

**CENTER FOR
STRATEGIC AND INTERNATIONAL STUDIES**

CSIS STATESMEN'S FORUM:

**HIS EXCELLENCY ALI AL-NAIMI,
MINISTER OF PETROLEUM
AND MINERAL RESOURCES,
KINGDOM OF SAUDI ARABIA
AND
THE HONORABLE SAM BODMAN,
SECRETARY OF ENERGY,
U.S. DEPARTMENT OF ENERGY**

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JOHN HAMRE: Ladies and gentlemen, good morning. Welcome to all of you; I'm delighted you're here.

My name is John Hamre. I'm the president here at CSIS. I'm delighted to welcome all of you today. I'm especially pleased to welcome Minister Naimi and Secretary Bodman. I'm going to let Secretary Schlesinger introduce them to everyone. Let me first say sincere thanks to Dr. Jim Schlesinger and to Rex Tillerson – they're on my board of directors. They're my bosses and I'm delighted they're here to help with this very, very important conference.

Let me also say a special word of thanks to the companies that have helped to make this possible – this dialogue -- and of course ExxonMobil, Chevron, CH2M HILL, Aramco, of course, and Foster Wheeler – and they've been instrumental in letting us hold this series. This is the third session that we've now had featuring a dialogue between our energy ministers, and I'm very pleased and honored that they would be here for that.

Just as an administrative word, when we get to the question and answer period there will be little cards, and if you don't have a card – we've got some of our staff round here that you can just flag and ask them for one, and please write down the questions and pass them in so that we can move them up and give them to the moderator, to Secretary Schlesinger.

It's not my role frankly to be substantive today. My role is to be entirely ornamental. But I can't resist – (laughter) – my wife does not agree with that statement. (Laughter.) The last thing I am is ornamental, I'll tell you. Yeah, this guy will never pass for arm candy, as they say. (Laughter.) You know, but I did want to, if I dare risk a brief substantive comment -- probably because I'm one of the few people here today that can say it the way I want to say it anyway -- which is we have had a raging debate in this town periodically -- it comes and goes, but we certainly are in the middle of it now – of these dramatic, bold calls for energy independence.

Now, to be honest, I find ironic because we don't say that America ought to be financially independent from the rest of the world – I mean, frankly we have to borrow \$7 billion a day to float our deficits. We don't say we ought to be food independent – indeed we want to ship to the world a lot of our food. We don't say that we want to be manufactured goods independent. Now we've got 18 million container ships coming into – containers coming into this country everyday with goods that we want and need. And yet somehow we have this popular political rhetoric of energy independence.

Well, I think it's – I think we're misleading the American public. We really ought to be talking about energy interdependence. That's really the nature – look at this world is now becoming – it's financially interdependence, it's manufactured good

interdependence, it's intellectual interdependence. We're setting up projects internationally with teams in Europe and in Asia, the United States to develop new products and services. I mean, we're profoundly in a world of interdependence and yet we have this hot rhetoric of energy independence.

And I think we need to be honest with the American public. That's not either healthy or realistic. What we really should be having is a dialogue about mutual energy security; that's the world that we really have to be talking. The American public, we have to be honest with them – that's the world we're in. And frankly, the turbulence that we now have in this country over energy in no small matter is attributed to the lack of security -- energy security in the world.

So forgive me for intruding on the speakers today with substance. That's not my role. But I did want to at least set the stage for why this dialogue is so important.

Let me turn to Dr. James Schlesinger. I think he's had at least six or seven cabinet positions through his tenure in Washington – probably we'll give him another one if he hangs around long enough – (laughter) – but that means I'll lose him on my board so I'm hoping that day doesn't come. Let me turn to, Jim, why don't you start. Thank you.

(Applause.)

JAMES SCHLESINGER: Thank you, John Hamre. And let me join John in welcoming everybody today.

To pick up where he left off, according to recent polls, the American public has reached the tipping point with respect to the menace represented by our energy situation and by rising prices. It is also true that the public believes that by achieving energy independence, we would lower the price of energy. Those two things do not go together.

It is also true that for the first time we face a surge in energy prices driven primarily by limitations on supply – surging demand notably from the rising Eastern countries, pressing against supply limitations. There is still some excess capacity but we do not have the refining capacity to take advantage of the heavy oils that are still there in the market.

