

International Energy Seminar
Part II: Joint-Seminar of Eurasia Group and IEEJ
“New Oil Regime After the Iraqi War”

Facilitator: Now we begin the second part that focuses on the new oil regime after the Iraqi war. The second part will start with a presentation by Dr. Ian Bremmer from the Eurasia Group. It will be followed by a panel discussion, to which Dr. Crispin Hawes will join.

Let me briefly introduce Dr. Ian Bremmer. Dr. Bremmer is President of the Eurasia Group and Senior Fellow and Director of Eurasia Studies at the World Policy Institute. Dr. Bremmer has held positions at the Harriman Institute, Hoover Institution, EastWest Institute and Lawrence Livermore National Laboratory. Dr. Bremmer is currently Co-chairperson and CEO of the Lehman Brothers Eurasia Group joint venture. He is a regular commentator on CNN, CNBC and CBC, and a monthly columnist for the Financial Times. Dr. Bremmer received his PhD in political science from the Stanford University. Dr. Bremmer, now you are invited to make your presentation.

Dr. Ian Bremmer, President, Eurasia Group: Thank you very much. Can you all see me over my name? Is that—yes? That is good. It is a pleasure to be here. It is always nice to come to Tokyo and particularly to join my good friend Dr. Naitoh. When he told me he was coming to the Institute, about six or eight months ago and said “We should work together,” I said “Absolutely.” I am sure many of you know that Dr. Naito is both well known and extremely well respected in the United States and not a man that you easily say no to. I am delighted to be co-organizing this event today as well as to be speaking at it so thank you to Dr. Naitoh and thank you to the Institute for Energy Economics here in Japan.

I would like to talk about a couple of issues concerning the post-Iraq oil regime. It is going to be a quick tour around the world of the places that I think are the most relevant for Japan. First, what the United States happens to be doing around them; and second, the implications that will have for Japan and its energy investments. So I would like to sort of touch on if I can Iran, Russia, Iraq, the Caspian and Saudi. I think we are going to be going into all of these issues as well during the panel but I would like to talk about them a bit.

First, if we look back two years ago when President Bush was elected, the presumption internationally as well as the presumption within the United States, was that Bush would be the energy President. President Bush of course having come out of Texas as the governor from an oil background and oil family; Vice President Cheney having come out of Halliburton as its CEO with a strong record of having lobbied effectively for the interests, both domestic and international, of the energy industry; Condoleezza Rice, a former colleague of mine at Stanford, having been on the board of Chevron and helping them internationally including getting into the Caspian region, signing what is one of the biggest deals they have ever been involved in Kazakhstan; not to mention the fact that Colin Powell, the Secretary of State, was presumed to be extremely friendly to the notion of greater international economic engagement and therefore considered friendly to US corporates looking to invest in countries that often were difficult to invest in politically. That was the presumption.

When Bush became president, there was also very little focus on foreign policy and very little belief that there would be focus on foreign policy so to the extent that there was a desire to be engaged more around the world, the feeling that energy interests would be first and foremost in those countries that were important was very high.

Looking of course post-September 11, life changed dramatically and immediately. President Bush became the foreign policy president; 2004, presidential elections coming up; and foreign policy is dominating the debate between Democrats, amongst Democrats and increasingly as President Bush gets more involved, Democrats and the President.

What exactly are we looking at? To what extent have oil policies really been a focus of this administration and how has that impacted both our policies in the country and how is that impacting Japan as it looks to protect its interests, as it looks to expand its investments internationally and as it looks at its own perhaps precarious dependence on the Middle East.

Let me start in perhaps the most obvious place where there was a dramatic change from expectations to reality and that is Iran. When the Bush administration came in, the universal presumption, and this is my presumption as well, was that sanctions on Iran would be either reduced or abolished completely. Many of you remember August 2001 when indeed the Bush administration had pushed fairly hard to try to get the terms of

ILSA changed. They were not successful. But there were lots of reasons that you would believe that the Bush administration would move in this direction. Cheney was on record as saying that he strongly opposed sanctions on Iran. Colin Powell strongly opposed international sanctions that were unilateral around the world and was on record as saying that Iran should be a policy of US engagement. President Bush had not spoken on the issue publicly but certainly the presumption was that he was going to follow that line.

That changed dramatically of course, and has now increasingly been a topic of concern between the United States and Japan. It is interesting the way it started. You all remember the State of the Union back in 2002, the “axis of evil” speech. Interestingly two weeks before that speech was given, there was no mention of Iran in the draft of the speech. The focus was on security, three types of security: economic security, national security and homeland security. That was the focus and that is a focus that President Bush is going back to now as we enter the 2004 elections.

In the area of national security one country was included and that was Iraq. Iran was nowhere to be seen. Roughly a week before the speech, however, the Israeli government intercepted a ship that included a large number of arms destined for the Palestinians. The Israeli government strongly believed that they had evidence that this shipment for the Palestinians came from Iran. They shared this information with Secretary of Defense Rumsfeld who saw it and was convinced by it. He went to the President directly and said this could not stand, we must include Iran in this speech. North Korea was added later because of concerns that the focus only on Islamic states would be damaging and destabilizing and send the wrong message both internationally and domestically. Bush was convinced, Iran was included in the “axis of evil,” and in US policy toward Iran effectively any prospects for rapprochement were over immediately. Secretary Powell was upset understandably. This was not the policy he had wanted but that was the end of it.

Since then US policy toward Iran has been unyielding. It has been a policy of squeezing the country economically and of doing everything possible to ensure that other states do not invest particularly in Iran’s energy sector. The United States has brought this up on numerous occasions and at length with Japan, which as we know has been strongly involved in investing in Azadegan. Indeed, earlier this year when there was the meeting between the US-Japan energy forum in Washington, I would say that the Iranian issue

dominated that agenda. The Americans certainly believed that the Japanese position was that they were going to defer perhaps indefinitely any decision to invest in Azadegan. Of course the Japanese concern was what happens if the Chinese or the Europeans invest anyway? Then, we, the friends of the United States have lost our economic interest with no benefit to ourselves or to the US. The same argument that has been made for many years by US oil companies concerning the Iranian sanctions implemented by the US, if they are not strongly upheld internationally, only punish US companies. Secretary of Energy Abraham was sent quickly to Europe with the intention of strongly engaging the Europeans to try to convince them to stay away from Iran. President Bush brought it up repeatedly with Russia's President Putin in terms of their support for the Iranian nuclear program and discussions were made at high levels as well with the Chinese.

The United States ended up with a fair amount of cooperation over the past few months on Iran, certainly more than they had seen for many years. However, we now have coming up later this week, the IAEA International Arms Inspectors Meetings. The Iranians have agreed that they will accept a further protocol around tougher inspections, tacking on a tougher approach with the non-proliferation treaty and we would expect strongly that the Europeans and the Russians will go back to more or less business as usual with Iran.

Is US policy toward Iran going to change? No. Will US pressure on Japan be reduced significantly as a consequence? Not particularly. To the extent that it will be reduced, it will be largely because of distraction with the election as we get closer to that: not because of Iranian compliance. There is really no trust in the Bush administration that the Iranians will adhere to their promises of not proceeding with nuclear weapons programs or research around it. There is a great deal of skepticism throughout the Bush administration about Iran's need for a civilian nuclear energy program given their oil capacity internally. There is concern over Iran and their continued involvement and support for Hezbollah, given the increasingly difficult situation and unstable situation around Israel-Palestine. All of this together continues to show an intransigent policy of the Bush administration toward Iran in the future.

