The Middle East and the New World Order

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The world is about to experience the greatest geopolitical transformation in at least the past three generations. The United States’ need for oil has greatly diminished, and its goals in the Middle East have changed. The United States now views the world wholly in relation to its other interests. Global and local demographics, new outsiders in the area, and a new contest shaping up between Iran and Saudi Arabia contribute to continuing instability in the Middle East. A global energy crisis could soon draw many countries into the Middle East, and a simultaneous political crisis could erode state authorities there, unleashing a new wave of violence and terrorism.

Before the world that we know today, the global system was imperial. France, Great Britain, and Japan traded with their colonies; their fleets protected that trade. It was a sequestered imperial system. A country tried to avoid trading with its neighbors; it tried to keep everything in house because it was impossible to predict when someone from the other side of the planet would start a war. Even if your country was not a target, it could lose access to resources, trade lanes, or the market that the country thought was so important.

If a country saw something it needed, it would go out and colonize, militarize, and confiscate it. The country would then fold the resource into its own imperial system. These systems competed for resources, markets, and trade access.

Those competitions turned into wars, and those wars culminated in World War II, which brought the global imperial system crashing down. At the end of the war, the United States brought its allies together for a conference at a place called Bretton Woods. What do you do at a conference? You bribe everybody with golf, and then you lock them into a windowless room. And at Bretton Woods, the United States explained to its allies that the global system was going to work differently when the war ended. Instead of every country or system having its own separate network, all global assets would be pooled. Everyone in this network would trade with each other. In addition, the United States promised to open up its markets to allow everyone to trade into the US 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 United States to fight the Cold War against the Soviet Union on its own terms. This conference was the origin of the North Atlantic Treaty Organization (NATO) and the beginning of the postwar alliances of Japan, South Korea, and Taiwan.

The idea was that everybody would be on the same page, militarily and economically, and free trade was the bribe to make this happen. It worked. The Soviet Union collapsed. Moreover, while the global population tripled, global GDP expanded by a factor of 10. NATO was expanded to country after country.

But when the Soviet Union collapsed, the security trade-off that had driven the United States to make the alliances in the first place disappeared. It was all over. The United States had no idea what to do next, so free trade was allowed to linger on. Free trade became the de facto way the world worked.

US Retrenchment

Over time, China became the world’s leading manufacturing power, Brazil started challenging the United States in agriculture, and Russia showed that you did not have to be the United States to throw your weight around on the international stage. Keep in mind, however, certain global facts, such as the following.

First, all of those countries acting against US interests could do so 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 own economic purposes. As a percentage of GDP, the United States is the least involved...
economy in the world. In 2015, only 9% of GDP came from merchandise exports, and most of that, rather than being global, is attributable to the North American Free Trade Association (NAFTA).

When you hear presidential candidate Donald Trump say that he would forcibly renegotiate every free trade deal on the books or hear presidential candidate Hillary Clinton say that she is opposed to every free trade agreement that has been negotiated in the past 25 years, including the ones that she personally negotiated, the statements are not rhetoric. They are not coming from the fringe. They represent the US political center groping for a replacement for a policy that is now 25 years out of date.

Third, when the United States finally does walk away from the table, it will still have 10 aircraft carrier battle groups, each of which has more offensive capability than the combined navies of the rest of the planet. The United States is transforming into a country with global reach but no global interests. For the 4 billion people on this planet who are utterly dependent on global trade for their well-being, this transformation is possibly the worst outcome imaginable.

Fourth, the United States is about to be too busy to do anything else. The political system is breaking down. The Republican coalition tends to win elections because it is made up of five independent coalitions—the business community, those concerned for national security, populists, evangelicals, and pro-lifers (those opposed to legalized abortion). They do not undermine each other. For example, the business folks do not really care what you do with your personal life, whereas the pro-lifers do not want to shut down the US Marine Corps.

With these groups, a platform that does not contradict itself is easy to contrive, and individuals all show up to vote. So, Republicans tend to win.

The Democratic coalition side is broader, but it is a much more fractious coalition, including African-Americans, the LGBT (lesbian, gay, bisexual, and transgender) community, socialists, environmental advocates (or “greens”), pro-choice (those in favor of preserving legal abortion), people under 30, union members, and unmarried women. African-Americans and the LGBT community tend to have different concepts of the meaning of civil rights. The greens and the unions disagree on almost everything, especially when it comes to industrial policy.