To discuss these things, we have our two distinguished visitors. The first who will speak will be Minister Ali Al-Naimi, who as all of you know, is the minister of petroleum in the Kingdom of Saudi Arabia. He has had an illustrious career. Unlike some of us, he went to work at 12 years of age. He went to work for Aramco and subsequently Aramco sent him to the United States. He received his bachelor's degree from Lehigh University. He received -- subsequently received a graduate degree from Stanford in geology and he is a leading voice within OPEC for moderation and reason.

Newsweek International recently profiled Minister Naimi. He described him as the Alan Greenspan of energy – the worlds most listened to muse. Given the strategic

significance of energy today, the characterization might more aptly be reversed to labeling Mr. Greenspan as formally the Ali Naimi of financial markets. (Laughter.)

Mr. Minister, the floor is yours.

(Applause.)

MINISTER ALI AL-NAIMI: Good morning, ladies and gentlemen. It is good to be back in Washington among so many old friends.

First of all, I would like to thank the Center for Strategic and International Studies, and its president, John Hamre, for organizing this prestigious and timely conference. In particular, it is a pleasure to stand here today with my friend, secretary of Energy, the Honorable Sam Bodman. I believe this type of dialogue is important to both our countries and our shared energy future.

Much has changed since we were together about a year ago here in Washington. But much remains the same. Demand for energy, and especially demand for oil, continues to grow. Our energy supply infrastructure, constrained by years of underinvestment, remains tight.

For the second year in a row, weather related events -- not political developments -- were responsible for a major disruption to U.S. oil supplies. At the same time, we saw the corrective nature and the benefits of an integrated global oil market at work. Additional supplies from foreign sources were drawn to the U.S. in the wake of Hurricanes Katrina and Rita, replacing lost domestic production and thereby softening the blow to U.S. consumers.

We are also seeing once again how changing mandated product specifications can challenge the industry's ability to deliver sufficient products to consumers. This occurs at a critical time when refiners are facing the added burden of substituting ethanol for MTBE as they prepare for the peak driving season.

Political tensions, tight petroleum product markets, and talk of the world running out of oil are fostering an environment of fear and uncertainty in oil markets and among consumers. The consequences are clear to us all - prices for crude oil, heating oil and gasoline have risen to record levels. This is not a situation in which anyone can take comfort.

Now recently, Secretary of Energy Sam Bodman was quoted as saying that current prices were "very disruptive." I could not agree more. Prices at these levels are not in the interest of either Saudi Arabia or the U.S. As President Bush and King Abdullah affirmed last year at their meeting in Crawford, our common goal is an oil price level that protects consumers while at the same time ensuring adequate investment.

Last week, Secretary Bodman and I, as well as over 50 ministers from around the

world, participated in an International Energy Forum in Doha, Qatar where consumers and producers continued to grapple with the concept of energy security and how best to achieve it. Consensus among producers and consumers on this politically sensitive issue remains elusive. We are stymied by an inability to reconcile our different perceptions of risk and to cast off the long-held myth which maintains that there is no commonality of interest between producers and consumers.

We are at the crossroads on the path to our energy future. The decisions we take today will help determine whether or not we can achieve sustainable energy security.

The global community faces tough choices as it struggles with how to achieve energy security. I believe we must act decisively because the current path poses a real threat of a continuing boom and bust cycle that robs us of the stability and predictability which promotes sound economic growth. At the same time, we must heed the lessons learned during previous eras of energy uncertainty and avoid repeating the costly mistakes of the past.

This morning, I would like to share my thoughts with you on the current energy security debate, including my observations about why consensus has been so elusive. I will then discuss those areas where I believe the United States and Saudi Arabia can work together to promote sustainable energy security.

Energy security tends to be defined most frequently in terms of price and availability. Consumers feel secure when prices are low and supply is plentiful. In such periods, it is of little concern to consumers from where their energy is coming.

On the other hand, producers feel secure when prices are high and demand is predictable. It follows that when prices rise or supply tightens consumers feel less secure. Alternatively, when prices decline or demand falls producers feel growing insecurity. These divergent views are not surprising given the different perspectives of consumers and producers.

And it's only natural that price is the central focus of any discussion of energy security. However, I believe that the energy security debate has been hampered by two tendencies. The first tendency is for some to view energy security as a zero sum game; that is to say, gains by consumers can only come at the expense of producers. Conversely, when producers gain, consumers lose. The second tendency is to define energy security in terms of price extremes; i.e., consumers are more secure when energy is very cheap and producers are more secure when energy is expensive. If energy security is defined in these terms, consensus is not possible.