I expect that this will continue to be an issue of concern, one of the greatest, especially as US-Japanese strategic relationships become closer as they have in the past year and continue to. This is the issue of difficulty. It certainly is a problem that is not going to go

away any time soon.

So the outlook for Japan around Iran may be good long-term, which we can talk about in the panel depending on what happens with the regime, but short-term certainly continued frustration and danger.

Let me talk about Russia. I feel like I am taking a little too much time. I have got to quicker on other issues. Interestingly the Bush administration on Russia—certainly there is a strong interest from the United States to support energy diversification away from the Middle East. Russia is the world's greatest diversification player. As the OECD countries and their fields become more mature and risk from international investment and new exploration projects becomes more volatile, Russia is viewed throughout the United States as perhaps the most stable place to continue to invest.

It is interesting to note that America's cooperation with Russia did not start with nor is it hinged upon energy cooperation. Again, here, security issues have trumped energy issues for the Bush administration. US-Russian cooperation have really been based upon security cooperation in Central Asia, Uzbekistan, the Kyrgyz Republic, in Afghanistan especially, in Georgia, around North Korea increasingly and most importantly, Russia-US counter-terrorist cooperation, gathering intelligence. The Russians have more and better assets in all of Eurasia on the ground than anyone else. The United States may have the best technology but does not have the people on the ground and that cooperation has build a great deal of trust.

Only after that trust was built did the US-Russia energy dialogue really take hold and did the US moved way from focusing on the Caspian in terms of energy and focus on Russia's potential and the promise of Siberia. So security issues are what really motivated the United States here. Now US-Russia energy cooperation is taking shape. For Japan, Russia is one of the most interesting places to be looking. The sudden announcement last year by Prime Minister Koizumi of the willingness to spend some USD\$5-6 billion in financing a major new pipeline from Angarsk to Nakhodka came as a surprise to the international community, a surprise to the United States. It certainly came as a surprise to Beijing.

The US position on this pipeline is generally positive but the question is do they believe that it will actually occur? The US would certainly far prefer Angarsk-Nakhodka to the alternative, a China pipeline because the Nakhodka pipeline would bring oil to the

world markets. The pipeline that would go to China would bring oil only to China. Certainly the United States prefers the options.

What will happen as a consequence? First of all, will the US support Japan in this regard and the answer is maybe. I think Vice President Cheney has been pretty clear privately that he likes the concept of the pipeline but the US is not going to support it unless they feel it is really going to get built. That means it needs to be brought up by the Japanese at a very high level and there needs to be a very clear and direct commitment to it. As to what will happen in Russia, the Russians I believe right now support, they prefer the Japan prospect, the Japan proposal to the Chinese proposal. But they also prefer the Chinese proposal to no pipeline and this is the key issue.

The Japanese pipeline is larger, it is twice the size. If the Russians build a pipeline to China, then that ends up if the Chinese decided they want to suddenly change the nature of the agreement, the Russians are stuck. There is no such leverage of any country over the Angarsk-Nakhodka proposal. Furthermore the Angarsk-Nakhodka proposal would use Transneft, the Russian pipeline monopoly; the Yukos CNPC proposal would be privately owned, something that Putin would prefer not to have happen. He wants to have as much control over those pipelines as possible. For all of these reasons, the pipelines look increasingly promising from the Russian perspective. Having said that, it is a lot of money; the Japanese have said on several occasions it has to be economically feasible. The Japanese private sector I would say is ambivalent at best about whether the pipeline would be constructed and as long as that continues to be the case, I think that the likelihood that it gets actually built is roughly 50-50.

Having said that, Mr. Khodorkovsky, the principle advocate of the China pipeline presently sits in jail. The new leader of Yukos is Simon Kukes, the person who facilitated the deal between BP and TNK, the super deal that had existed in Russia before today, and is very close to the Kremlin. As a consequence while Yukos has been out of favor in Moscow over the past years, that will increasingly not be the case. Yukos will have more leverage, they will have greater capacity to convince the Kremlin that their pipeline is a good idea, and they will probably end up working with Transneft, which will remove one major obstacle for that line. All of which means that if the Japanese are serious about building a pipeline from East Siberia to the Pacific, they will need to move relatively quickly. This will have to be, I believe, a 2004 decision by the Russians. So that is what has been happening around Russia. Again, a key point—the Bush administration is focusing on national security first and foremost.

I only have a few more minutes. Caspian. It is very interesting, I mentioned that I could imagine a situation where the United States would support Angarsk-Nakhodka. They would do it by saying it is the equivalent of Baku-Jehan. The US government does not build pipelines. They will say this over and over. But they do support pipelines that are believed to be in their strategic interest. Baku-Jehan was a pipeline that no one believed was economically viable when the US government first promoted it but after ten years of consistent interest and focus, Baku-Jehan is now indeed being built.

Interestingly, the Caspian once again, now that Baku-Jehan has proved a success, has slipped off the American agenda. Despite the fact that US oil companies have strong interest in the Caspian, for example ChevronTexaco is increasingly having difficulties at the hands of Kazakhstan, which has renegotiated tax structure and renegotiated the agreement that they have on the ground with ChevronTexaco. ChevronTexaco has tried to get the US support for them in Kazakhstan, the equivalent of the kind of support they have been getting around CPC and the problems they have had in Russia. The Bush administration has been very slow to respond. Part of the reason for that is the scandal around Jim Giffen, the huge foreign corrupt practices scandal which the Bush administration believes is a liability. So they have been unwilling to take a very active and senior role recently in actively supporting US oil interests in the Caspian, for fear that this could be very embarrassing to them and certainly look inappropriate in the context of potential energy scandals coming up to the 2004 presidential elections. As a consequence of that, we have seen relatively little interest from the US in the Caspian. Furthermore, most of the US officials that were working on the Caspian on energy issues have been transferred, a lot of them to other central Asia issues around security. So if you were working Kazakhstan and Azerbaijan, chances are you are now paying more attention to Uzbekistan, the Kyrgyz Republic and Georgia, not to mention Afghanistan, where there are security issues at play. Also a number of high level officials with support and interest in the Caspian are now working on Iraq.

So the level of capacity to be involved in the Caspian from the United States has decreased. Stability in the region seems lower because of what we have seen in Azerbaijan with the President out of commission at this point. No one has seen him for the past two months. The near civil war and the civil disturbances going on in Georgia, and the increasing lack of corporate governance and transparency in Kazakhstan. The Caspian, which had for the past ten years looked increasingly gradually promising for

the Japanese, now I think looks increasingly difficult.

Last couple of points. Iraq and Saudi—I am down to short time so I am really not going to give them justice but please ask questions around the panel. The presumption among many internationally around the war in Iraq was that the President was really interested in controlling that oil and that was a motivation for the war. Especially now that weapons of mass destruction have not been found and that the Al-Qaeda links were said to be very tenuous, the belief is that this must have been a war about oil. You hear this a lot internationally. First of all, I strongly do not believe that is the case. I think the war was about oil insofar as Iraq is located in a part of the world that is not only a significant oil producer and has significant reserves, but also is located in a part of the world that is critical in terms of oil for geo-strategic importance. But also because of the feeling that Hussein was a risk taker in that world, the instability in the Middle East was increasing, a risk-taker in terms of Iran, in terms of Kuwait, in terms of the attempted assassination of Bush Senior, and as a consequence much better to removed Hussein when he is weak than to wait when he is strong.

