iraq, and they finally are starting to produce some oil. They're just getting to the point where the Chinese might actually recover their costs. Then who comes along but ISIS. Who is ISIS?

I just can't help but believe – and maybe a report said this in fact – that the impetus behind ISIS was the US and the Brits and the Saudi's basically funding, arming, and training these guys. They fight like real soldiers and they've done exceptionally well.

They march into Iraq and they basically force the removal of Maliki. They totally disrupt Iraq's economy, threaten to shut down the oil fields, and they forced Iraq to change its leadership and basically come hat in hand back to the United States, "Oh, please, please save us from ISIS," which also – coincidentally – is going after our other enemy, Bashar al-Assad in Syria.

Do they go after Jordan or Israel or Turkey? No. Coincidence, right?

C. AUSTIN FITTS: Right.

JIM NORMAN: They go after the Kurds a little bit, and we like the Kurds. So when they go after the Kurds we bomb them and stop them. Other than that, we couldn't pay these guys to do a better job than they've been doing going after our enemies.

C. AUSTIN FITTS: I see pictures of them in the desert wearing black gloves. I



say, “Maybe nobody wants to see the Toledo, Ohio skin color.”

JIM NORMAN: Really. They drive around in these caravans of brand new Toyota pick-up trucks. Where did those come from?

C. AUSTIN FITTS: Somewhere in there this has to be good for defense spending because all those defense contractors are telling investors, “Don’t worry about the budget. Don’t worry about sequestration. We’ll make up for it with foreign sales.”

JIM NORMAN: Yes, right. My point is that Iraq has basically been put in a peephole, and all those Chinese investments are seriously at risk now. What the Chinese thought was going to be their client state in Iraq is not anymore.

“What the Chinese thought was going to be their client state in Iraq is not anymore.”

So, yes, the Chinese buy a lot of oil from Iraq, but they pay top dollar for that and they have to ship it halfway around the world. The Chinese are basically no more ahead of the game than they were before. In fact, Chinese oil policy has been a consummate disaster here. The country had encouraged its oil companies to go out and buy up oil reserves all over the place – foreign oil reserves – to develop them and own them and ship the oil back, but they’ve squandered untold gazillions of dollars buying properties in the wrong places, landlocked, unable to get this stuff out of the ground or into a market, let alone back to China. So these companies have taken huge, big write-offs on a lot of this stuff.

In fact, they’ve squelched their whole overseas acquisition strategy. They’ve been trying to put the money back into Chinese oil production, which is difficult. It’s just not a very good oil province.

C. AUSTIN FITTS: Let’s turn a little bit to US manufacturing because lower energy costs are going to be good for US manufacturing, right?

JIM NORMAN: Yes, not to mention that gasoline is under \$3 a gallon. I’m going to go buy a pick-up truck!



C. AUSTIN FITTS: I couldn't believe it! I went and bought gas on the way home and it was below \$3. I almost thought the machine was broken and it was a mistake.

Talk a little bit about manufacturing because there's no doubt that the increased domestic supply and particularly the lower gas prices has really been a boon for US manufacturing.

JIM NORMAN: I think that's true, and particularly with natural gas prices. If natural gas was priced on an oil equivalent basis, it would be three or four times as expensive as it is, but we've managed to keep the bifurcated market in which liquid hydrocarbons get to trade at phenomenally high prices per BPU. Natural gas is really cheap. Natural gas is, I think, the single biggest cost element for American manufacturing.

Energy generally is the biggest single cost component for US manufacturing, far more than labor. Of that energy cost, one way or another it ends up being natural gas. I guess electricity is in there, too, but a lot of that is natural gas fired.

Natural gas is a huge leg up for the United States manufacturing economy, and it's why you are seeing actual migration of manufacturing jobs back into the United States from China and other places. Chinese costs are much higher, and their labor costs are going up faster than the US. The US just has more productivity.

It's better to stay at home, especially if you see protectionism rearing its head somehow. It's better to stay in your home market than to build abroad and export it back into the US.

C. AUSTIN FITTS: All reports are – and have been for a while, Jim – the weather this year, particularly in the Northeast and in the Midwest, is going to be pretty cold. Is that going to have an impact on prices? Ditto if it happens in Russia and the Ukraine?

JIM NORMAN: Yes, but again, there is plenty of oil and gas. The cold will certainly affect the prices at the margin. They NYMEX is a much bigger



factor in the pricing, though. You've had fuel prices even in New York come down a lot, and I expect they will come down some more, too. They will still be expensive, but I think fuel in the United States is going to be affordable and there will be plenty of it.