Then, in the middle, there are the groups that Republicans and Democrats try to swing to them—Hispanics and Catholics. Both groups tend to be economically liberal, and they tend to be socially conservative, but they are both very amorphous.

This system is how politics has worked in the United States since the 1930s. What is happening right now in the political system is that these “traditional” party coalitions are already broken beyond repair. The last time this happened to the United States was in the 1930s. There was the Great Depression, and the country moved into World War II. The United States had the most popular president in its history, Franklin Delano Roosevelt. It took the United States 15 years for the parties to settle into their new form, the form that we know today.

Even if the United States was convinced that its economic and physical security required international engagement, it is about to step out to lunch, and it is going to be a very, very long lunch. Just as the rest of the world needs the United States, it is leaving the building.

US Demography and Intergenerational Warfare

If the first piece of the international jigsaw is the absence of the United States, the second piece of the jigsaw is demography. Figure 1 is a standard demographic profile that shows India, a developing country. Children are at the bottom; then, young adults, mature adults, and retirees. Men are on one side; women on the other. Simple mortality makes it a pyramid.

You can split this representation into three relevant chunks.

First, there are the young workers, aged 18–45. They are starting out, and it is all about consumption because they start with nothing. Globally, this group is buying cars and buying houses and going to college and raising kids and smoking pot. It is spend, spend, spend, spend. But they are new. Their incomes are low. Incomes do not match their needs. So, they have college loans, car loans, and house loans. The group is high growth but high debt.

Then come mature workers, people roughly aged 40–65. The kids are moving out; the house is being paid down. They are looking to retirement, and they are saving. They are at the height of their spending power, but they are not consuming much. All of that money is going into the retirement funds. The government sees this group as the tax base—high investment, high taxes, low spending.

Then, there are the retirees, who cannot take the volatility of the markets. So, they step back from the system. Stocks and bonds become Treasury bills and cash.

If Figure 1 shows how demographics normally fall out, Figure 2 illustrates demographics in the developed world (excluding the United States) in 2030. Apparently, in such countries as Canada, back around 1972, people forgot how to have kids. Instead of a baby boom, Canada now has a baby bust two generations in the making. These countries have a huge bulge in the group of people aged 50–60.
Figure 1. Shifting Demographics: India, 2015

Figure 2. Shifting Demographics: The Developed World (excluding the United States), 2030
This demographic picture means that such countries as Canada have more tax income and more investment dollars than they have ever had in their history. That situation has allowed Canada to build one of the world’s most liberal social welfare models and still have enough money left over to fund the entirety of the Athabasca oil sands projects in Alberta, the world’s most expensive energy effort. In six years, however, that bulge moves into retirement. All that money that is coming in will reverse, and instead of contributing to the system with tax payments, these people will be pulling from the system through pensions 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.

No replacement generation is coming along, which means that the consumption coming up will be limited. Canada has not experienced consumption-led growth in 20 years and will not for at least another 30 years. And because of the country’s rapidly aging demographic, soon Canada will have no investment, which leaves only exports as a source for growth. It is a good thing Canadians have NAFTA.

**Problems with the Baby Boomers.** One of the problems with the Baby Boomer generation, usually the majority of my audience, is that there are just too many of them. They do everything as a swarm. When the Baby Boomer generation went into the job market back in the 1970s, they took every single job that was available and there still were not enough jobs, so many had to take jobs that were well beneath their skills or abilities. They thus pushed down their own compensation for decades. They have been struggling with that situation their entire professional careers.

Now that they are nearing retirement, they are doing exactly the same in the investment world. They have supersaturated all available investment products in North America, driving down yields. They are tolerating more risk than they should. Now, they have spilled that money out into the wider system. So, such disasters as Enron are their fault. The subprime crisis is their fault. In six to seven years, on average, when they all enter retirement, all that money has to turn around and come home. We are in an investment boom right now, and the bust is just around the corner.

**Problems with the Millennials.** Millennials—those born between 1981 and 2000—have many of the same challenges as their parents, the Boomers. Millennials could be called the “echo Boomers.” There are too many of them for the jobs that are available. But they have a couple of core advantages that their parents did not have.