Allow me to discuss why sustainability is critical to energy security. Experience shows us that energy security is transitory when the underlying conditions necessary for long-term stability are not present. For example, from the mid 1980s until 2000, prices remained low and energy security was not a major concern for consumers. The primary basis for this security was the existence of large quantities of spare capacity in the supply

chain. But this period of low prices created the conditions for its undoing. Low prices discouraged investment in capacity and accelerated demand growth. This combination eventually removed the spare capacity on which the sense of security was built. In doing so, the stage was set for a significant price increase and a growing sense of energy insecurity among consumers.

Now producers who associate high prices with energy security have also experienced the illusion of energy security. In the run-up of prices in the late 1970s and early 1980s, many producers thought that they had achieved energy security. Demand was strong. Prices were high, and supply was tight – very much like the conditions we are experiencing today. Yet their sense of security did not last long, as high prices inevitably undermined demand while stimulating capacity expansion. In both cases, energy security was merely a mirage.

Energy security cannot be maintained when prices are at extremes – too low or too high. Truly sustainable energy security for consumers and producers requires three conditions – price stability, supply and demand reliability, and affordability. These are the three pillars of sustainable energy security. Affordability applies to both consumers and producers. If producers are forced to sell their energy resources at low price, they eventually cannot afford to make the capital investments required to maximize long-term capacity. On the other hand, producers undermine their own security when their resources are not affordable to consumers. The foundation of sustainable energy security is a price low enough to avoid harming consumers, yet high enough to assure adequate return on investment for producers. President Bush and King Abdullah in their wisdom recognized and reaffirmed this fact at their meeting in Crawford last year.

I believe our energy problems are global in scope and that the stability and predictability we desire can only be achieved when countries work together. I say this because oil markets are part of a globalized system. The negative consequences of withdrawing from the global economy far outweigh any perceived benefits. Long-term energy security cannot be achieved at the expense of others; it must be a win-win proposition. This means that energy prices must be higher than some consumers would like and lower than what some producers would like.

However, the idea that the energy security is best achieved in cooperation with others unfortunately is not universally accepted. As is common in periods of market turmoil like we see today, there are some who argue for self-reliance or going it alone. While self-reliance is appealing, the efficacy of such an approach for achieving long-term energy security is an illusion built on the myth that security can be achieved through protectionist measures aimed at blocking certain types of imports or goods and investments from certain regions of the world. Such measures are a retreat from the gains afforded by globalization. Those countries backsliding into protectionism believe that they are better off by withdrawing. The reality is that the world is becoming more interdependent, and prosperity today and in the future is tied to full participation in the global trading system. Not only is a country worse off when it builds walls around itself and slips into protectionism, but the global system as a whole suffers.

Today we have a global oil market where geographical borders are of diminishing relevance. The price of oil today is in fact a world price which is determined transparently in the marketplace. Oil prices are established through the interaction of buyers and sellers in thousands of individual transactions occurring daily from Hong Kong to Houston. Oil has achieved the status of a true commodity and a financial instrument, bought and sold in financial markets with the number of so-called "paper barrels" traded vastly outnumbering the volume of actual physical oil traded worldwide each day.

A popular misconception these days is that a country can decouple its domestic oil prices from international prices by lowering imports. The reality is that oil import levels are not a good measure of economic security or vulnerability to price increases. Security and vulnerability do not rise and fall with import levels. Even if a country imports no oil at all, its domestic oil prices will move directionally with international prices.

It follows then, that there is no truth, whatsoever, to the popular belief that the dependence on foreign crude oil leads to higher prices for gasoline at the pump. The prices of both domestic and foreign crudes are set globally through the interaction of supply and demand. Any differences in the prices between domestic and foreign crudes are due to variations in quality, taxes, and location. Yes, crude oil prices are an important component in the cost of gasoline. The relative level of a country's dependence on foreign oil has no meaningful effect on the prices consumers pay for gasoline at the pump. For example, consumers in Japan, which imports nearly 100% of its needs, are currently paying about \$4.33 a gallon for gasoline. By contrast, in the U.K., which is a net exporter of oil, consumers are paying an average of \$5.85 per gallon.