Now that Hussein has been removed and the United States is engaging in the restructuring, the reconstruction, there is certainly no question that the US has an interest in having influence over how the Ministry of Oil is set up and ensuring that they have some influence over the eventual production of Iraqi oil. But control is another matter. The US certainly has no interest in trying to keep Iraq out of OPEC. I think it is recognized by everyone that that would be an incredibly destabilizing issue for Iraq in terms of its neighbors and in terms of the Middle East. I think that there is very little interest in trying to determine at the end of other day where all of the investment goes. The US will have influence but they will certainly not have control. That is becoming increasingly obvious as well as even the interim governing council which will soon next year be replaced by a transitional government, is displaying its active independence. The Defense Department, to be fair, in the United States has had much stronger direct interest in having more direct control of Iraqi energy and I think that in the efforts to move Chalabi and a number of the exiles into positions of great power in Iraq in the early days showed that clearly. But the Defense Department is now playing much less of a role in day-to-day governance. They were shunted aside on the political side in Iraq by Condoleezza Rice just a few weeks ago. I think the Defense Department has made it increasingly clear that the role that they were taking in public diplomacy and reconstruction in the first two months is not one that they are going to be as aggressive

about in the future. Part of that is a natural progression of transition. Part of that is a failure of some of the early Defense Department polices on the ground in the reconstruction.

So what do we expect in terms of Iraq for Japan? No investment any time soon. Even the US majors and super majors at this point believe that Iraq is far too unstable and the security situation is far too difficult to think about serious long-term investment. Right now, the types of investment you are seeing are basically the Halliburtons, the Bechtels and infrastructure. There is no role at this point, I think, even for ExxonMobil in Iraq, never mind for the Japanese majors. That certainly will change, but for the next 12-18 months I think it is going to be very slow going.

Finally, Saudi Arabia. Here it is interesting I think. To the extent that the Bush administration has been engaged in effective public diplomacy, Saudi is probably the one country that they have been most sensitive about. Very concerned and knowledgeable about the fact that however far you push the Saudis, the alternatives to the House of Saud at present are certainly worse for the US and for western investment community.

I do believe that there is increasing long-term danger in Saudi Arabia both for the US and for the Japanese. There is certainly a great deal of instability in Saudi Arabia long-term. But for the next couple of years, I believe that Saudi Arabia will stay pretty much in place. They have tremendous capacity of local control within their country. This in spite of the terrorist attacks and demonstrations and other instability we have seen and started to make the markets a little jittery. In my view the major danger near-term that the Japanese should be thinking about in terms of Saudi Arabia is market impact. Headline risk. In other words to the extent that the international investors see that more comes out of Saudi that looks unstable, is that going to put a greater political risk premium on the price of oil? That is possible. The markets could overreact, but Saudi Arabia short-term is not as much of an issue.

Let me wrap up by saying first of all is Bush the energy president? Is he truly the president around the world who has been promoting the more parochial interests of US oil companies? If "energy president" means long-term concern for stability in the Middle East and stability more broadly, you could argue the answer is yes. If it means supporting the international policy that has been in the interests of US-based oil

companies, the answer is definitively no. And, I think that it is important to recognize how around the world, national security interests have consistently trumped oil interests in the United States, when the two have been perceived to be at odds. That is an important issue.

For the Japanese it is a mixed outlook. The Middle East and Japanese dependence on Middle Eastern energy certainly looks more troublesome in the future both in Iran, specifically in the short-term; as well as in the Middle East more broadly, in the medium to long-term. On the other hand Russia is the place that I think shows the greatest promise at this point. But there is the question of economic feasibility. I am a political scientist. I am not an economist. I do not have the capacity to tell you whether it is smart to spend that kind of money on the pipeline but from a strategic perspective, it certainly makes a lot of sense for Japan. Thank you all very much. I am looking forward to your comments and questions on the panel.

Facilitator: We will soon enter the panel discussion. Please wait a little while we set up the stage.

Now we are ready to start the panel discussion. I will introduce the panelists. Dr. Crispin Hawes from the Eurasia Group will join the discussion. Dr. Crispin Hawes directs Eurasia Group's Middle East & Africa practice group. Dr. Hawes came to the Eurasia Group from the Economist Intelligence Unit (EIU). He has twelve years experience analyzing political and economic risks in the Middle East and North America with the Economist Intelligence Unit, Credit Lyonnais Securities and London-based consultancies. He is an Arabic speaker and graduate of the School of Oriental and African Studies in London.

So the panelists include: Dr. Bremmer who have just given a presentation, Dr. Hawes, Dr. Toichi from IEEJ, and Dr. Naitoh who will direct the discussion. Please start whenever you are ready.

Masahisa Naitoh, Chairman and CEO, Institute of Energy Economics, Japan: Let's start the panel discussion. Since Dr. Bremmer has already given an overview in a systematic manner, we shall focus on specific issues and respond to comments and questions from the audience. After I speak briefly about the general structure of the discussion, I will ask each panelist for comments. I would like to divide topics into three groups. Firstly,

while Dr. Bremmer has spoken a lot about the situation in the Middle East after the Iraqi war, what will be its actual impacts on the oil market or on the global oil situation? Secondly, I have some questions regarding energy sector investments to Russia, which seems to be quite promising according to Dr. Bremmer. Considering the Yukos scandal and similar happenings, however, will Russia remain in future as a good country for us to invest to? With regards the pipelines, do they pay off in view of the amount of reserves? Thirdly, in view of such situations prevailing in the Middle East, Russia and Central Asia, and also in view of the major growth of demand in China, I would like to know how you consider the energy security in the North East Asia and what are your honest opinions about Japan's current and future strategies. I will raise questions on each of these three major subjects. I will first invite the three panelists to respond to these questions and then invite comments from the audience.

Let us start with the first subject. I invite each panelist to share his view about the global oil situation in future. More specifically, what is your opinion about the Saudi crown prince's visit to Russia, which was first time in the history? Does it have a substantial meaning in the context of Russia-Saudi coordination or is it only ceremonial? When Iraq increases its oil production in future, what will happen to the OPEC control mechanism, and then what actions Saudi will take? Will Russia support Saudi's actions? I suggest that we take the time span up to 2010 when we discuss about Saudi. As Dr. Bremmer mentioned it in connection with the US policy, the social instability in Saudi is expected to get worse after three or five years. Dr. Bremmer also mentioned potential instability of price and production with the possibility of risk premium. I expect to know a little more about the situation: what wildcards may appear in front of the current political structure around the House of Saudi in the time span of three to five years, or of ten years? So one of our interests should be the mid-term and long-term future of the OPEC control over the oil market. I invite you to speak one by one in the order you are seated: Dr. Hawes, Dr. Bremmer and then Dr. Toichi. You have about five minutes each.

Dr. Crispin Hawes, Director, Eurasia Group: Thank you Dr. Naitoh. I think this year has been a good demonstration of the importance of political risk in international energy markets. I think it is fair to say that throughout most of this year, the fundamental supply-demand balance has not implied the type of crude prices that we have seen. But those crude prices have been generated by a range of political risk issues, domestic politics in Venezuela, international and regional politics in Iraq, domestic politics in Nigeria, so I think it has been a good year for a political risk consultant to have the

importance of political risk underlined.