First, they have a different educational outlook. Millennials are actually fairly well prepared for our new economy, where everybody has a new career every other Tuesday.

Second, half of Millennials still live at home. Of the half that have moved out, many have been able to pay the rent only because of continual bank transfers from the financial institutions of Mom and Dad.

**Problems with the Gen-Xers.** People from Generation X (Gen-Xers), like me, were born between 1965 and 1980. We are the smallest generation in history. The technical term for our financial position is “we are screwed.” The Boomers have decided that we have to pay for their retirement, despite the fact that they outnumber us.

Gen-Xers are also expected to make up for the intergenerational fund transfers that are already being made from the Boomers to the Millennials, and we Gen-Xers 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.

Nevertheless, we should be thankful for Millennials for three reasons. First, their population bulge is why the United States is not in recession. That is a consumption-led demographic. Consumption is where the growth is coming from. All that beard oil, all those flip-flops—they add up.

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

Third, all the other developed countries have the Canada problem (as shown in Figure 2). Because of US demographics, the United States is the largest consuming power and the largest financial power in the world today. In 15 years, the United States will be the only financial power and only consuming power but only because of its demographics, certainly not because of policy.

**Global Demographics**

Now, jumping around the world, let’s take a look at the demographic situations in Russia, Germany, Italy, and China.

**Russia.** As Figure 3 Panel A shows, the Russian Federation suffered a 60% drop in the birth rate following the Cold War. In five years, 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. Therefore, if Russia is going to use military tactics in an attempt to reshape the world, it has to do it now—as it is doing.

**Germany.** Germany has, as Figure 3 Panel B shows, a huge bulge in the middle. Its aging demographic profile characterizes most of Western Europe.
Figure 3. Shifting Demographics: Russia, Germany, and China, 2015

A. Russia

B. Germany

(continued)
People criticize the Germans for not spending more, but Germans do not have a demographic makeup that can support spending. They do have a demographic that is capital rich and is generating a lot of exports. That export- and investment-rich demographic can pay for the bailouts of the periphery of the European Union—but only for another seven years.

**Italy.** Italy is characteristic of the periphery. It has dire aging demographics, which suggests that the European financial crisis is unsolvable. The periphery no longer has any consumption-led growth. Those countries have aged past it. The periphery countries should be capital rich, but because of their debt, all of the capital has to go into debt servicing.

At some point soon, the Europeans will have to figure out how to make Europe work without exports, without consumption, and without money.

**China.** Finally, consider the People’s Republic of China. Figure 3 Panel C shows a spike of 25-year-olds, followed by many fewer coming along. That is 120 million people. That is real consumption. But some 25 years after the one-child policy, the country is running out of 25-year-olds, so that consumption is peaking right now and will not recover.

Another issue is China’s surplus male population. Depending on which province is considered, the sex imbalance is 10%–15%.

One of the effects of the sex imbalance is that when the manufacturers on the coast realized they were facing labor shortages (and they have had labor costs increase by a factor of 10 in the past 15 years), they went inland to find new workers, but they only brought back women because you can cram women into dorms without having to worry about security. Consequently, men and women of child-bearing age are not simply separated by socioeconomic status in China; they are separated by physical province.

This demographic is already as terminal as what happened in Italy. The policymakers recently dialed back on the one-child rule and turned it into a two-child rule. But tell me this: How long does it take to make a 25-year-old? So, beneficial consumption-led and labor outcomes from this change are a generation away. And China does not have that kind of time.

I will examine the demographic situation in the Middle East in the next section.

**Middle East Stability**

Let’s start with the bottom line: All of the forces that have shaped the Middle East for the several decades—US domination, global energy markets, global trade, and no foreign empires—are in the process of making a screaming 180-degree turn.
Energy: US Oil Independence and Oil Dependencies. North America has, for all practical purposes, already achieved oil independence. That is where we start when we consider the Middle East. Figure 4 shows the structure of oil prices. The horizontal axis is the volume of output, and the vertical axis is the full-cycle breakeven cost.

Back in 2012, shale was not a big deal, but since mid-2014, a series of technological breakthroughs has greatly lowered the per barrel cost of shale production. For example, refraking and in-drilling allows an operator to return a decade-old well to its original output for less than half the cost of the original effort. Technological advances also include multilateral drilling, which used to allow horizontal connections for one well bore of 150 meters but now allows a bore of 50 kilometers. Micro-seismic imaging, which provides a 3D image of the drill, suggests exactly where to go and where to frack, which can reduce per barrel input costs by as much as 80%.