Now I want to address what I believe needs to be done to enhance our future energy security. Let me begin by saying that I take strong exception to the notion that our current difficulties are a harbinger of things to come. The current problems that are resulting in high prices are not insurmountable. They do not warrant the rejection of oil. We should not lose sight of the fact that oil is merely a means to an end -- it is, simply put, an efficient energy carrier. Oil provides value and has brought prosperity to many. It can facilitate the process of bringing prosperity to even more of the world's population.

We use oil because it provides the lifestyle we desire. It remains the most efficient and cost-effective fuel for transportation and will until technology dictates otherwise. Forcing consumers to prematurely switch away from oil to less efficient alternatives entails economic costs that must ultimately be borne by the consumer. This is not the way to foster sustainable energy security.

As I said, our current difficulties can be overcome. However, while sustainable energy security is achievable, it is not guaranteed. We must produce and consume energy in the most efficient manner possible so as not to waste valuable natural resources -- oil included. We must also work to remove constraints which limit our ability to bring

energy supplies to consumers. I believe that Saudi Arabia and the United States, as the largest producer and largest consumer of oil and with a 70-year history of cooperation in energy, are in a unique position to provide leadership in promoting sustainable energy security.

Fostering long-term energy security will require the U.S. and Saudi Arabia to confront four key challenges: improving data, removing impediments to deliverability, protecting the physical security of supply system, and maintaining the flexibility necessary for overcoming unanticipated disruptions.

Challenge number one – while much needs to be done to improve oil market data, there is a particularly pressing need for predictable energy demand data. The lack of reliable information on demand markets makes it very difficult to assess the risks and rewards of investing billions of dollars to increase capacity. When faced with these decisions, producers must evaluate both market-driven forces as well as unpredictable government policies which can either inflate or reduce future demand for energy. Unfortunately, we fear that some producers, when faced with such uncertainty, will choose a risk-averse approach which means they will not make timely investments in new capacity.

Much work needs to be done in the area of improving oil market data. We have made a significant start with the inauguration of the Joint Oil Market Data Initiative which is known by the acronym JODI. The JODI will shortly release its second report, and with the participation of over 90 countries and six international organizations, I believe we will see notable progress toward the goal of improving oil market data.

Challenge number two – the need to remove constraints on deliverability. Now, resource availability is not a threat to sustainable global energy security. There is plenty of oil left to be produced and technology, as we heard yesterday, will help us recover an ever greater percentage of the oil in place. While availability is not a concern, it is clear that the industry must confront serious bottlenecks and constraints on our ability to deliver products to end consumers. This is what I have termed our deliverability problem. The challenges will increase with the growth in energy demand that is expected over the next 20 years.

We in Saudi Arabia are committed to resolving this deliverability challenge. We are undertaking a massive investment program to increase our production capacity to 12.5 million barrels per day by 2009 with the potential for more later if market conditions warrant. This expansion will make a significant contribution to meeting the world's increasing needs for energy. In addition to our program to increase oil production capacity, the Kingdom is undertaking large projects in a number of areas, including oil and natural gas exploration, petroleum refining, petrochemicals, power generation, water desalination, mining, and manufacturing.

In the downstream, the world faces a problem that is currently very critical to the oil market – limited refining capacity and the mismatch between the available crude

slates and refinery capabilities. To help address the limitations of existing refining capacity to process medium and heavy crudes, Saudi Arabia is undertaking a two-pronged strategy. First, we are developing reserves of lighter crudes in our current production capacity expansion program. Second, we are expanding our capacity to refine heavier crudes in domestic refineries and international refining joint ventures. As part of this effort, Motiva, our U.S. joint venture with Shell Oil, just announced last Friday our plans to upgrade and increase capacity at our Port Arthur facility.

While we are confident that we will make a valuable contribution to increasing our ability to produce and deliver energy to the world's consumers, Saudi Arabia, alone, cannot solve the world's deliverability problems. All parties will have to actively participate – consumers, producers and energy companies. Each has a role to play in upgrading our energy infrastructure along the entire supply chain.