C. AUSTIN FITTS: The other thing that happens is that every time the oil price runs up you see the renewables business kind of gear up and all sorts of interest growing in renewables, and then the oil price runs down and it gets disassembled. It's kind of like heartbreak hill.

JIM NORMAN: A lot of it should be because a lot of it was never economic to begin with. A lot of these wind projects, they have been failures. The solar voltaic industry is in financial distress, as well as the wind energy.

A lot of these schemes were never really economic on their own anyway. They all depended on huge subsidy deals. If electricity gets cheaper, it's just not going to work. I'm bemused by all these reports about thousands of idle giant windmills in California and elsewhere that aren't even worth fixing because the cost of going up there and taking them down and putting a new generator in them is just not worth the cost, so they just sit there idle.

I think you're going to see more of that.

C. AUSTIN FITTS: My understanding is the price of solar continues to come down, so at some point we could get to the point where solar could be competitive with coal. We're not there yet, but it's getting closer.

JIM NORMAN: I'm thinking of building a house in a very northern state, and I'm definitely going to put in a solar photovoltaic system partly because of utility rules in the place that require the utility to be your battery. You can generate power in the summer, run your meter backwards, and then take it out in the winter. It kind of negates your electric bill. That makes a lot of sense, and I think you will see a lot more of that.

C. AUSTIN FITTS: Every week we do 'Let's go to the movies' and I recommend a movie. This week I recommended that we watch *The*



Prize. It was a documentary made from Yergin's book. Since you brought up the book, have you seen the documentary?

JIM NORMAN: No. I haven't seen that. I don't have a TV – I blush to admit.

C. AUSTIN FITTS: I don't have a TV either, but I have one of those DVD players, so I watch all my stuff for The Solari Report on the DVD player.

What do you think is going to happen? Currency war to trade war to war. What do we think the risks of war are?

JIM NORMAN: Well, I would have given the odds as slim to none maybe six months ago, but where there is smoke there is fire. When you hear Putin and people like that openly alluding to their nuclear weapons capabilities vis-à-vis NATO, there is no place for that kind of talk unless somebody is actually thinking about this stuff.

Clearly posturing around the Asiatic Rim between Japan and China and the other Asian nations, China has opened up a can of worms here that is going to result in significant militarization all over that region. When you get military assets floating around and bumping into each other, the possibilities for a miscalculation rise geometrically.

It's not good.

C. AUSTIN FITTS: Sitting back and looking at it, it looks to me like a decision has been made to bust Putin by any means necessary, but it seems to me that that can be done with oil. You don't need military action to do it.

JIM NORMAN: That is right. They never specifically say 'oil'. If you listen to the wording on all these sanctions, "We'll go after their energy sector." They don't want to say 'oil'. Washington will never admit we're manipulating oil prices – absolutely not.

C. AUSTIN FITTS: Right.

JIM NORMAN: They can't give away the plan. I think everybody in the know



knows what is going on there. They go after their oil companies, they will go after their oligarchs, they will go after all those guys, but you can see it's a staged, graduated state of economic warfare. Putin can see that the longer he lets this go on the more likely it is we're going to go after his bread and butter, which is that oil price. You're seeing it in space right now.

That's what I'm saying. This price could go way south – way south – before it stabilizes.

C. AUSTIN FITTS: If they take oil way south, what do you think happens to gas?

JIM NORMAN: Gasoline prices, you mean?

C. AUSTIN FITTS: No, natural gas.

JIM NORMAN: Natural gas, again, kind of trades on its own equilibrium basis. I think there is plenty of gas. Those prices will probably stay pretty stable. There really isn't a lot of substitution for natural gas to oil or vice versa. I think gas could remain relatively stable.

“There really isn't a lot of substitution for natural gas to oil or vice versa.”

C. AUSTIN FITTS: So the bifurcation stays. And what about arctic drilling? If this fight continues to stay bitter or get more bitter, do a lot of the arctic drilling deals that Putin has made change?

JIM NORMAN: Oh, they have already fallen apart. Exxon has already pulled out pretty much of their arctic drilling deal. Without Western companies – the technology and the money – Russian companies don't really have the stuff to do anything with it. Even if they found oil up there it would be decades before they could get it to a market. So what's the point?

I think it's just going to go nowhere.