The result is a massive change in the cost structure. The breakeven cost in the US shale patch is below $42 a barrel and headed to below $35, making it cost competitive with every energy production zone on the planet that is not on the Persian Gulf itself.

Next, consider the other challenges to the Middle East and, by contagion, the world.

Terrorism. Figure 5 shows the countries of the world, without the Americas, from failed states to rising stars. Countries in blue, such as Turkey, rule the chaos because they have everything they need to succeed in a post-US world. Countries in green, such as France, should remain in more or less the same situation they are in today. Countries in red and brown are where things are falling apart.

The light-brown countries have something special to help them in the chaos, such as a unified population, self-sufficiency in food, or an ally they can trust. They can meet the challenges of the future head on. They may lose more often than they win, but they will be capable of muddling through.

The countries in brown will not muddle through. They are utterly dependent on the global system in its current form. They lack the ability to impose an alternative even in their own neighborhoods.
As for the countries in red, they are not going to be around in a few years.

Now, consider this situation in relation to terrorism. Transcontinental terror groups need a specific social and military environment in which to flourish. They want to operate under a government that is strong enough to impose a veneer of civilization (because if you have anarchy, terror groups have to fight for their own backyard), but they do not want a government that is so strong that it could come in and wipe them out. The brown countries are the places where terror groups can actually function. If you cross-correlate those countries with the Islamic population in the world, there are only four zones where terror groups with extra-regional reach can even theoretically thrive—and all are contained. The Western Sahel is Nigeria’s problem (Boko Haram). The Chechens are Russia’s problem. Kashmir is an India–Pakistan problem. What is left is Western Iraq: the current zone of operation of the Islamic State (ISIS), which is bracketed by the major local powers of Turkey, Iraq, and Israel.

The structure of the world as global trade breaks down will make transport and financial transfers more difficult, so the magic mix of security that terror groups require will be very hard to come by in the Arab world. Either “national security” states will arise that can stomp the terror groups out or national chaos will reign, as in Libya, where these groups cannot function.

So, the first problem is that terrorism is coming back. It is a big problem, but it is a local problem.

Middle East Demographics. The second challenge in the Middle East is demography. The primary protesting group in any country is composed of unmarried men aged 15–25. In the Arab world, particularly in Egypt and Iraq, that group is huge, as Figure 6 Panels A and B show. At the bottom of the list for this characteristic are the Gulf states—Saudi Arabia and the United Arab Emirates (UAE) in Panels C and D. In both cases, these are imported workers, and in both cases, the governments have the internal security services and resources to deal with it. So, I do not worry about Saudi Arabia or the UAE, even though the structure looks bad.

I would worry about Bahrain and Oman, the countries that cannot afford to maintain social security. For the poor parts of the Arab world, the “Arab Spring” is going to happen over and over again.
Figure 6. Demography in Egypt, Iraq, Saudi Arabia, and the United Arab Emirates, 2015

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Figure 6. Demography in Egypt, Iraq, Saudi Arabia, and the United Arab Emirates, 2015 (continued)

C. Saudi Arabia

D. United Arab Emirates
The only country in the region that does not have to worry about this demographic issue is Iran because a baby bust occurred in the aftermath of the 1979 revolution. Iran’s 15–25 age group is shrinking rapidly. That issue will cause economic problems for the country down the road, but from a security point of view, if a rebellion was going to occur in Iran, it would have happened five years ago. So, Iran is free to spark revolutions elsewhere without worrying about the possibility of one of its own.

Upside-Down Global System. The third challenge also relates to what happens when the global system changes. Figure 7 shows US strategic interests projected for 2020. Countries in dark blue represent the nations closest to the United States—the inner core. Countries in light blue are Bretton Woods countries that were allies in the Cold War. The orange countries represent the other side in the Cold War; they are rivals and problem states. The lightest-blue countries are the fields of battle.