Challenge number three – the pressing need to protect our energy infrastructure. Terrorism is a threat to us all, and both our countries have suffered at the hands of those who wish us ill. In their efforts to strike at us, the terrorists have begun to focus on disrupting our energy infrastructure. The recently foiled attempt on the facilities at Abqaiq in Saudi Arabia is just one example of the threat we face. In Saudi Arabia, we have been aware of the potential threat to energy facilities for some time and we have invested heavily in both technology and manpower to protect against such acts of violence. The threat from terrorism to the world's energy infrastructure is not limited to any one country or region. We must all be vigilant and prepared to protect our facilities from those deviants whose aim is to disrupt the flow of energy to the world's economy.

As recent developments over the past year have demonstrated, terrorism is not the only threat to the security of our energy infrastructure. Natural disasters, like hurricanes and earthquakes have the potential to seriously disrupt our energy supply system for extended periods of time. Just look at what happened to oil and gas production in the U.S. Gulf of Mexico after the hurricanes of 2004 and 2005. While the solutions may be different, Saudi Arabia and the U.S. need to look at ways to harden our systems against these potential threats.

Challenge number four – maintaining sufficient flexibility in our energy system to meet unexpected developments that can adversely affect markets. We in Saudi Arabia have long recognized the value of spare capacity to enhancing the security of the global energy system. That is why it has been and will continue to be our policy to maintain 1.5 to 2 million barrels per day of spare crude oil production capacity. Over the years, the existence of spare production capacity in Saudi Arabia and in other countries has acted as an insurance policy for consumers, helping to lessen the negative impact on prices of wars, strikes, and natural disasters.

The world's cushion of spare capacity unfortunately has been eroded over the past few years. Experts attribute this to surging global demand and insufficient investment in production capacity during the low price environment of the 1980s and 1990s. Saudi Arabia and the U.S. share an interest in restoring a greater measure of spare capacity to

the global system.

Producers are not the only ones that can take steps to improve the flexibility of our petroleum system to deal with unexpected disruptions. Consuming countries can also play a role as many do through their commitment to maintain strategic reserves of crude oil or refined petroleum products. As recently as last year, we saw the value of these reserves. A coordinated use of petroleum stocks among the members of the IEA in consultation with Saudi Arabia helped avert an even more pronounced increase in prices due to the major destruction inflicted on the U.S. energy infrastructure by hurricanes Katrina and Rita.

Our ability to restore flexibility to the system and improve deliverability is greatly enhanced in an environment that offers sufficient incentives for the industry to invest in new capacity. While this may not be a concern in the current price environment, it was the case for many years, and may again be an issue in the future.

Before closing, I would like to say a few words about the U.S.-Saudi relationship. We in Saudi Arabia are committed to fully integrating our economy with the global economy. Under the guidance and direction of the Custodian of the Two Holy Mosques, King Abdullah, we are taking bold steps to reform and diversify our economy. As part of this effort, Saudi Arabia joined the World Trade Organization in 2005. We are privatizing industries and developing new organizations and legal structures to encourage both domestic and international investment in the Saudi economy. As a result, Saudi Arabia is experiencing unprecedented economic growth, and we look forward to a strong and diversified economy.

The kingdom is undertaking a number of major ventures in natural gas exploration, petroleum refining, petrochemicals, power generation, water desalination, mining, and manufacturing which will create investment and employment opportunities for Saudi Arabia and its citizens. I believe that they will also create attractive opportunities for American companies and American employees. Successful completion of this massive undertaking will require technological prowess, resourcefulness, and a standard of excellence for which American companies are recognized. We look forward to partnering with them once again in exciting new endeavors.

In summary, I believe that sustainable energy security is only achievable through dialogue and cooperation. Growing demand for energy will create considerable challenges for producers and consumers. Both will share a common interest in, and derive mutual benefits from, cooperative efforts to ensure a healthy global economy.

Through our collective efforts Saudi Arabia and the U.S. can do much to ensure the availability and reliability of reasonably priced supplies of energy for consumers. By doing this we will make a significant contribution to the prosperity of the world's people. I look forward to working with my friend, Sam Bodman, to explore ways to enhance our shared energy security.

Finally, it is my firm belief that the future will offer many opportunities to deepen and expand U.S.-Saudi commercial relations. We know that Saudis and Americans, working together, can achieve great things. We hope American companies will join us in building a strong and vibrant Saudi economy for the future.

Thank you, ladies and gentlemen, for your kind attention, and sorry for a long speech.

(Laughter, applause.)