I think in the back end of this year, despite promising growth figures in the US and some very impressive retail growth figures in China that have been released in the last couple of days, I think we still have to look at the fundamentals and say that current prices would remain above where we would expect them to be at this time of the economic cycle. They remain there because of this enduring political risk premium that my colleague Dr. Bremmer spoke of. Over the next three or four months, in the absence of further political risk issues, one would expect prices to slide. But given the experience of this year, I think it would be a brave person to bet that we are not going to see more political risk issues push crude prices up in the next three or four months. Nevertheless, I would think that looking at OPEC decision-making over the last three months, the organization, particularly Saudi Arabia, is keen to reduce output in order to deal with sliding prices. I think it is also fair to say that looking at output data release over the last couple of weeks, that the implementation of the cuts announced on the 24 September have been at best patchy and I think probably Saudi Arabia is the one country that can look at itself honestly and say that it has implemented its required production counts but very few of its partners in OPEC have done that. This seems to me to be the challenge that OPEC has often in the past failed to reach to cut production in a declining market. The fiscal situation in many OPEC countries tends to encourage short-term decision making which tends to encourage a very slow reaction to sliding prices. Maintenance of high output that then creates further down the line an unnecessary slump in prices as countries adapt to the realities of the international market.

There have been exceptions in the past but they tend to have occurred when prices have slid so far that the situation has got quite desperate and this I think is where the relationship between Saudi Arabia and Russia comes into play. It is no coincidence that Saudi Arabia has taken this year to send an unprecedentedly high profile delegation to Moscow and I think you can make a strong argument that the relationship between Saudi Arabia and Russia may soon be at least as important as the relationship between Saudi and any of the other major producers within OPEC. It was after all the relationship between Saudi and non-OPEC producers that laid the basis for the production cuts and therefore price increases in late 1998 and early 1999. I would think that Saudi Arabia is trying to push in the same direction at the moment.

Looking ahead toward 2010, wildcards—I am going to pick one on the supply side and one on the demand side. On the supply side I do not think I will be sticking my neck out too far to say that world energy markets are looking with some concern at the domestic situation within Saudi Arabia. And Dr. Bremmer mentioned the possibility of a short-term peak in prices caused by domestic problems within Saudi Arabia. Certainly given the current nervousness in the market and the susceptibility to reaction to political risk issues in the market, even small and possibly economically insignificant attacks on isolated oil installations within the kingdom might have the disproportionate impact on global prices, at least in the short-term. In the longer term the questions of the sustainability of the current complexion of the Saudi government—that is not necessarily to suggest that fundamental changes in the regime but perhaps an alteration in areas of influence within the family.

And on the demand side, Mr. Mandil and Dr. Birol from the IEA built an impressive scenario and forecast based on the assumption of solid Chinese growth. That would be my wildcard, the impact of a failure to reform, or the assumption of solid Chinese growth is built on an assumption of further reforms and the steady reform program ongoing in China. Interruptions to that reform program would seem to me to be a very significant wildcard in terms of developing energy planning over the next 10 or even 20 or 30 years. Certainly that would be fluctuations in steady growth in China, be they up or down, which certainly would be a strong wildcard in terms of global energy prices over the next two to three decades.

Dr. Bremmer: Thank you. A couple of brief points. First, in terms of Russia-Saudi, it is interesting that the Russian decision to try to really improve the relationship with Saudi Arabia tightened the co-ordination around energy with Saudi Arabia or at least presenting that face I think is linked to US problems with Saudi Arabia and particularly the US decision to remove troops. I remember speaking with Mikhail Margelov, who was one of Putin's key international advisers, a few months ago about this issue in New York and he said very clearly that the lack of tension between the United States and Saudi Arabia leaves an opening for the Russians to play a more significant role. He said that the Abdullah meeting went very well. The implication I read from that was that the decision to bring back production—was it 900,000 barrels a day in the Vienna meetings?—which was I think larger than international analysts had expected, was in part because of Saudi beliefs that the Russians were on board and cooperative with higher oil prices. Whether that is simply the Russians saying that or whether that is

actually the Saudi reality is open to speculation but certainly I expect to see closer Saudi-Russian discussions around these issues. How much the Russians actually will go ahead and live up to coordination is another matter. Historically, the Russians have been interested in producing more than they have often said publicly and the level of direct control that Putin—he certainly has a lot of leverage—but the level of direct control he has over the oil companies and over the oligarchs is also open to some speculation and we could talk about that when we get into Russia.

One other point about Saudi-Russia is that one of the issues that came up—and was not a priority but was certainly mentioned between the two countries—that has the potential to rip apart this relationship in the long-term is Chechnya. Putin certainly brought it up. It was also part of the press conference that concerns that Saudi nationals had been involved on the ground in the Pankisi Gorge in Georgia and in the North Caucasus to help train terrorist camps on the ground. Of course, Russia has a tremendous problem with terrorism in terms of Chechnya to the extent that it is worse over time and it is linked or believed to be linked with Saudi nationals. That is obviously going to pose a difficulty for the Russian government.

Mr. Hawes spoke already about the dangers and the risk premiums around Saudi Arabia. I would just mention briefly that we should keep in mind two things. First of all, King Fahd is effectively out of the picture right now. Crown Prince Abdullah is 79 years old; his outlook for the ability to continue ruling Saudi Arabia has to be measured more likely in terms of months as opposed to years simply because of his advanced age. If there were a sudden inability of Abdullah to run the country, we do not believe that the problems would be moving to Saudi opposition. Saudi opposition is not nearly developed enough. There is far too much control within the country for that to occur but it could very easily switch the balance of power within the House of Saud. Most likely to take his position would probably be Defense Minister Sultan. That would certainly cause more tensions between the House of Saud and the Wahabi establishment.

Long-term that is of course the danger, that the House of Saud simply does not have the ability to maintain the legitimacy that is conferred upon it by the Wahabi clerics. The drivers here are very simple. They are a demographic explosion, huge population growth that continues unabated, economic limitations and spiraling unemployment. Can that last for five years? Maybe. Can it last for ten? Probably not without profound shaking reforms in Saudi Arabia. Long-term I believe that Saudi Arabia represents the

most significant downside political risk in the Middle East but only long-term, not in the next 12, 18 or 24 months.

Masahisa Naitoh, Chairperson and CEO, Institute of Energy Economics, Japan: Dr. Toichi, would you like to speak next?

Tsutomu Toichi, Managing Director, Chief Executive Economist, Institute of Energy Economics, Japan: Yes. Dr. Hawes and Dr. Bremmer have spoken on some profound issues around the Russia-Saudi relationship and domestic problems in Saudi. I will present a few of my view about the same issues but from a different angle.

About the Iraqi war, there has been a lot of speculation generally whether it was not a war about oil. I would like to summarize my outlook on the global oil situation over the next five or ten years after the Iraqi war. Looking at the current situation in Iraq, the prospect for early restoration of its political stability and the output of its oil seems rather weak, contrary to our high expectation in the beginning. I think that everyone now shares a more or less similar view. President Bush recently announced a major shift in its policies about Iraq, a shift to an approach that focuses on an earlier transfer of power to Iraqis. At the same time, he reaffirmed the continuation of US commitment to democratization in the Middle East. If the United States continues to implement what the Bush administration calls “democratization” in the Middle East, it certainly will concern not only Iraq but also Saudi Arabia, with all its problems mentioned by Dr. Hawes and Dr. Bremmer, and Iran which also has its own problems. As I believe, it implies that there is a very high risk of the entire Middle East moving into the direction of considerable instability with an increasing speed.