C. AUSTIN FITTS: Arctic drilling could have significantly increased their reserves, couldn't it?



JIM NORMAN: Russia has already got so much oil on the ground. This is my point. They could be producing twice as much as they do now just by drilling more wells in fields they already know about. They don't have to find any more reserves.

Their problem – and the whole industry's problem – is how to keep this up in the ground to keep the price up.

C. AUSTIN FITTS: So does any of the climate change stuff relate to the oil card?

JIM NORMAN: One point I make in there is that these kinds of economic warfare policies never go anywhere without a thick bodyguard of lies – to paraphrase Churchill.

C. AUSTIN FITTS: This is why we love you, Jim Norman! “A bodyguard of lies!”

JIM NORMAN: Back in the 80's there was a whole array of propaganda tools that were rolled out, and you're starting to hear some of it now. For instance, “The Saudi's are reducing their prices in order to maintain their market share.” Remember that was the same line that was used in the 80's to justify the Saudi's dropping their price.

In fact, Washington had been arm-twisting the Saudi's to cut their price, and they actually went to what was called ‘net back pricing’ in which the Saudi's said, “We'll match anybody else's price.” That was just to let the oil prices fall and freefall, pushed down by short-trading on the NYMEX back then.

So you're setting a similar stage up here for rationalizing why the oil price could just fall out of bed here. The ‘global warming’ thing, I've always thought that the science behind it was so suspect. It's not bogus. It just smacked of propaganda and an actual cult-type brainwashing process. The purpose, I think, was aimed at China to basically force them to increase their manufacturing costs by using cleaner fuels, stop burning coal, clean up their act, etc.



C. AUSTIN FITTS: They have a pollution problem. There is no doubt about it. They have a terrible pollution problem.

JIM NORMAN: I think if they are smart they will fix that on their own, which I think is what they're saying. They kind of did this 'sleeves out of your vest' kind of deal with Obama. They promised to clean up their act for the next 30 years or something like that. I think even the Chinese realize they need to clean up their act, but global warming is not from CO₂. No way is it from CO₂.

C. AUSTIN FITTS: I was wondering to what extent they are using that as something to help with the engineering of energy management. To me, there are bigger games afoot.

I have to ask you about Keystone because now that the Republicans have won, how are they going to shut off that supply?

JIM NORMAN: Well, you know, I don't think Keystone really matters that much. That was just kind of a political football, and I guess they are voting tonight on this. The Democrats actually want to approve the thing now, partly to help out Mary Landrieu get reelected.

First of all, it's a much safer way to move crude than hauling it in rail cars. That's number one. Environmentally, there is no grounds for all these environmental objections to Keystone. They make no sense.

C. AUSTIN FITTS: Well, if you are a rancher and it's coming over in your property and you don't want it to, that is where it comes in.

JIM NORMAN: You don't want the rental payments for that? I bet any rancher would beg them, "Please put your pipeline on my land, will you?"

I think the real reason that the US has opposed that for so many years when we were pushing the oil price up was that if you actually brought 830,000 barrels a day of Canadian crude to the Gulf Coast and dumped it on the refining center down there, you would have a hard time finding a home for it and it would hurt the price.



Then you would have to put even more money into the NYMEX to counteract it some way. So it was just a problem from an oil card perspective. It's geopolitical pricing.

C. AUSTIN FITTS: It's just to make your management that much more difficult.

JIM NORMAN: Right. So who needs that? Let's just leave the oil there for a while. We'll build it when we need it and want it, which may be now. I think now is the perfect time to let that thing go through. Get it built. In a year it will be ready, and you're telling Putin, "Oil prices are going to be low for a long time, so get used to it."

C. AUSTIN FITTS: Right. Do you think it makes a difference that the Republicans now control the Senate?

JIM NORMAN: Well, now you're getting into politics. My view is it's Tweedle Dee and Tweedle Dum. I don't think there is that much of a difference between either of these parties, and the reason is because we live in a national security state. Let's face it. I mean all these guys basically do what they're told to do, and they're given a little sandbox on the side where they can kind of mess around with their own pet stuff, but I really don't think they have any substantive control over the underlying direction and priorities of the permanent government. That's my cynical view.

C. AUSTIN FITTS: When I worked in Washington there used to be something called the 'Secretary's discretionary fund'. Sometimes we'd call it the 'Secretary's discretionary budget'. That was a little pile of money where he could pretty much do what he wanted, and with everything else he did what he was told.