DR. SCHLESINGER: Thank you, Mr. Minister. And thank you for that long speech that was both forward looking and comprehensive. I should have mentioned that amongst his various hats, Minister Naimi is also chairman of the board of Saudi Aramco. And we have here today with us the president and CEO of Saudi Aramco, Mr. Abdallah Jum'ah.

(Applause.)

Some of you, but not all of you, attended the technical briefings that we were giving yesterday by Saudi Aramco, both on exploration and on operations. And for those of you who have heard those technical briefings, I think that apprehensions about an immediate twilight in the desert will have been substantially reduced. (Laughter.)

Our next speaker is Sam Bodman, the secretary of Energy. Sam Bodman is unique in the annals of the Department of Energy in that he is the first secretary actually to be technically trained. (Laughter.) He attended Cornell and received his bachelor's degree, and then subsequently received a doctor of science degree at MIT and taught chemical engineering for six years as a professor at MIT. He confesses that he is not a geological engineer but a chemical engineer.

Subsequently he became head of Fidelity Investments. Here in Washington he arrived shortly after George W. Bush, was the deputy secretary of Commerce, then the deputy secretary of the Treasury, and is now the secretary of Energy. There is no one I submit who is better able to empathize with a secretary of Energy during a period of rising prices than I. (Laughter.) It has grown less fashionable in these last six-and-a-half years to say Mr. Secretary, we feel your pain. (Laughter.)

Sam, the floor is yours.

(Applause.)

SECRETARY SAMUEL BODMAN: Thank you. Thank you, Jim, for that very nice introduction. I'm glad that we share a number of things in common, pain being one of them. (Laughter.)

I want to start by thanking the CSIS for hosting this dialogue, the chairman, the

president, John Hamre. I appreciated the opportunity to participate in this event for the first time, in my case last year, and I am very pleased to be back here today.

These are times of tight-oil markets and very high energy prices, and I think it's especially useful to maintain open lines of communication, particularly between Saudi Arabia and the United States at this time. I think it's also beneficial that the public sees and understands that we are working together to keep oil markets stable and well supplied. So I appreciate the efforts of CSIS in hosting this forum, which it seems to me is directed to that end.

In addition to these considerations, it is always a pleasure for me to meet my friend Minister Al-Naimi. For both personal and professional reasons, I am very pleased that we are able to talk fairly frequently. My most recent trip to Saudi Arabia was last November, during which we had very constructive consultations and I was able to visit Saudi Arabia's headquarters, its newest facilities, and got a sense of the state-of-the-art technology that I know was discussed here yesterday by Mr. Jum'ah, among others.

I have to tell you that I found it to be a very impressive experience to visit the facilities and to get a sense of just what efforts are being made by Saudi Aramco. And then just last week, as has been mentioned, the minister and I saw each other at the International Energy Forum in Qatar. Some of what I will be saying here this morning will be very similar to the statement that I made at the International Energy Forum meeting, the IEF meeting just last week.

Before I do that, I do want to say a word about the current gasoline prices and this administration's response to them because any discussion of oil markets here in the United States must be viewed and understood in the context of those conditions.

Last week, the president announced a four-point plan to confront rapidly rising gasoline prices, beginning with a commitment to ensure that consumers are treated fairly. He has ordered the federal government, including those of us at the Energy Department, to investigate whether the price of gasoline at its various stages in the distribution chain have been in any way unfairly manipulated.

The president also called upon the oil companies to reinvest their record profits back into the process of refinery expansion and technological innovation, and has asked Congress to repeal the tax breaks the companies receive for certain types of expenditures including drilling in the ultra-deep water in the Gulf of Mexico. This president has called for the elimination of incentives for oil and gas exploration over the last two budget years, that being on the thesis that at these prices of energy those incentives are not required.

The president is also calling on Congress to allow everyone who purchases a hybrid or clean diesel vehicle this year to receive a tax credit for that purchase rather than to leave the number of eligible purchases capped as is done under current law. We are asking them to streamline the process for building new refineries and expanding existing

refineries so that production can keep pace with demand.

We have asked for Congress to – for the authority to reform the Corporate Average Fuel Economy standards, or the CAFE standards, as they are known in the trade, those for passenger vehicles. Most people are not aware that the administration is not authorized to undertake those standards for passenger vehicles. We are for SUVs and light trucks, which we have accomplished twice. In addition, the president has directed the EPA Administrator Johnson to issue temporary waivers if local fuel mandates are creating chock points in the supply stream.