During the Cold War, the United States could not afford anything that would threaten the integrity of the alliance. Consider what happened in the Persian Gulf. The reason the Persian Gulf has been so calm these past 60 years is because the United States kept an aircraft carrier battle group on station in the gulf at all times to prevent Saudi Arabia and Iran from fighting. This peacemaking was not because the United States particularly liked either of them. It was all about the oil. The United States needed the oil to flow in order to fuel global trade. Although its own imports of Middle Eastern oil were relatively modest, the United States needed global trade to cement the Cold War alliance to guarantee its security.

Now, US security is a domestic concern. The country does not need the Cold War alliance. It never much used free trade, and because of shale, it no longer even needs the oil. The links in the chain of dependencies that kept the United States involved in the Persian Gulf have all broken at the same time.

So, the United States is checking out. It is entering a period of retrenchment, or isolationism, if you prefer. It will have a sharply shorter list of allies, with a sharply shorter list of interests. If you are not one of those allies, and you are 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.

The competition between Saudi Arabia and Iran is occurring now at every level—political, cultural, religious, and ethnic. Also, because shale has removed North America from the global energy markets, it is an economic competition. These two countries are sending exactly the same product along exactly the same trade lanes to exactly the same customers.

The global situation is as if we had moved back into the 1800s, with two countries that really do not like each other vying for control of the region. Iran is not quite sure what is going on, but it is excited about its opening. Saudi Arabia, in contrast, is terrified, and
it has to come up with a two-part plan to destroy the Iranian state.

Step one is the price war, which, so far, has amounted to an 80% cut in Iran’s oil income. The result is a reduction in Iran’s capacity for bringing in money, income, and investment. Saudi Arabia is now doubling down on that outcome in an attempt to crush any foreign interest in the Iranian oil patch.

Step two is to bleed Iran economically and physically. Saudi Arabia is bringing its money, its intelligence assets, and whatever weapons it can ship to any group that is willing to go to war with Iran, Iran’s allies, or Iran’s proxies. The region is home to eight major conflicts, three of which are now in open wars—Yemen, Syria, and Iraq. This strategic competition is about to become far more direct.

Some 2.5 million religious Shia live in Sunni Saudi Arabia. Iran, home to Shia adherents, has for years been trying to stoke a rebellion there. Similarly, about 3 million ethnic Arabs live in Persian Iran; they are concentrated in the province of Khuzestan in the country’s extreme southwest—home to 80% of Iran’s petroleum production. Just as Iranian intelligence is attempting to foster a revolution among Saudi Arabia’s Shia population, Saudi intelligence is attempting to return the favor among Khuzestan’s Arabs.

Assuming no one else gets caught in the crossfire, 11 million barrels of oil per day of output face some degree of threat.

What will be the result? Eventually, Iran is going to understand what Saudi Arabia is doing. How does Iran retaliate? The only way Iran knows how to fight is to try to close down the Persian Gulf. That strategy has always been straightforward. You close the gulf, triggering a global energy-induced depression, and the Chinese, the Japanese, the South Koreans, the British, the Germans, the Italians, and the French all come to Washington, DC, and say, “Fix this. It is part of the Bretton Woods deal. You keep the energy flowing.”

And 10 years ago, the plea would have worked. But today, the United States just does not care. Saudi Arabia, however, will help because it has a bypass pipeline. If you take the gulf offline, Saudi Arabia can still get 6 million barrels per day out. Oil prices will more than double, but Saudi Arabia will still be able to get two-thirds of its output out.

If you are Iran, your only remaining option then is an outright invasion. How would that go? Too many factors are in play to tell.

New Foreign Players. The fourth challenge is that many new foreign players that do not have the United States’ hands-off approach are coming into the region. Consider the former Soviet Union; large areas are tundra, desert, or mountain. Then, the Russian wheat belt is surrounded by 6,000 miles of open, indefensible terrain. The single most vulnerable location on the Russian periphery is Ukraine. Not only is Ukraine the most economically valuable portion, home to the most Russians, the best farmland, and the best naval frontage, but also it directly abuts the German and Turkish spheres of influence. Without Ukraine in the Russian fold, Russia is inherently insecure.

The Russian plan since the czars has been pretty straightforward: Expand beyond the wheat belt until you reach geographic barriers and anchor in them. Somewhat ironically, such an expansion actually reduces Russia’s 6,000 miles of indefensible border down to only 1,500 miles of plugged gaps. The problem today is that this traditional approach involves absorbing all or part of 16 countries, 5 of which are members of the European Union and NATO.

