As prepared for delivery

Baker Institute Event in Abu Dhabi

Thank you, Ambassador, for that generous introduction.

Ladies and gentlemen, it is an honor to speak before this distinguished group of business and government leaders.

It is also a pleasure to return to the U.A.E. -- and particularly to this magnificent city, where I met so many times and worked so closely with Sheikh Zayed, the undisputed “Father of the Emirates.” One of the awards of which I am most proud is Sheikh Zayed’s “First Order of Merit,” which I received in 1998.

Although Abu Dhabi faces a difficult moment, I am confident its entrepreneurial spirit and determination will help it find its way to recovery.

Let me begin by saying that this is a critical time in the Middle East. What happens in this part of the globe over the next few years will shape the future of the region, and indeed, the world.

And so, let me focus on three issues that are critical to the stability of the region. First, the global economy. Second, world oil markets. And finally, the prospects for peace between Israelis and Palestinians.

After my remarks, I will be glad to answer a few questions so that we can discuss other topics.

First, the economy.

Last year marked the first year since World War Two that global output declined. It shrank one percent in 2009 compared with average annual increases of 3.5 percent since 1946. Meanwhile, global trade plummeted nearly 25% in 2009 -- an historic 60-year decline.

Fortunately, there were signs by the middle of last year that the global economic slide had halted. Today, we appear to be on a rebound, although it is fragile. The world economy faces major challenges if we are to continue the recovery and prevent future financial tsunamis from swamping the global economy.

Inflation is a looming problem. The fiscal stimulus packages put in place in 2009 required most countries to run budget deficits. As a result, government balances deteriorated in 14 out of every 15 countries around the world. Inflation – and interest rates – may today be low in many major economies, including the United States. But when economic activity picks up, central banks will face the difficult task of containing inflation without raising interest rates to levels that they snuff out further growth.

In addition, countries need to work together to regulate financial transactions. Lending institutions must be required to maintain more conservative capital requirements. Esoteric and opaque derivative products need better oversight. Transparency will be essential. Originators of loans – notably mortgages – should be required to keep "skin in the game" by retaining a portion of them. So should the financial institutions that package mortgages into securities. Of course, we must be careful not cross the fine line between regulation and strangulation because too many restrictions can delay our recovery.

One thing that we should not do is replace the U.S. Dollar as the main currency of official reserves. Recent events notwithstanding, the U.S. economy has proven beyond any doubt its ability to adapt to changing economic environments and to lead the global economy to safe harbors amid turbulent financial seas. Want proof of the durability of the dollar? Note that during this economic crisis, the cost of selling American debt has remained low.

Any shift away from the dollar as reserve currency – particularly if quick and sharp – could be highly destabilizing. And there are no clear alternatives in sight. The most obvious one – the Euro – is facing its own troubles, as countries like Greece struggle to maintain even a semblance of fiscal discipline.

Of course, if the dollar is to keep the trust of the global financial community, the United States must diffuse its ticking debt bomb. The United States currently has a debt that totals 93 percent of its gross domestic product. For the next three years, that level will hover around 100 percent -- a level that rivals its debt in terms of GDP at the end of World War II. Quite simply, America must resolve this problem.

Third, we also need to address the imbalance between high-saving and high-consuming economies. China and the United States are surely the most important case in point. But the imbalance between energy-exporting and energy–importing countries also creates potentially destabilizing volatility in international financial markets. This is a subject I will return to later in my remarks.

I want to stress one thing: I'm not suggesting here that every country keep its current account in perfect balance. But I do believe that large and protracted imbalances create conditions conducive to the creation of assets bubbles and their inevitable – and painful – collapse.

Of course, other issues will require global cooperation. Countries should resist the temptation of protectionism that purport to safeguard domestic markets. We've gone down that path before. And all it did was worsen the Great Depression. Most importantly -- now, as before -- we need to come together and preserve the international financial system that has underpinned global prosperity for the past six decades.

Similarly, international cooperation is no less important in my second topic -- global oil markets.

In recent years, the intertwining of global oil markets and international finance has been so tight that it is hard to contemplate one without considering the other.

My experience in 1990-1991 -- as Secretary of State for President George H.W. Bush -- is instructive. The United States, the International Energy Agency countries and the Gulf Cooperation Council countries worked cooperatively to prevent a crisis in the oil market. This coordination between major oil importers who controlled strategic emergency stockpiles systems and important oil producers with vital spare oil production capacity helped to prevent speculation-driven price spikes. That, in turn, minimized the economic damage from the sudden loss of oil supplies from Iraq and Kuwait during the first Gulf War.

This contrasts with the economic dislocation experienced during the 2008 oil price bubble or the 1998 Asian financial crisis. Those events hit oil producers particularly hard by driving sudden market imbalances. The lesson of the repeating interactions of the oil cycle with the global business cycle is that neither OPEC nor the United States benefit from market instability.

Fixing these cycles can be a win-win. The industrialized West must look to energy efficiency and alternative energy to prevent an unfettered growth in oil demand that is impossible to meet. Tempered, steady adjustments in oil demand would similarly smooth the sudden influx of massive petrodollars surpluses into relatively small Gulf economies. Sudden major recessions in the West leave Middle East producers without a consistent revenue stream needed to satisfy the region's long-term economic growth. By the same token, a collapse in oil prices leaves oil-producing governments without the revenue to adequately invest in future oil resources, sewing the seeds for the next supply crisis.