And, through the Advanced Energy Initiative, we are seeking to increase investment in research that we believe holds great promise for transforming the way we produce and use energy, particularly in our transportation sector. The president has called upon us to redouble our efforts – us meaning the Energy Department -- to redouble our efforts to produce hydrogen-powered vehicles, cellulosic ethanol, and better, more efficient hybrid vehicles.

The president's goal of increased research and investment in new technologies will not only help us deploy clean, new energy sources, but it will also take pressure off of traditional energy markets.

In addition to these efforts to deal with the demand side of the equation, we're also working to increase supply. This includes encouraging Congress -- once again encouraging Congress to authorize the environmentally responsible exploration in ANWR, in the National Wildlife Reserve in Alaska, which is of course here at home, here part of the country, and working with our partners overseas to expand the international supply. All of that brings me back to the theme of today's discussion.

First of all, I want to say, I want to take this opportunity to say that the United States and Saudi Arabia are, and I believe will continue to have very strong trading relationships with strong mutual interests in the free flow of oil through open markets around the world. I also want to congratulate, on behalf of the administration, Saudi Arabia on its recent accession to the World Trade Organization, to WTO. We are very pleased for them, and we think that that will materially aid our mutual relationships. Greater Saudi participation in the global trading system will be beneficial to global commerce.

In addition, I am pleased to note that both our nations continue to be strategic allies in the war on terrorism, a war which, as the most recent bombings in Egypt demonstrate, continues to demand our constant vigilance.

As energy ministers, we are aware that a major target for terrorists is the production and flow of oil. Terrorists seek to disrupt oil markets and cause financial havoc because the terrorists know that in the long run their worst enemy is the spread of freedom, stability and economic prosperity around the world. And that is why enhancing the physical security of the world's energy infrastructure was the subject of considerable

discussion at last week's IEF meeting, and I strongly endorse the calls that were made there for enhanced security.

All of the participants at that meeting understood, just as all of you in this room understand, that continued robust global economic growth depends on secure, affordable supplies of energy. This means that both developed and developing nations, as well as oil-producing and consuming nations, must work together to ensure reliable supplies of affordably priced energy. The tight market is also revealing perhaps more urgently than ever, the need to expand the global oil and gas infrastructure at all levels. I think this is necessary because one of the key factors currently supporting higher world oil prices is the market's fear of a supply disruption. The market's geopolitical concerns are framed in a context of limited excess global oil production capacity. Fearing for the continuity of supply, market participants try to protect themselves by seeking inventory, bidding up prices for available supplies.

While analysts debate the magnitude of the so-called fear premium in the price of oil, in my mind there is no doubt that that premium does exist. The role of market psychology and price formation grows as the market tightens and becomes more volatile. As holders of the world's only substantive spare production capacity – that is, Saudi Arabia – and the world's largest strategic petroleum reserve – the United States – I believe that both countries are in a unique position to provide supply assurance to world oil markets that the world seems to be seeking. The United States and Saudi Arabia should undertake collaborative efforts to ensure continuity in the flow of world oil supplies.

In the wake of last summer's hurricanes, our two nations demonstrated our ability and willingness to cooperate in taking action to mitigate a serious supply disruption. Neither nation wishes to interfere in the efficient functioning of the world oil market. However, during times of supply loss, by working together we can supplement the market's own response by cooperating to add supply to make up for that which has been lost. In addition to these kinds of coordinated efforts, I hope that the United States and Saudi Arabia will continue their long history of communication and cooperation on energy issues at the senior technical level.

As an example, the U.S.-Saudi bilateral energy consultations at the senior technical level have typically taken place at least every two years. Our senior technical officials know each other, they respect each other, and they can be very frank and direct in dealing with each other. Our long relationship has encouraged a sharing of views on an ongoing basis. Each side is comfortable picking up the phone and calling the other.

The goal on both sides has been to ensure transparency in our relationship. We're also encouraging greater transparency and the free flow of information, as has been mentioned by the minister, through the Joint Oil Data Initiative, or JODI, which is a major effort of the International Energy Forum to promote greater transparency and integrity of hydrocarbon data. During my November visit to the Kingdom, I participated in the launch of the JODI database in Riyadh. The United States is very eager to work

with Saudi Arabia and the nearly 100 other countries participating in the JODI exercise to increase the availability of reliable data on which investors can base sound decisions.