For the United States, this issue is rapidly fading from relevance because from the US perspective over the past few years, NATO countries have seemed to be fair-weather allies. The idea that the United States is going to put tens of thousands of troops on the plains of Europe to defeat a demographically desperate and nuclear-armed Russia with nothing to lose while all the countries the United States is assisting are using more Russian energy in absolute and relative terms than they did in the days of the Soviet Union—such an idea is a hard sell.

Nevertheless, the plan will not be easy for Russia. It is going to have simultaneous conflicts with Scandinavia, Germany, and Turkey. Russia may think highly of itself, but it does not think that this is a war it can win. Russia needs a distraction. It needs to take some of these players off the board.

And that is, ultimately, why Russia is in Syria. Consider where ISIS operates and where it has actual control: There is only so much control you can have in an empty desert where no one lives. With the exception of a small part of the Euphrates, which at its widest point is less than 16 kilometers (about 10 miles), the rest of its occupied land is utterly useless.

Usually, what has happened in this region—going back to antiquity—is that when a local group starts causing too many problems, armies (such as the Mesopotamian, Napoleonic, or Syrian) sweep in, kill a lot of people, burn everything to the ground, and then leave. Normally, the conquerors do not even patrol the area because it is not worth their time.

That clearing has not happened yet because Syria and Iraq are in civil wars and Turkey is on a vacation from history.

The part of Syria that matters is where it actually rains and where people can live. The Aleppo-Damascus corridor is home to 60% of the Syrian population and 85% of the food production. Before Russia’s 2015 intervention, the lines of battle in this core were static. Russia’s intervention made the conflict far more fluid, enabling ISIS to penetrate into the core and bring
its unique style of economic management to the part of the country that actually enables Syria to grow food. The (intended) result was a million refugees who had no choice but to go north into Turkey and then beyond into Germany. Russia’s play was to flood Turkey and Germany with so many refugees that it would destroy that bilateral relationship and make them incapable of taking steps to counter Russia in Ukraine.

It worked beautifully. Morally, this move by Russia is the most repugnant thing I have seen in foreign affairs in the past 15 years. Strategically, it is one of the smartest things I have ever seen. The beauty and horror of it is that Russia can do this again and again.

Finally, a whole series of new players that have never had anything to do with the Middle East are about to come in: Asia.

Consider the East Asian tanker war. Whenever an energy disruption occurs in this soon-to-be world, energy gets used as a political football. Four markets have to suck up the shortage—China, Japan, South Korea, and Taiwan—because they are all about 7,000 miles from the nearest oil supply. Everyone else takes their shares before tankers get to Northeast Asia. If you are China, Japan, South Korea, or Taiwan, you have one thing that you can do to combat this situation—namely, sail your navies 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 does not take it from you and that this partnership holds together.

**Conclusion**

The end result is a cornucopia of chaos, with the following being the leading outcomes.

In one scenario, China, Japan, South Korea, and Taiwan find themselves forced into the military conflicts of the Persian Gulf, which may not be based on the principle of “keep them apart and keep the energy flowing.” Instead, a more direct, intimate, and violent involvement may occur that will resemble the imperial age, during which countries had to physically get the asset, guarantee its shipment, and perhaps sabotage everybody else’s interests.

Another factor is the energy price split. On the one hand, in North America, small and medium-sized companies produce the crude oil on the basis of market conditions. The transport is primarily short haul and mostly via pipelines within two developed countries, Canada and the United States. The industry is stable, and the crude probably has a price ceiling of $60–$70 per barrel.

On the other hand, everywhere else, the major players are giant state-owned companies that make the production decision on the basis of strategy as much as economics. The transport is long haul, measured in thousands of miles that go through zones the companies and states do not control and where security is a constant issue. The floor in that environment is probably $150; then, add on a $50 premium for Northeast Asia, where volume is simply insufficient and supplies will face constant interruption.

Another factor is that manufacturing as we know it is about to end. Before Bretton Woods, giant industrial complexes were common; the strategy was “one-point production.” These days, “cluster manufacturing” is the hot term. In cluster manufacturing, a company brings in inputs and turns them into finished products, and the products are then distributed around the world.

