

Your Highness, Excellencies, Distinguished Guests, Ladies and gentlemen,

I am honored and pleased that John Duke Anthony invited me to this important conference on Arab-US Relations. There are few areas in foreign policy as important as this relationship and John has worked very hard for decades to bring Americans and Arabs together to discuss the major issues confronting the region and our role in it. The Arab-US Policymakers conference has grown from its modest beginnings to a major conference and, the impressive list of speakers and participants shows that interest in the issues has continued to grow.

I have been asked to address some of the issues related to the importance of Arab oil and gas to the United States and to the world. A few statistics confirm the vital importance of oil and in particular Middle East oil to the world economy. Oil is and will remain the most important fuel and the Middle East will continue to be the most important oil producing and exporting region.

- Despite an increase in oil prices from about \$ 3 a barrel in 1973 to about \$ 80 today and policies to switch from oil to other fuels, oil's share in global primary energy consumption has only declined from 50 to 35 percent . The OECD countries consume some 45 mbd in 2009 compared with about 40 in 1973. The easy part of fuel substitution and efficiency gains has been accomplished in the past 40 years but, the most difficult part is still to come (transportation sector).
- In the advanced industrial societies, two thirds of the oil consumption is used in the transportation sector and it will take decades to replace oil in that sector with other fuels such as biofuels, natural gas and electricity.
- While oil consumption has stagnated in the OECD in the past decade, oil demand in Asia has continued to grow by more than 25%. Behind these numbers is population growth and transition to urban economies. China has moved 400 million peasants into the urban money economy and plans to move another 400 million into the urban, energy-intensive economy in the coming decade. India, perhaps some 10 -15 years behind China in

economic modernization, is moving in the same direction as does much of non-OECD Asia. Though less than half of Asia's oil consumption today is used in the transportation sector but, most future Asian oil demand growth will come from that sector. The global car fleet is expected to double in the next 25 years, with most of the growth in Asia and in particular China. Biofuels, which now contribute about 1% of road transportation fuels today, may rise to 5% by 2030 according to the IEA but will remain small in comparison with fossil fuels. The global contribution of Electric cars is expected to rise (IEA) to about 7 million cars in 2020 (about 15% of the market) based on current government targets (but will these targets be achieved?).

- *Despite current high oil prices and major efforts to enhance efficiency and substitute oil wherever possible, IEA, EIA and other oil market projections for the next 25 years show an increase in global oil demand of some 20 million b/d, all from outside the OECD.*
- On the production side, efforts to increase global oil production have become more difficult as the easy (and cheap) oil has largely been found and the international oil industry is forced to moved into exploring for and developing ultra deepwater oil, arctic oil, oil sands and GTL. It has been estimated that global decline rates from producing fields is somewhere around 4% (or 3.5 – 4 mbd) annually, requiring the equivalent of 4 new Saudi Arabia's (in terms of production) to satisfy global oil demand twenty five years from now. The low end of the current oil price range (\$ 60- \$ 70/bbl) is today's marginal cost of finding, developing and producing new oil.
- The IEA expects a steady decline in OECD oil production over the next quarter of a century, making in particular Europe much more dependent on imported oil than it is today. Many other regions outside of OPEC will also face production declines, leading to significant growth in the demand for OPEC and in particular Middle East oil. The IEA estimates demand for OPEC oil to grow from about 46 mbd in 2008 to 54 mbd by 2030. Most of the increments are projected to come from the Middle East.

- Since the oil supply disruption of 1973-74, more oil supplies have been disrupted by US and UN imposed sanctions than by deliberate actions of producer states. Only once was oil withheld from the market (1973 Arab oil embargo) in response to the US re-supplying Israel in the middle of the war during the 1973 Arab-Israeli war. Since then, Saudi Arabia and the other GCC countries have always come to the rescue when supply disruptions would otherwise have caused major oil price hikes.
- US policy since President Nixon has focused on Energy Independence as one of the main pillars of US energy policy makers. Some progress was made during the Carter Administration but, past efforts to significantly reduce oil imports has generally failed. The past two Administrations have emphasized cutting oil imports specifically from the Middle East (Middle East and Venezuela – Obama) from countries “that do not like us very much” or are “hostile to the United States”. Such language was used on the White House web site in early 2009 when President Obama took office. Imagine that the official website of a major Arab oil producing country would refer to a policy to reduce its dependence on imported food or military equipment from the US because it will come from a country that does not love them. We import all of our vital rare earth minerals from China. Does China love us? China recently cut off Japan from rare earth exports for two weeks based on an argument over disputed waters in the East China Sea. Rare Earth is a vital input in the construction of computers, missiles, hybrid car batteries, and so on. While we (the US) import about 55% of our oil consumption, we import 95% of rare earth minerals and all of it from China. Moreover, singling out the Middle East region in efforts to reduce oil imports is a useless policy because oil is fungible. Physical reduction in oil from a particular region will increase oil prices all over the world regardless of the country or regional from where the oil originated, i.e. oil is fungible. Finally, US oil imports from the Middle East are only 15% of total oil and product imports. Any further reduction will further reduce the commercial and strategic interests of the oil producing countries in the Middle East in the US and strengthen the presence of China and other competitors (the flag will follow trade).