I think that it was in this context that Dr. Hawes and Dr. Bremmer mentioned a potential increase in the political risk and therefore in the risk premium. Looking at the current situation from this point of view, it seems to me that the current level of political problems in different OPEC nations is unprecedented in the OPEC’s history of more than 40 years. It has been mentioned that each of the original OPEC nations, namely Iraq, Iran, Saudi and Venezuela, has a major political problem. With such a background, the current situation after the Iraqi war does not seem to invite a major change in the oil control regime; rather, the situation seems to be favorable for Saudi Arabia to maintain its substantial influence as a swing producer. This, in turn, must be a major reason of the oil price maintaining a very high level, reflecting instabilities and political risks in Saudi

Arabia. The question, therefore, is how long it will last? Mr. Bremmer has said that Saudi will maintain its political stability at least for the next few years; probably even for the next five years; but it will be quite difficult for Saudi to make it for ten years. For a meanwhile, however, I don't think that the current regime based on Saudi's dominating influence over the oil market can change so easily.

Speaking about Russia in this connection, the role of Russia especially in terms of the strengthening of its relationship with Saudi Arabia is currently in focus. When we look at its behaviors in the past, however, Russia has the history of paying various lip services to the OPEC nations but has it really reduced its output or implemented other strategies that substantially influenced the oil supply-demand balance? The answer probably is no. Especially in these days when oil companies are being privatized, it is very doubtful whether a Kremlin's order to reduce the output can be executed with success or not. Even though the Government may have a considerable leverage through Transneft, the Russian pipeline monopoly, I strongly doubt its ability to coordinate with the OPEC in cutting the production. From a political point of view, however, the Putin administration must maintain a high oil price for it to succeed in economic reform and win a high level of support. In this respect, Russia certainly shares their interest with Saudi Arabia, other Middle Eastern producers and other OPEC nations like Venezuela.

Assuming that the current oil control regime is maintained at least for a while, the biggest concern in the current picture is about Saudi Arabia; about how it may change its oil policy, particularly in terms of its relationship with the United States. In this context, there is one issue about which I expect a comment from Dr. Bremmer, which is an issue about a group of people in the Bush administration called neo-conservatives. I imagine that many of them are holding the idea of weakening Saudi's oil power. I expect Dr. Bremmer to speak on this issue. Thank you for listening.

Masahisa Naitoh, Chairman and CEO, Institute of Energy Economics, Japan: Thank you. I regret that our time is limited. With regards the question you just raised to Dr. Bremmer about the neo-conservatives' intent to weaken Saudi's oil power, I will invite Dr. Bremmer to give a comment as he concludes our session, after each panelist has spoken about the three subjects I chose in the beginning.

Now we must move to the second subject. I invite each of you to share your view about the situations in Russia and Central Asia. The first question concerns Russia: what will

actually happen to the Majors' Russia investment policies? After some recent happenings like the Yukos scandal, it is suspected that the Russian central government may strength its control in future. In this connection, what will happen to the Majors' investment policies? Another question is about the possible disharmonies between the central government and local governments, such as those concerning Sakhalin. Do you expect President Putin to further enhance the central government's control over the local governments after the presidential election? With this global political situation in view, I would like you to speak on the Majors' investment strategies. In my experience of working for the advisory board to President Putin, which I mentioned in my opening speech, I was often surprised to know how dramatically the Russians change their attitudes according to changes in the global political situation; hence, this question. For example, their positive attitude to BP and other companies in early last year contrasts their positive attitude to ExxonMobil in October. The recent US-Russia Energy Summit may also have played a certain role. Even though such political issues are not often discussed in Japan, they could be a producer of major changes. I invite you to speak on these issues, particularly Dr. Bremmer who must be familiar with them.

With regards the Caspian, it has been mentioned that the situation is a little problematic with such countries as Kazakhstan, Azerbaijan and Uzbekistan. How do you evaluate the significance of oil produced by these countries and the significance of Japanese investments to these countries? Also it has been mentioned with regards the pipeline security that the pipeline from Azerbaijan to Jehan had to be routed like that solely because of Turkey being a NATO member; such routing makes sense only in the context of global politics; economically it does not make sense and an alternative route to the Kharg Island could be more preferable. So what should be our focus when we discuss the capital investment security as part of the energy security? How should we look at the investment side of the energy security issue in view of happenings like the tension in the US-Turkey relationship that appeared when Turkey refused the United States a permission to use their air force facilities? So the second question, inclusive of these points, concerns Russia and the Central Asia. I invite each of you to speak in the same order. Dr. Bremmer, would you like to start?

Dr. Bremmer: Okay, I will give Dr. Hawes the Saudi-neo con question which he certainly follows much more closely than I do. Let me address a number of issues that have just been brought up by Mr. Naitoh. Let me start with Turkey and the Caspian because they are shorter and then move to Russia where there is a lot to say.

Turkey—first of all, a slight disagreement or difference of views I would have with the question, which is I actually do not believe why the reason that the US supported Baku-Jehan was because of Turkey being a NATO member. In fact, it frustrated American officials for a number of years that the Turkish government did not embrace Baku-Jehan as much as they thought they should have. What was more important I think was the fact that the US desperately did not want the Iranians to get their hands on the Azeri pipeline, and also did not want the Russians to dominate energy investment and therefore political control in the Caspian. How far things have come in a short period of time where now no concern about Russians dominating on the ground in central Asia or in the Caucasus and the US actively trying to facilitate Russian investment as opposed to Caspian investment. A Small issue.

Nonetheless, I think that in terms of Turkey as security importance, Turkey was looking pretty bad right after they did not allow the United States to open the northern front in Iraq. In fact, we had discussions with members of the Bush administration that were openly wondering what would happen to international investment in Turkey if the US gave nothing in international aid, not 8 billion in guarantees and so forth. Zero. Our response was it would be pretty dramatic in terms of lots of capital flight out of Turkey immediately and I think fortunately the Bush administration decided not to take that route. Now of course the Turks have said, “We are willing to put 10,000 troops on the ground in Iraq.” The Americans did a lot of lobbying to make that happen. The Iraqi governing council then said “Sorry, we refuse to have them,” and it was kind of an embarrassment for US foreign policy but it also puts Turkey in a better position. I think the role of Turkey as a consequence in terms of its security importance is increasing. Over time it is improving. The major issue there is the enormous amount of outstanding debt they have. If there is a change in US policy in the future, Turkey would get hurt very, very quickly.

We talked a little bit about the Caspian before. A major addition I would make would simply be Azerbaijan. That is the place we have seen the big change recently. President Aliyev, a very strong and experienced ruler, if not the most democratic over the past ten years, is now succeeded by his son, Ilham who is known best for his carousing, his gambling and his penchant for attractive women. It is somewhat of a different scenario. I actually think that Azerbaijan is going to face some instability in the near future, not because of the opposition in Azerbaijan which is very fragmented and which really has no capacity to kick out the present government. We saw there were some

demonstrations after elections and some people were killed but that disbursed very quickly. The problem is that when you have a limited amount of capacity to rule and experience like Ilham does, the necessity of you providing patronage, networks, with a lot of money and with scarce resources to keep them all happy, and to keep the government stable goes up. It is kind of like Beshar Assad in Syria. Even though many people believed that he was more economically open than his father, he disappointed a lot of people in terms of privatization and economic reform because he had to spend so much of his scarce resources just to maintain stability and maintain power. I think this is a bigger problem in Azerbaijan than it is for Syria. I am concerned about that and I think that Azerbaijan as a consequence will be more unstable, at least over the coming six months. Also there are a number of people who are potential presidents in waiting within the old Aliyev clan, within the security vertical as they call it is Azerbaijan. If Ilham looks weak, they might jump on that. So the prospects of a coup in Azerbaijan are not high, but they are not negligible.