Bretton Woods did away with that. Bretton Woods made international trade and transport cheap, safe, and reliable. Those old single-point industrial processes were broken up; plants were relocated to wherever it made sense. The average supply chain went from one or two steps to dozens, then hundreds, and ultimately, thousands of steps.

Containerized shipping characterizes today’s production. But the first time one of these tankers is shot at, captured, or sunk, that is it. The cost of transport will skyrocket, and the half of the world’s supply chains focused on Northeast Asia will collapse overnight. We are on the verge of a world where inputs, production, and consumption do not simply need to be protected; they need to be co-located, and the only place right now where co-location occurs is North America.

Finally, consider the capital flight issue. When a breakdown in trade or in social stability occurs, when markets collapse for demographic reasons, or when the lights go out because of insufficient energy, investors have to find a safe place to stash their cash. In ascending order, those places are New Zealand, Australia, Switzerland, Canada, the United Kingdom, and the United States.

So, those of us in Anglo-America are now in this weird world where, for demographic reasons, the overall volume of capital is steadily shrinking, yet spurts of capital flight driven by geopolitical concerns sometimes will override what is happening with demographics. This overriding occurred in 2015, with some $2.5 trillion flooding into Anglo-America. But you cannot count on such a flood every year—and as global populations age, the bar will rise steadily.

The result of all of these trends and factors is a world that will fragment and display a breakdown in global trade.
Question and Answer Session

Peter Zeihan

**Question:** What does the new order mean for the price of oil?

**Zeihan:** In the short term, until the Russian conflict or the Saudi–Iranian conflict gets going, we’re looking at an absolute ceiling on prices. One of the funny things that’s going on in oil shares is that the price structure has dropped so much that there really is a functional ceiling right now, probably about $50.

That ceiling will continue to drop as shale techs continue to improve, with shale production displacing higher-cost production in such places as Canada, the “nodding donkey” fields in western Texas, and California.

So, output is relatively steady. It has even risen a bit. It’s not falling. And as long as those geopolitical shocks don’t occur, prices should not rise anytime soon.

As soon as those shocks happen, everything changes. If a break occurs in the global market, the populist government of the United States, whether it’s Clinton or Trump, will most likely immediately slap on an oil export ban to protect US voters from high prices. So, prices might be high and erratic globally but relatively low and stable in North America.

How can investors profit from that situation? They can’t on the production side. But take a look at chemicals and refining.

One of the side aspects of the shale revolution is that natural gas in the United States is, in essence, free. Methane, ethane, and liquefied petroleum gases are eating into the feedstock that has normally dominated the chemical industry. US refiners and petrochemical industries are expanding massively because the costs in North America are minimal and the product can be sold on the international market for a hefty profit.

In short, a complete bifurcation in the oil and gas market will occur. In Anglo-America, prices will have a ceiling of $60–$70 per barrel. Everywhere else, the floor will be about $150. For producing countries that enjoy Western hemispheric security, such as Venezuela, this bifurcation will be a wonderful opportunity; investment will not go to Venezuela when prices are $50, but it will go there when the price is $150.

**Question:** Can the huge flow of refugees into Turkey and Europe—Germany, in particular—actually come to the rescue of Europe’s demographic problem?

**Zeihan:** The short answer is no because the wrong people are leaving. About 80% of the flow of Syrian refugees are men aged 15–25 who don’t have technical skills and don’t speak the European languages, so they are looking for low, baseline work. 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.

Europe needs skilled labor, and the big problem with global emigration in the new era is that the cream of the crop—the skilled laborers who have a suitcase of cash or a degree—are going only to the countries that are economically stable, not necessarily the ones that are demographically hurting.

**Question:** Do the recent Iranian election results suggest some long-term reform in terms of the next supreme leader? What effect does that have on the Islamic Revolutionary Guard Corps (IRGC)? How does it react? How does that change the picture, and how does Israel fit into these changes?

**Zeihan:** Let’s start with Israel because the question is pretty simple. Israel’s problem is that it won. Every conflict that it’s been involved in that was strategic, it’s won. Now, every country that borders Israel—Lebanon, Syria, Jordan, and Egypt—is either a failed state or militarily incapable of posing a threat.