US Oil imports will remain vital for decades to come. The EIA 2010 annual US energy outlook projects oil and oil product imports into the US at around 10 mbd by 2035, pretty much unchanged from 2010 imports.

- Reducing the percentage of fossil fuels in TPE will take decades and will require a major effort from the US government. The US lost its lead in solar and other renewable technologies when it stopped funding renewable after the Carter Administration. The Obama stimulus program created a once and for all massive infusion of funding for renewable and efficiency improvements but, after this money has been spent, major funding cuts are expected.

Germany, Spain, China, Korea, Japan and others are leaders in various forms of renewable energy. We will be replacing some of our imported oil with imported solar panels, imported windmill turbines, imported lithium batteries dependent on lithium and rare earth minerals imported from yet another set of countries.

- Based on the past quarter of a century, we can only imagine what may happen in the Middle East during the next 25 years. Just over thirty years ago, at the end of the Shah's government in Iran, oil production in that country was close to 6 mbd. Today, Iran has difficulty maintaining production capacity of 4 mbd. There are many internal and external reasons why we should not assume that the region will always comply with the oil production volumes the consuming world demands. Some countries may not be able to increase production (for a variety of reasons) while some others may decide to reserve some oil for future generations.

Qatar imposed a moratorium on new gas export projects five years ago and may not increase exports in the future and, King Abdullah of Saudi Arabia has said recently that he would like to reserve future oil finds for future generations. The growth of oil and natural gas consumption in the region has become unsustainable and hence, the new drive to develop Nuclear power and renewables.

Since the Middle East oil boom of the 1970's, progress has been made to diversify local economies away from over-dependence on the petroleum

sector. Several more decades will be needed to complete this process. The governments of the oil producing countries in the Middle East today are less interested in pleasing us than in pleasing their own better educated population in need for jobs. Moreover, we must not assume that they will produce whatever we decide we need in the future while we are stopping domestic E&P in major parts of the U.S. for environmental reasons.

Competition for Arab oil will rise sharply in the decade(s) to come; competition for their rich markets will increase in the decades to come; competition for strategic influence in the region will increase in the decades to come. Confidence in the United States in the region has diminished over time because we failed to bring peace between Palestine and Israel and we are no longer considered an honest broker between the competing interests. Our leaders believed in 2003 that invading Iraq would be quick and easy ("veni, vidi vinci") . Seven years into conflict we have not achieved our political goals in Iraq and, today we are witnessing PM Maliki visiting Tehran , where President Ahmedinejad arranged for a rapprochement between Maliki and Moqtada Sadr, enabling PM Maliki to hold on to his job as Prime Minister. Maliki went to Iran, Syria and Turkey to receive blessing for a new government. Tehran was the kingmaker, not Washington. Despite the fact that our military are involved in two major conflicts, Iraq and Afghanistan, there are still some voices in this town supporting a military attack against Iran's nuclear enrichment facilities. Doing so would set back Iran's efforts to obtain a nuclear capability by a few years but, it would unite the country and potentially unleash havoc in the region. Fortunately our President does not favor an attack on Iran.

If we intend to hold on to our remaining influence in the region, we will have follow a more enlightened policy towards the region based on US national interests. The Israeli-Palestinian conflict continues to radicalize the region and needs to be resolved soon in fair and equitable manner and the US has to change from a supporter of one side in the conflict to an unbiased arbiter. While the US position has weakened significantly in Iraq, we must

continue to strive for an inclusive government rather than one based on one of the major religions. Our relations with Iran will remain very difficult in the years ahead but military confrontation could lead to major upheavals in the region. The objective of the US and its allies must be to keep the peace in a volatile part of the world where 60-70 percent of world oil reserves are located and half of the world's future oil production.

Herman Franssen

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