Russia—the most important point. President Putin made a deal with the oligarchs when he came into power. That deal was very simple. We will not question where you got all that money and in return, you will pay taxes and you will stay out of politics. The deal was made. There was nothing signed but it might of well had been. Khodorkovsky, like Mr. Gusinsky and Mr. Berezovsky from the previous Yeltsin era, decided to ignore that deal, Khodorkovsky actively promoted opposition parties, publicly disapproved of the way the president in Russia was running the country, and even bought himself a newspaper and installed one of the most public anti-Putin journalists as editor.

Elections are coming up in Russia: parliamentary on 7 December and presidential in March. Putin warned Khodorkovsky on numerous occasions to desist or he would be in trouble. Mr. Khodorkovsky did not believe him. He believed that he had sufficient support, that it would be too dangerous for Mr. Putin to move against him. He was wrong. Khodorkovsky is in jail, his shares have been seized. I do not believe that he will maintain a blocking stake in Yukos; I do believe he will stay in jail at least through parliamentary elections and quite possibly much longer than that. I do not believe that this move against Khodorkovsky should be viewed as a broadside against Russian business. I do not believe that it should be viewed as an attempt to renationalize or re-privatize the businesses of other companies. Nor do I believe that Yukos is going to be eaten by the government or restructured.

In fact, I would go so far as to say that I believe that a significant foreign investment in

Yukos is more likely now that Khodorkovsky is gone, than before. Now, that is an unusual thing for me to say. I say it because Putin was not going to allow, ExxonMobil or ChevronTexaco to buy a significant stake of Yukos and allow Khodorkovsky, his nemesis in the opposition, to increase his power while he was running the company. Now that Khodorkovsky is gone, there is a much greater chance than eventually a foreign company will be allowed to invest. Mr. Kukes, the new CEO, has said that they do not need foreign investment. Of course, he just came in. In six months, he will probably change his mind. I personally think that ChevronTexaco or another company is more likely to make that investment than ExxonMobil because ExxonMobil will want a controlling share. They will probably want a majority and Putin will probably be unlikely to want that to happen. But I think he will want foreign investment, so I think that will eventually occur.

In general, I think that Russia is still maintaining its stated course, which is a consolidation of power; it is not democracy, but it is a system that is reasonably open and welcoming to foreign investment. And the decisions by President Putin to bring a raft of his St. Petersburg allies, like promoting Mr. Shuvalov to one of the deputy heads of the administration, butting Mr. Kozak in charge of the special prosecutor's office, a move which delighted international investors, and also talking up Mr. Kudrin, the reformist-oriented deputy prime minister, all of these move have clearly reassured the international markets. I think that Russia is not a place that we should be worried about—yet.

Masahisa Naitoh, Chairman and CEO, Institute of Energy Economics, Japan: Dr. Toichi, would you like to speak next?

Tsutomu Toichi, Managing Director, Chief Executive Economist, Institute of Energy Economics, Japan: Since Dr. Bremmer has spoken in sufficient details, again I will briefly present a few of my views. Basically my view is similar to the ones presented by Dr. Bremmer. In the background of a series of recent events concerning the Yukos scandal, there is a shift of power following the collapse of the former Soviet Union and the end of the cold war: the previous power possessors like the military, KGB and state-owned companies are on the losing end while the new business groups called oligarchs are on the winning end. I believe that the recent events are political reactions to the overdoing of the oligarchs particularly in the area of politics, adjusting the power balance in the other way around. A decline in the leverage of the former Yeltsin family

politicians and a significant empowerment of the former KGB officials and Putin's allies from St. Petersburg can also be seen as a similar shift in the power balance. Nevertheless, since Russia will maintain its policy of inviting international investments particularly in the energy sector, I don't think Russia will move toward the state ownership of energy resources. I believe that their basic direction is toward the proper establishment of tax system and registration that can ensure the collection of due amount of money from companies. I believe that Russia will maintain this direction. The recent Yukos scandal may affect a little, but because at least it is very certain that Putin will be reelected by the presidential election next year, I don't expect a major shift from this direction at least up to 2008. After that, the situation around Russian investments may change depending on who succeeds Putin. However, I think that the current situation will be maintained up to 2008.

Masahisa Naitoh, Chairman and CEO, Institute of Energy Economics, Japan: Thank you. Now we shall move to the third subject and discuss about it while focusing on its implications for Japan. One of our concerns is the pipelines. In the opening speech, I suggested an approach that could be an alternative to the Japan-China competition concerning the East Siberian pipeline concept. I questioned whether it may not be possible for the downstream countries, that are equally going to be the purchaser of oil and natural gas, to unite and cooperate with each other in presenting a grand concept to upstream countries in the Middle East and other parts of the world. I would like to hear from you how you evaluate the feasibility of an approach like this.

More specifically, adding to the China route and Nakhodka route from East Siberia, which compete with each other, there are other potential routes such as the KoRus line supported by the Rand Corporation and others, which goes from Russia through North Korea to South Korea without entering China. At the same time, I am very much interested in what will happen to the KEDO project. If North Korea is to abandon the KEDO project, how can its energy be supplied? While the hydraulic energy and the use of coal are impractical, the only choice is natural gas. If North Korea abandons the KEDO project and a natural gas pipeline is planned, should Japan ask the pipeline to be extended to Japan while promising a financial support? As reported on today's paper, companies including BP, Russian Oil, CNPC and KOGAS are jointly pushing forward the Kovikta gas field project. In addition, there is another independent project for the Sahaline-1 pipeline. About these different possibilities of pipelines, insiders have told me that while China and Korea are eager to have pipelines on their grounds, Japan is

being stuck because it lacks the demand for natural gas. Depending on what North Korea will do with the KEDO, I am afraid that Japan may become the only country in the North East Asia that does not have a pipeline. I wish to hear how you evaluate Japan's strategies from the outside.

Dr. Bremmer mentioned the Azadegan oil field some time ago. If a country like China and France snatches the deal while Japan withholds its decision about the Azadegan oil field due to the US pressure mentioned by Dr. Bremmer, how will the United States take the responsibility? Putting it in another way, what could be the US strategy for compensating Japan? What support the United States may promise to Japan if it gives up the Azadegan oil field?

So I invite you to speak generally about Japan's strategies for oil development in the Middle East, Russia and Central Asia, with specific stories if necessary, and your general advice to Japan. Dr. Hawes, would you like to start?

Dr. Hawes: I am going to move straight onto the Iranian and Middle Eastern relationships and leave the Russian and Siberian pipeline relationships to my colleague. Clearly the US has wanted to put an enormous amount of pressure on Japanese companies to reduce their interest in the Azadegan field and also the Bangastan field, which is also a focus of negotiation. I think our feeling is that in the current environment, the presence of not only Total but also Statoil and potentially CNPC, as potential alternative bidders to strengthen the Japanese position, clearly Japan's energy deficiency requires a long-term strategic relationship with countries in the northern Gulf and we would expect the Azadegan field development to form a key part of that. And certainly, as I say, the US ability to directly influence either Chinese or French investment decisions in Iran is likely to prove fairly limited. So, I would expect the US perhaps to cut its losses on that issue and recognize the very close relationship the Bush administration has developed with the Koizumi administration around a range of issues, not just in Iraq but also in North Korea and elsewhere.