Now, beyond those countries is another belt of states that are potentially threats, and Israel would certainly appreciate it if the United States would fight those wars for it. The United States has no interest in doing so, but Israel will be fine. In fact, it has already replaced the United States with another ally, Saudi Arabia. It is a nice little deal: Israel is providing military assistance to Saudi Arabia to teach Saudi Arabia how to use its own weaponry (almost all of it is from the United States). If push comes to shove, Israel will be getting Saudi oil.

Iran’s situation is more complicated. Assume for the moment that everything goes in the liberal direction and that everything in Iran is built around the reform process. In that case, we will see in about five years the first meaningful development in Iran of a consumer market on an industrial base. But Saudi Arabia’s price war will destroy its finances long before that. Had liberalization happened 5 or 10 years ago, Iran would have recovered. Now, it’s simply too late in the game.

The IRGC has no problem killing a lot of people to get its way, so I’m not convinced that this reform process is going to go as well as people hope.

**Question:** What economic or political benefits does Saudi Arabia expect to get by destroying Iran...
economically? Can’t Iran and Saudi Arabia develop into a peacable area, as happened in Ireland?

Zeihan: The economic development plan that Saudi Arabia is putting into place is honest and real, but it will not bear its first fruit in the next 15 years because the first thing it has to do is bring in experts to train the local population. Therefore, Saudi Arabia’s goal is to destroy Iran as a functional economy. Otherwise, after a conflict, Iran could be left as the predominant energy player in a newly volatile world with double energy prices (triple energy prices from where it is right now).

The cultural aspect of the Saudi economic plan alone is a decades-long process. It has potential—Saudi Arabia is certainly going to splash a lot of cash on this program—but the initial output is going to be a long time coming.

As for the Ireland comparison, the reason Ireland was able to pull itself into the modern world is that it served as a bridge, or lily pad, between US investors and the eurozone market, using England as the logical linchpin. For demographic, financial, political, and geopolitical reasons, European stability is breaking down.

Brexit has brought this crisis from the theoretical and future to the actual and present. Ireland now has to figure out how to succeed without foreign investment or trade or European financial assistance. The only way the country has ever done this successfully in the past is encouraging half of its population to leave. Unless Ireland can develop an entirely new model within the next three years, its future is going to look a lot more like its past.

Question: How would a pipeline to Canada’s east or west coasts affect the tanker war you were discussing?

Zeihan: No pipeline is going through British Columbia because the province has basically said, “We’ll take half of revenues”—not half of profits, half of revenues. That deal is already dead.

As for an east coast pipeline, assume for the moment that all of the provinces that have to be crossed ultimately come to a deal: That’s a five-year construction project. So, Alberta does not have meaningful alternatives for getting the crude to market that don’t involve the United States. Albertan crude oil is heavy and sour. Shale crude oil is light and sweet. The goal was to mix the two in refineries in the center of the United States, where most of the shale output is, creating a medium sour blend that all US refineries could use.

But it’s too late. The US refineries have given up on that deal, and they are retooling their refineries to work with the light, sweet shale crude.

That’s the first problem for Alberta, that their core market has now been destroyed. Problem two for Alberta is that it’s the only province in Canada with a US-style demographic, with Gen-Yers.

Problem three for Alberta is that it’s the only province that is paying into the federal budget now. Everybody else is a recipient.

Problem four is that the Canadian government, led by Prime Minister Justin Trudeau, 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—even assuming the energy price recovers, which it probably won’t.

Problem five, which is more Canadian than Albertan, is that secession is legal. Alberta could secede and join the United States.

We’re now in a situation in which Canada can’t enjoy its standard of living without Alberta and Alberta can’t enjoy its standard of living as long as it’s in Canada. Anywhere else in the world, firearms would already be in action.

Question: Could advances in renewable energy technology change things?

Zeihan: Such advances could actually speed the changes up. The only developed country that’s relatively close to the equator is the United States, which means that the only developed country that could impose solar en masse is the United States. People talk about lithium batteries being able to maybe square the circle on the intermittency issue with solar, but you just can’t get by the fact that the United States gets 12 times the solar radiation of Germany. Even if lithium lives up to its hype (and I’d not bet on success there), it really only helps the United States because the United States would only need storage that works for three to six hours, whereas Germany needs to store it for three to six months. That sort of technological breakthrough is not even being considered right now. The United States could actually achieve a greater level of independence in a decade than is possible for Japan, South Korea, Canada, or Europe.