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## **Trends in the Middle East: Implications for Oil Geopolitics and Energy Security**

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### Opening Remarks

The Baker Institute began its energy research program in 1995 with a major inquiry into the Persian Gulf region. Today, over a decade later, Middle East issues continue to loom large when considering global energy security. President George W. Bush has made democracy promotion a major tenet of his administration’s approach to the Middle East. However, it remains unclear what the long-term ramifications of this policy approach will be, especially given the situation in Iraq and the upsurge of sectarian divisions between major Sunni and Shia communities throughout the Persian Gulf and the Indian subcontinent.

The situation between Israel and the Palestinians remains halting and fragile, adding to other existing pressures in the region. Israel’s conflict with Hizbollah in Lebanon in the summer of 2006 highlighted the dangers of lingering conflict that could, if not properly managed by effective diplomacy, expand to embroil a wider range of countries – including Iran and Syria whose active support for such sub-national groups as Hamas and Hizbollah continues to be a destabilizing factor.

I recently returned from a trip to Tel Aviv and Jerusalem to chair the Baker Institute Israeli-Palestinian Workshop on territorial issues. We are doing serious “bottom up” research and work to provide policymakers with tangible and achievable options to resolve key final status issues such as borders and Israeli settlements. But nothing will be accomplished unless there is a return to the negotiation table by the parties (Israel, Palestinians, and the international community, especially the United States) in an active

and sustained manner. Also, I noted serious concerns in Israel over Syria and Iran. Recent border tensions between Israel and Syria are a manifestation of the fragile situation in the region.

It is clear from the Israel-Lebanon conflict of 2006 and ongoing violence inside Iraq that these issues demand a political solution and that the costs of a military solution would be unsustainably high. In an article I wrote for *Foreign Affairs* in December, 2006, I make the case that U.S. policy in the Middle East must move from conflict management to conflict resolution. This will require strong political will on the part of the leaders in the region and the international community.

This violence and tension in the Middle East comes against a backdrop of volatile global energy and financial markets. As will be discussed by Professor Mahmoud El-Gamal today, many of the global economic trends apparent in markets today are quite reminiscent of 1973 when the U.S. dollar was weak, U.S. national debt high and excess OPEC oil production capacity limited in the face of rising world oil demand.

In the past, the industrialized West has counted on the countries of the Persian Gulf to make the sizable investments needed to maintain enough surplus capacity to form a cushion against disruptions elsewhere in the world. Looking forward, however, questions have arisen about whether the Persian Gulf countries (and OPEC in general) will invest adequate amounts to meet the rise in oil demand in the United States, India, China and emerging economies in Asia and elsewhere.

Unlike past decades when private, publicly traded oil companies played a major role in the worldwide oil exploration business, national oil companies (NOCs) will be responsible for a lion's share of the increase in oil output and investment over the next two decades.

The growing importance of NOCs to the global supply-demand balance raises questions about their emerging policies and priorities. National oil companies have important responsibilities to play in their home nations. They play a role in redistributing national wealth from domestic energy resources; they play a strong role in the pursuit of national energy security and domestic industrial and economic development. In some cases, NOCs are a tool of foreign policy. But all these objectives, while extremely important to national goals, can thwart an NOC's ability to expand its oil and gas production.

Bloated workforces, expensive consumer fuel subsidies, and debilitating political interference remain features of a number of major NOCs. All reduce their ability to return the maximum oil production per investment dollar. Still, we should not oversimplify as there are many highly effective NOCs, including several represented here today. But, unless NOCs as a group increase their efficiency, world energy markets may be headed for a rocky future.

The tenuous situation of international oil markets sits atop the growing risk of political instability in the Middle East. The region as a whole faces severe social and economic problems as government have had difficulty putting politics in place that could provide the resources and adequate services for growing and restive younger populations.

Terrorism remains a significant threat to oil facilities in the region.

And, Iran's role in Iraq and elsewhere in the region has great bearing on the stability of the Middle East and by extension energy security. An expanded proxy war in Iraq – fanned by the actions of its neighbors – could create a political and humanitarian crisis of even greater proportions and would be detrimental to the region as a whole.

Saudi Arabia has expressed concerns about such a scenario from the highest political levels. The kingdom is deeply worried about the possibility of escalating violence in Iraq and the fate of the Sunni Arab community there. The Saudi government has a strong interest in national reconciliation in Iraq and for the peaceful co-existence of Sunni and Shia Arab populations. Saudi Arabia itself has a large Shia population, which resides in the oil producing areas of the kingdom's eastern province.

Hints that Arab Sunni countries might back Sunni fighters inside Iraq against Iranian-backed Shiite militias are a warning of possible negative scenarios that could emerge if stability cannot be achieved in Iraq through political means. Gulf Arab leaders also remain concerned about the possibility of an Iranian attack on oil facilities in the Gulf, either directly or through the sponsorship of terrorism.

In considering how to deal with Iran on its nuclear policy, it cannot be forgotten that Tehran has geographical leverage on the oil flows via the Straits of Hormuz. For its part, Iranian hardliners have fanned worries with aggressive rhetoric. In an extreme example, Hussain Shariatmadari, an advisor to Iranian Supreme Leader Ali Khamenei, announced recently that Shia populations in Bahrain demand the reunification of “this province of Iran to its motherland.” While this statement was modified by other Iranian leaders' comments, it had its political impact on the Arab Gulf countries.

Maintaining the free flow of oil to world markets is not just a critical national concern to the United States but also a global one that concerns key countries such as China.

Conflict resolution and international cooperation will be key to confronting the strategic challenges of our future energy needs. There needs to be much broader discussion at the governmental level of the global challenges we face in the energy arena and the best means to achieve energy security.

If I leave you with one message this morning it is this: it is in the vital interest of importing and exporting countries alike that our energy future be based on partnership, not conflict. We cannot allow the Middle East, already home to tragic violence, to become the scene of great power confrontation over energy. In this respect, I for one, would urge serious engagement dialogue and strategic cooperation between the United States and China on key Middle East issues and policy.