Again, looking back to the IEA presentation earlier on, I think the level of Chinese demand is clearly a key factor in terms of developing oil price patterns over the next couple of decades. But also as mentioned elements within the Bush administration having a different approach to Saudi Arabia than perhaps the White House does, I think at the same time we have to look at those three countries in the northern Gulf—Saudi

Arabia, Iran and Iraq—who between them at the moment, current levels of proven reserves are somewhere around half a trillion barrels. It is hard to imagine Asian economies, whether developing or developed, over the next ten years not maintaining very strong long-term strategic relationships with all three of those producers and certainly the importance of the northern Gulf and the peninsula over the next 20 or 30 years as the dominant oil suppliers I think will only increase as non-OPEC producers find their reserves depleted over the coming few years.

In terms of upstream development I think the inadequacies or perhaps the inefficiencies of some OPEC producer policies have been the greatest inhibitor to development and I think in a week when we are seeing finally the Saudi gas round signatures being applied for Total and BP and Shell's investments, I think the development of perhaps a greater clarity among OPEC producers toward investors will be a key policy determinant in the ability of Japan and other Asian consumers to maintain those long-term relationships and perhaps secure longer-term relationships with those producers. Certainly I think it is fair to say that a number of Gulf states have been less than helpful in terms of their investment terms over the years and probably the exception here over the last decade has been Qatar. It may be that Qatar as a very small country in terms of population will provide the example for Gulf states in terms of the way they have developed investment and the terms they are prepared to offer, particularly in relation to the lack of opacity and transparency in investment terms for Asian and non-Asian consumers over the next decade or so.

Masahisa Naitoh, Chairman and CEO, Institute of Energy Economics, Japan: Dr. Toichi, would you like to speak next?

Tsutomu Toichi, Managing Director, Chief Executive Economist, Institute of Energy Economics, Japan: Since our time is limited, I will speak briefly on several points. About the East Siberian pipelines, the situation is taking the shape of Japan-China competition particularly at this moment: Russia is going to take either the Japanese proposal or the Chinese proposal. In reality, however, the project is economically beneficial to Russia in terms of the diversification of supply destinations; it is beneficial to Japan and China on the demand side in terms of the diversification of supply sources away from the Middle East. In this sense, this is a project from which each country may gain economically. Excessive competition and tension between Japan and China, as they are happening now, should be avoided as much as possible. I think it is important to

develop opportunities for discussions among Japan, China and Russia over a long-term vision of the pipeline development.

Masahisa Naitoh, Chairman and CEO, Institute of Energy Economics, Japan: Dr. Bremmer, would you like to speak next?

Dr. Bremmer: I tend to agree with that. I think that it will not happen until after a decision has been made on which pipeline gets made first. I think eventually you want to talk about 10, 20 years, I think both pipelines will be built. The question is does it first go to China with a spur to the Pacific or does it first go to the Pacific with a spur to China? There is no question that the China line will eventually be built, with Transneft if not owning it, at least managing and operating it. That actually helps because it means that the Japanese and Chinese are negotiating with the same basic principle. But until I think a decision is made on which line is getting done first, I do not at this point see the Japanese and Chinese forming a common front. In terms of how the lines eventually get done, and at the end of the day, what is going to happen with all this East Siberian oil, I think Japan and China will end up cooperating. I think that is not only true in terms of this pipeline but I think it is true in terms of Siberian energy exploration and I think it is true more broadly in terms of the integration of the Japanese and Chinese economies. There may be strategic competition but if you look around the world, Japan has really two economies that it relies and in some ways is impacted by really significantly—the United States is one and China is the other. I think that over time, that is only going to continue to be the case.

Masahisa Naitoh, Chairman and CEO, Institute of Energy Economics, Japan: Even though the time is up, I would like three of you to speak very briefly about your opinions on Japan's oil development strategy. In Japan, an idea that considers oil as commodity has been prevalent. In contrast, China, India and some other countries consider oil as an strategic item. This idea is strong particularly in China. Between the two contrasting views, Japan's oil development policy is based on the view that considers oil as commodity. How do you see this from an objective point of view? I invite each of you to speak briefly on this.

Dr. Hawes: I would suggest actually that Japanese policy is a mixture of commodity and strategic issue. I would suggest that the decision to invest in Azadegan has an element of strategy about it, not just in terms of the commodity. In the longer term, clearly the

exponential growth rates that we expect to come out of the Chinese economy would require China to view petroleum as a strategic issue for at least the next decade. There are enormous issues around power distribution and networking within China but clearly until China reaches a more stable low-level growth rate which may happen over the next 12 to 15 years, when it will have the luxury of regarding petroleum as a commodity, I think until that stage it will continue to view it strategically. But I think that as I say, Japan's interest is not purely commodity based. It is also a strategic industry.

Masahisa Naitoh, Chairman and CEO, Institute of Energy Economics, Japan: Dr. Bremmer, would you like to speak next?

Dr. Bremmer: I will leave this one to the two economists.

Masahisa Naitoh, Chairman and CEO, Institute of Energy Economics, Japan: Dr. Toichi, would you like to speak?

Tsutomu Toichi, Managing Director, Chief Executive Economist, Institute of Energy Economics, Japan: This discussion has a long history: a question about whether oil is a commodity or strategic item. Oil certainly is a commodity in so far as its price is determined or at least largely influenced by the market. However, since oil has a strategic significance, as evident from earlier discussions about the Middle East and Russia, it is certainly not a type of commodity that private companies can control for all of its aspects; it is necessary for the government to play an expected role. Japan historically advocated a policy that encouraged development initiatives of private companies. At this moment, however, more emphasis seems to be needed on the government's role in supporting the efforts of private companies toward higher competitiveness in the global market; and also more emphasis on building a new type of relationship between the government and private companies.

Dr. Bremmer: Just very briefly, I think it is an interesting question. It can be a bit of a false distinction. I generally agree with Mr. Hawes. The United States is said to believe that energy is a commodity and yet the US has very strong ideas of where pipelines should and should not be built and as I tried to make clear in my remarks earlier this afternoon, if you look at a presidency that one would expect would be most driven toward oil as a commodity strategic concerns have consistently trumped those economic issues. If that is true for the United States, which is far less dependent on external source

for its energy demand, that is certainly true for Japan. I made this point when I testified for the JNOC in parliament last year—hearings I guess you should say—and I make it today. I think we should be clear that the United States always says it does not build pipelines, it does not force pipelines to be done, it is not in the energy business. The US is in the energy business. It has to be. Any country in the world nowadays, any government must be in the energy business. It is just a question of what the limitations are.

Thank you very much.

Masahisa Naitoh, Chairman and CEO, Institute of Energy Economics, Japan: Excuse me that I have lost track of time. We have only a limited amount of time for questions and answers. I propose that we take 10 to 15 more minutes for responding to questions. If you have a question, please raise your hand. Tell us your name before formulating your question. Please go ahead.

Q: I think a few points. Whether we like it or not, most of the world, at least a large percentage of the world's oil reserves are located in the Middle East and which the Arab countries are majority countries. I will just say these things in brevity. The second point is that if we would have stability for example in Russia and in China, I think the stability will be far greater than any other region and perhaps not even allow for outside intervention. I am comparing this to the Middle Eastern oil countries. Today in your talks, every time you mentioned the Middle East or something, you brought up the political aspect but when you mentioned Russia or China you did not really bring up the severe implications. For example, a visit of Japanese Prime Minister to Yasukuni Shrine would make the Chinese upset so we did not really talk about the colonial error and all those problems that have not been solved.