Today, researchers from the Baker Institute will present research that highlights the impact that emerging U.S. energy and climate policy will have on oil and natural gas markets. If juxtaposed with new initiatives for economic reform and diversification in the region, a more stable pattern for oil demand and petrodollar inflows and outflows would simply ease the dangers of global financial crises for all concerned. This was the experience of 1990 when many looked at the successful cooperation between the United States, the OECD and the GCC as evidence that related severe oil and financial crises could be a thing of the past.

Oil and natural gas will be important commodities of world economic importance for generations to come, even as the United States, the EU and China experiment with alternatives energy sources. As the United Arab Emirates, Saudi Arabia and Qatar have shown with new programs in science and technology, prosperity lies in embracing a wide range of opportunities to work together to ameliorate the oil boom and bust cycle in the short run while considering a sensible transition for the very distant post-oil era that can be developed in a manner that preserves economic prosperity for the Gulf.

International cooperation with also be key to addressing the Arab-Israeli dispute, my third and final topic.

The situation today is in stark contrast to five years ago, when I believed that a window of opportunity existed that was similar to the one that occurred in 1991. That year, we in Washington seized the moment to convene the Madrid Peace Conference, the first face-to-face meeting of Israel and all of its Arab neighbors.

Chief among the positive signs five years ago was the "Cedar Revolution" in Lebanon, where "people power" forced a change in government there much as it had months earlier during Ukraine's "Orange Revolution." Meanwhile, after Palestinians conducted a free and fair election to chose Abu Mazen to replace Yasir Arafat, Mazen and Israel Prime Minister Ariel Sharon appeared to understand and respect one another.

But much has happened since then.

- The 2006 Israel-Hezbollah War crippled Lebanon and set back advancement achieved during the Cedar Revolution.
- Iran appears determined to continue developing its nuclear program -- both peaceful and military.
- Stability has been hard to achieve in Afghanistan and Iraq.
- And when Sharon stepped down, Israel lost a leader who had endorsed the Road Map for Peace put forth by the United States, European Union, and Russia.

What is most discouraging, however, is the division inside the Palestinian polity. And that creates a conundrum. How do you achieve a peace agreement when you don't have all the Palestinians at the table?

The Egyptians are working hard towards that end. And we should be thankful for it, because it's pretty hard to negotiate peace when your negotiating partner is in two different camps.

Israel, in the meantime, is in a difficult position. It's going to be very hard for her to retain her democratic <u>and</u> Jewish character as long as she occupies the entirety of the West Bank and Gaza. More and more Israelis are realizing this. And so it's very much in her interest for her to achieve a secure peace with her Arab neighbors.

Of course, the only way you get a secure peace is to negotiate it.

And that’s what President Barack Obama and his chief negotiator, George Mitchell, have been trying to do -- with little success to date. But they must continue to work at it. Although persistence does not guarantee results -- results in this particular dispute will not come without it.

In the lead-up to the Madrid Peace Conference, I made eight trips to Syria to get them to change 25 years of Syrian policy and talk face-to-face with Israelis. If I'd quit after the first seven trips, it wouldn't have happened. And so you just have to keep after it.

As efforts hopefully continue, above all else, we need to remember and appreciate five historical "truisms" about this dispute.

First, there is a Catch-22 regarding the issue. Israel will never enjoy security as long as she occupies the Territories and the Palestinians will never achieve their dream of living in peace in their own state alongside Israel as long as Israel lacks security. Its a tragic version of the chicken or the egg question.

Second, there is no military solution because neither side will "win" the conflict by dominating the other.

Third, a political process and dialogue are essential in the Arab-Israeli dispute. Whenever the political process breaks down, there will be violence on the ground.

Fourth, hardliners on both sides have been the biggest impediment to a solution, including Arabs who won't accept Israel's right to exist and Israelis who want to keep the land.

And fifth, only the United States can serve as an effective mediator because of the country's special relationship with Israel. But the United States can only be effective in this role only if both Palestinians and Israelis believe that America is not playing one side against the other.

Fostering the Arab-Israeli peace process will, of course, continue to test the resolve, patience, and leadership of all who seek a settlement that is satisfactory to both sides. The United States, however, cannot "create peace" in the Middle East. Only Arabs and Israelis can do that. Washington's role is to help them. But Washington also needs the support and cooperation of London and The Prague, as well as other important political capitals.

Ladies and gentlemen, there are many other topics that could be discussed today, and perhaps we can address some of those through your questions.

The world faces daunting global challenges. I've just touched on three: reviving the global economy; limiting volatility in oil markets; and securing a just and lasting settlement between Israelis and Arabs. There are others, including the threat of international terrorism.

Finding answers will be difficult.

But if there is anything that we should have all learned – or relearned – from the recent financial crisis, it is that we are all in this boat together.

The challenges we face are global in reach, and they will require global solutions.

Thank you.

And now, I would be glad to entertain questions.