JIM NORMAN: Right. Imagine a government in which the national security establishment controls 80% of all the money and gives the visible part of the government 20% to play with – just to go away and leave it alone. That's what you've got.



Actually there was a book written by a Tufts University professor that basically said exactly that. Vote all you want; it's not going to do any good. Either party. The die is cast here.

What troubles me particularly, though, is that the electoral process itself has been so fatally compromised and corrupted. I mean, the only candidates we are even given a look at, let alone who get on a ballot, are people who have either sold their soul to this establishment or are so controlled by it and carefully vetted, groomed, trained, and coached that that is all you're ever going to get.

That's all we've had for the last 20 years.

C. AUSTIN FITTS: But I would make a plug for local elections. There is still some wiggle room.

JIM NORMAN: I still vote. I still vote in my local elections. None of them ever win, but I vote.

C. AUSTIN FITTS: We had a great campaign here for Sherriff a couple of years ago, and the good guy won. It was fantastic!

JIM NORMAN: Good.

C. AUSTIN FITTS: The whole county – all the hard-working citizens – pulled together and said, “No!” It was great!

JIM NORMAN: I think that does happen at the margin, but at the national level in the nuclear age things aren't left to chance.

C. AUSTIN FITTS: Right. They can't.

I'll never forget this. There is a great book on the history of Bechtel. One of the things I've gone back and looked at recently is the history of Dwight Eisenhower. The more I learn about him, the more I like him.

“What troubles me particularly, though, is that the electoral process itself has been so fatally compromised and corrupted.”



I'll tell you two stories about him. There is one confrontation between him and Bechtel, and one of the Bechtel's came in and said that he ought to approve Bechtel owning a nuclear weapon. The story sounds strange, but if you've ever been a regulator and dealt with outrageous demands from the private sector, I absolutely believe that story.

My favorite one is after he authorized the existence of Area 51, under the authorities used to set up Area 51 the CIA was responsible for security. I would argue as time went by for more and more financing.

Anyway, he wasn't getting regular reports and he got very frustrated. Finally he called up the guy at the CIA and told him that if he didn't get in his office the next day and give him a full report that he was going to fly to Colorado, get the first army, and invade Area 51.

JIM NORMAN: He'd have to. That's the only way he could find out what was going on.

C. AUSTIN FITTS: Since then we've never let a General become President.

But you're right. I think that one of the reasons I really recommend if you haven't read Jim's book *The Oil Card*, the reason I recommend it is because you need to understand that we're dealing with leadership which is subject to national security concerns and cannot possibly disclose what they are doing.

The more they disclose what they are doing and why they are doing it, the more it compromises the effectiveness of what they are doing.

JIM NORMAN: Which is why I think the highest elected officials don't even know what is going on. They don't have high enough security clearance for this.

The President of the United States security clearance only goes about halfway up the chain of command.

C. AUSTIN FITTS: Right.



JIM NORMAN: There are much bigger fish being fried here than what you see on the nightly news.

C. AUSTIN FITTS: Right, and I would also say that the risks they are managing are much more dangerous than many people who haven't been in that position appreciate.

JIM NORMAN: I think that is true.

C. AUSTIN FITTS: C. AUSTIN FITTS: It's not so easy being in their shoes. The game they are dealing with is a brutal game.

JIM NORMAN: Right. This is why I think Putin's behavior is very telling. I think he knows the vulnerabilities there. He knows the buttons to push, and he's going to go push them.

C. AUSTIN FITTS: Right. Unfortunately some allies of mine came up the other day. They came out with a video saying, "Good news: There are a wonderful group of Asian families that the Dragon Elders, who are the wealthiest families in the world, are going to come save us all. The dollar is going to drop to nothing, and we're going to get capitalized by their gold. Everything is going to turn out okay."

You listen to this and you think: What happens?

I'll just ask you. What would happen if we ever turned control over to a group of Asian families? What would happen to the United States and the American people?

JIM NORMAN: Well, it would just never happen that way. I mean, if we did it wouldn't work that way.

C. AUSTIN FITTS: Right.

JIM NORMAN: Maybe we already did and we don't even know it. There are some conspiracy folks who might even argue that.



C. AUSTIN FITTS: I don't know. That's in complete defiance. If you look at all my experiences of reality – whether it's Washington or Wall Street markets – there is nothing.

If you are a group of wealthy Asian families, why would you have not taken care of the pollution and the brutal poverty within your own sphere? Why would you instead use your money to bail out a group of American consumers who have enjoyed a false prosperity financed with the hard labor of millions of Chinese?