So I guess me being from the Middle East and Arab specifically, I think for the Japanese it is probably better to try to build the long-term relationship with Arab countries and Middle Eastern countries because you do not have to compete with anybody. I mean they have been asking you to come all along and there are lots of fields there and if you are going to listen that there is instability, I mean sure, there is instability everywhere. So I guess it is best to go where all the oil reserves are, where it is very easy to get them and that is it. Thank you.

Masahisa Naitoh, Chairman and CEO, Institute of Energy Economics, Japan: Thank you, a very good comment. Thank you. Does anyone else have a question?

Q: I wish to speak briefly. My concern is about a Turkey-Russia gas pipeline project, namely the BlueStream pipeline. I heard that the project had not been making any progress after August or September due to a problem with price. So I would like to know what can be happening now with the BlueStream gas pipeline project. My another concern is about the BTC (Baku-Tbilisi-Jehan) pipeline project, about which I think Dr. Bremmer shared a rather pessimistic view and mentioned a possibility of withdrawal. On the other hand, we have also been informed that the gas pipeline between the Caspian and Turkey will be built simultaneously with the BTC oil pipeline, which is expected to be built by 2005. Steel pipes for the gas pipeline are scheduled for production next year; purchase orders for the pipeline project are now beginning to be placed; bids have been awarded. With such a progress being made, a withdrawal from the project will not be quite easy. Among other topics you mentioned, a story about the pipeline from Kovikta in Russia to Korea through China and the Yellow Sea took my interest. Is the Japanese government interested in this project, which may cause it suddenly decide participation, as with Prime Minister Koizumi's previous visit to Russia? I would like you to provide us with more information if you can.

Masahisa Naitoh, Chairman and CEO, Institute of Energy Economics, Japan: I will invite one or other panelist to respond to your questions. About your last question, however, I would say that the Japanese government probably does not have such an idea at this moment. With regards other questions, I would like to leave them for the panelists.

Q: Dr. Toichi, will you be able to say something?

Tsutomu Toichi, Managing Director, Chief Executive Economist, Institute of Energy Economics, Japan: Excuse me, I currently do not have much information about the topic you raised. You are talking about the KoRus line. Is that right?

Masahisa Naitoh, Chairman and CEO, Institute of Energy Economics, Japan: Honestly speaking, I have not heard anyone in Japan mention the story about the KEDO. I heard the story about the KEDO from a UN advisor several weeks ago, who asked me whether Japan would be interested in considering participation to the project or not.

This story hasn't been reported at all and I heard about it then for the first time. So I haven't really checked the government's view. However, I can say that I haven't heard anyone mention this story in Japan.

Dr. Bremmer: I will touch on a couple of these issues. I think there may have been a translation issue around Turkey. I did not say that I did not believe that BTC would happen—BTC being Baku-Jehan—I think Baku-Jehan will happen. I think the US government was upset in the early nineties, the mid-nineties when they were having a hard time getting BP and others interested in Baku-Jehan. They were having a hard time and they were upset that Turkey was not more effusive, more enthusiastic about the pipeline. But at this point I think pretty much all the ducks are in a row.

The BlueStream pipeline of course, Turkey has long had many ideas of all of the different places they can get gas. The demand in Turkey for gas has not been up to all of those and as a consequence there has been a conflict between what the Turks have agreed to pay for and what they are actually willing to take on and that has definitely caused delays in BlueStream. I do not see any change in that any time soon.

But I would like to return to the original question of the doctoral student which I think was very interesting. Look, you are right, the fact of the matter is that most of the big new capacity as we saw from the IEA presentation, the new production is going to be increasingly in places that are developing and accordingly in places that are going to be unstable. But common sense tells you that to the extent that it is possible, staying away or hedging yourself away from instability tends to be a good idea. I think there is a great deal of difference between instability and lack of democracy. You can have countries that are consolidated authoritarian regimes which are reasonably stable. It does not mean I like them, it does not mean I think we should embrace them. But it does tend to mean that people will invest in them. Indeed, I would argue that consolidated democracies—your G7, most of them, not all of them—are some of the most stable countries in the world, but consolidated authoritarian states are often more stable than democracies in transition.

The problem in much of the Middle East is not that there is only a lack of democracy. There is also a lack of democracy in Russia. There is also a lack of democracy in China. The problem is that there is also a great lack of stability. It is difficult for me to stand up here and recommend to the Japanese that they go headlong into investing in Iran when

we happen to believe that there is a great likelihood that the present Iranian government will not be the same government in five years' time. It is hard for us to make the call that you should invest headlong in Saudi Arabia when you believe that in five to ten years' time, the present House of Saud and the institutions around it such as they are, are unsustainable.

Russia and China, say what you like about the countries, but the overwhelming likelihood is that the present governments more or less, give or take will probably continue to be the governments in five to ten years' time. In many countries in the Middle East, that simply is not the case. That is why I would argue that the great danger exists around overdependence on oil supply and energy supply broadly from the Middle East.

Dr. Hawes: While I agree with Ian's point, I think as Ian pointed out, that the balance of global reserves tilts so far toward the Middle East that inevitably there will be significant investment there. I would also suggest that it has been inadequacies in the part of the regional governments within that area that has deterred investment and although it is not an Arab state, I think the Iranians have struggled over the last few years not just because of the attitude of the United States to investment in Iran but also because of the inability of the Iranian oil ministry simply to process the level of bids that they have invited for acreage. There are restrictions within the Iranian constitution for perfectly understandable reasons on the involvement of foreign companies within the oil sector and these restrictions are in no way unique to Iran. I expect that the bulk of the new acreage within Libya that will be offered over the next 12 to 18 months will take a very long time to see development simply because of the same problems of actually processing the level of bids. There are 30 blocks that are going to be offered in Libya, just processing the bids for those bids will take years. I think when I pointed out Qatar as the exception, I think that is a valid point. Qatar has taken a unique view toward investment in attracting foreign investment in the Middle East. It may, I would argue, be a view and approach that many of its neighbors would do well to pursue as well. It is not simply a matter of hedging against instability or hedging geographical variety within your oil portfolio. It is almost a matter of the difficulties that have been presented and ultimately deterred oil investment within the region over the last 20 or 30 years.

Tsutomu Toichi, Managing Director, Chief Executive Economist, Institute of Energy

Economics, Japan: I agree with the earlier-mentioned idea that Japan should strengthen its relationship with the Middle East by making more investments. I am basically in agreement with that idea. While the Bush administration is committed to bringing more democracy and freedom to the Middle East, its hasty attempts to impose American ideals on them will not succeed easily, considering the varieties of historical and ethnical issues in the Middle East. It will take time: political and social structures will not change in a matter of few years. Even in Japan, the continuous emphasis on structural reforms over the last ten years since the collapse of the bubble economy has not produced much progress. We must expect that the Middle Eastern countries would need quite a long period for reforming their political and economic structures. With this in view, and in consideration of the significance of the Middle East as a global energy supply base, I believe that Japan should support them more in various aspects so that they may maintain stability as they reform their political and economic structures. While Japan has already been offering various supports including technical assistance, Japan will need to expand such supports with the aim of helping their structural reform and transition to a new democratic regime of a style that truly fits the Middle East. This effort will help produce an environment that may facilitate Japanese companies' investments to the Middle East. In this context, I am very much concerned about the Bush administration's policy for democratizing the Middle East because it looks rather too hasty; it may increase instability rather than stability. I believe that it is important for Japan to provide a support that may help reduce such negative consequences as much as possible.

Masahisa Naitoh, Chairman and CEO, Institute of Energy Economics, Japan: Thank you. Even though there should be more questions, we must close the session now because the time is over. I thank all of you for attending the seminar today.

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