JIM NORMAN: I think that the guys in Beijing have to worry about this a lot more than we do. I think they are the ones who are at severe risk of basically the old Chinese warlord set tapping them on the shoulder and saying, "Time's up. Goodbye."

C. AUSTIN FITTS: Yes.

JIM NORMAN: They would just have to head for the hills because it's such a spiny, corrupt elite that runs that country. They could not withstand a general popular uprising. The army just would not be with them. I think it is a very fragile system, and I think the United States would be happy to just have the country run again by a group of families – the way it was for hundreds of years.

C. AUSTIN FITTS: That wouldn't surprise me at all. I think it's tricky business because no matter how difficult it is to keep this group of people in North America employed, keeping the Chinese employed is a much trickier business.

JIM NORMAN: To me, this is the biggest flaw of the whole US economic warfare strategy. I think that the guys in Washington have persuaded themselves, "Oh, yeah. We can topple governments bloodlessly just by pushing some economic levers here." Life is not that neat and tidy. Things always go wrong. Things get out of hand. People get desperate. They make desperate decisions.

You're playing with fire here. You're just playing with fire. When you see



these gyrations in the oil price, somebody is playing with fire.

C. AUSTIN FITTS: Right, because each time you swing you destroy lots of lives and businesses.

I'll just close on one note. On the way back last week I was listening to a series of CDs that describe the history of nuclear testing at the Nevada test site. One of the things they discussed were several tests where the scientists knew that it could seriously harm the ionosphere. You're listening to this thing and you're thinking, "Why would anybody risk this? I don't get it."

I think sometimes the national security state takes risks that are hard to fathom.

JIM NORMAN: They are, and I go back to this book by this Tufts University professor. I apologize. I can't remember the name of the book or the author's name, but his point is: Who is this national security establishment? His argument is: Well, it's a bunch of good people who are all in their honeycomb beehive doing their thing, trying to do good. As for evidence for that, I don't know. That's more wishful thinking than anything. I mean, it's a nice idea. Maybe it's true, but even if it's true, with all these people busily working away for the common good somewhere you can end up with horrendously bad outcomes.

"Maybe it's true, but even if it's true, with all these people busily working away for the common good somewhere you can end up with horrendously bad outcomes."

C. AUSTIN FITTS: Right.

JIM NORMAN: Theoretically, democracy is supposed to check and balance that, but we don't really have that anymore. It's a propagandized outcome.

C. AUSTIN FITTS: What I think really checkmates it is not just democracy but markets. Markets allow people to communicate; markets allow healthy cooperation and competition to go on. We get a lot of our aggression out



in the markets.

What is amazing is globally in almost every society one thing that is funny is everybody says, “He won. Jack Ma did it.” He won, and that’s okay.

Markets can invent a lot of this, and one of the challenges of having prices no longer communicate a useful number in a market, to engage in economic warfare you corrupt price. When you corrupt price, you corrupt communication. When you corrupt communication, then you don’t have a healthy way of cooperating and competing. I think that can get pretty dangerous.

JIM NORMAN: That’s right. That, in fact, I think is the real desultory conclusion of the book *The Oil Card*. When you get done reading it, you realize, “Oh my God! If the oil market has been jacked around this way decade after decade, what have they done to the bond market? What have they done to the stock market and so many other markets? Is there any market you can trust anymore? Could you ever trust them?”

The whole ‘free market’ mantra that we have grown up with is really out the window.

C. AUSTIN FITTS: It’s out the window. Yes.

JIM NORMAN: And even if markets are working, you can’t believe it.

C. AUSTIN FITTS: Right. It’s a very managed market. Anyway, Jim, *The Oil Card* – we can get it at your website and we can get it on all the usual suspects.

JIM NORMAN: It’s at Amazon. Yes. Actually I think we’re almost sold out of it, but you can always get an e-book copy of it.

C. AUSTIN FITTS: Okay. Good. Well, I’ve got to make my plug. We need you to make another one.



JIM NORMAN: My publisher says that too. One of these days...

C. AUSTIN FITTS: Well, Jim Norman, you're the best. I can't thank you enough for joining us on The Solari Report. You have a great evening, and keep us posted. If you have anything to say, we'll get you back on, okay?

JIM NORMAN: Fair enough. Thank you.

C. AUSTIN FITTS: Bye.

JIM NORMAN: Bye, Catherine.

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