Let me conclude by touching on what I think is another important point, which places the question of oil-market stability in the larger context of energy security. I believe that it is in the mutual interests of all nations to diversify their energy portfolios to include more alternative and renewable sources. This is the foundation of the president's Advanced Energy Initiative announced earlier this year during the State of the Union address. Diversity is good for both consuming and producing nations. It inherently improves energy security by reducing dependence on any one type of energy. It reduces pressure on traditional energy markets and it is good for the environment by increasing sustainability of the world's natural resources as well as reducing emissions.

Energy diversity strengthens energy markets across all sectors because it recognizes that we consume energy in many ways for many purposes and that we are all best served by encouraging energy supplies for many sources. I believe that this is an objective that we all share and that we can work on together to achieve. On that note, let me once again thank CSIS for hosting this event, and thank my colleague, Minister Al-Naimi, for traveling here to participate in this discussion today. I count it a great personal privilege to stand here before you and to participate in this event. Thank you very much.

(Applause.)

DR. SCHLESINGER: I trust that shortly we will have some questions, for those of you who have picked up the cards. While we're getting started, both of you mentioned terrorism, the threat to our infrastructure. It is interesting to note, Mr. Minister, that of late, al Qaeda has shifted its position in that in an earlier period the capacity in Saudi Arabia was regarded as a heritage of the Saudi nation and of the Muslim world. And it is only lately that they have shifted to targeting infrastructure in Saudi Arabia. And I throw this out to both of you since you've mentioned terrorism. What does that shift in tactics imply since there is a broad array of infrastructure targets, but none is more significant than Saudi Arabia. Through Abqaiq flows, what, 6 or 7 million barrels a day of oil to be processed. It, Ras Tanura and others are vital to the world's oil supply, and we congratulate the Saudi government, as well as Saudi Aramco, on the excellent security that has been designed over recent years.

MIN. AL-NAIMI: Well, you know, the objective of the terrorists is very straightforward. They would like to exact the most damage or hurt to what they consider their enemy. And their enemy is anyone that does not believe in their concepts. They don't care whether you are another Muslim or any other religion. So their thrust is to exact the most damage, and where can that be except hitting at the most strategic product that the world needs, and the hurt they are looking at is making it extremely expensive and unavailable. That is really why they are after the infrastructure and that's why Saudi Arabia is putting a lot of resources and protecting its oil facilities and its infrastructure. And they are not going to stop only at Abqaiq. They will probably try again and again. But I am confident that we will frustrate their efforts.

DR. SCHLESINGER: Sam?

SEC. BODMAN: I think the question was what does this portend, what does this mean, and I guess from our standpoint it means, just as I said in my remarks, as I think the minister said in his remarks, we're working hard to provide every assistance. I telephoned the minister the day of the event and we spoke. I know that this government has made available any resource that we can make available to help analyze and understand what the implications are, what kind of security should be provided, and that is an ongoing effort. So we're doing what we believe to be the right thing in order to help in any way that we can.

DR. SCHLESINGER: Thank you. In order to ease your pain, Mr. Secretary, I'll throw you a soft ball. (Laughter.) For Secretary Bodman, "Has the administration taken a position with respect to the NOPEC legislation recently adopted by the Senate Judiciary Committee? Recognizing that this is an election year, will the president publicly oppose this measure?"

SEC. BODMAN: Whatever the president wishes to do is up to the president and not to me. I can tell you that we do not believe that this legislation is enforceable, and I personally do not support it.

DR. SCHLESINGER: Mr. Minister, would you care to comment on some of our domestic politics?

MIN. AL-NAIMI: It is not the practice to either comment or interfere in other countries, particularly a country that is very friendly to Saudi Arabia. I would leave it at that.

DR. SCHLESINGER: However, I wish to be introspective for a moment and suggest that you may find some irony that simultaneously we are begging you to increase capacity and at the same time threatening to sue you if you do. (Laughter.)

SEC. BODMAN: Mr. Jum'ah, you can't laugh at that. (Laughter.)

MIN. AL-NAIMI: May I clarify? I don't think the U.S. is at all begging Saudi Arabia to increase capacity. As I have said in my remarks, it's actually the responsibility of all of us, producers and consumers, to work together and contribute to the stability of the oil markets. I believe producers are taking the initiative today because they recognize the rise in demand, and they see it confronting them for the foreseeable future.

DR. SCHLESINGER: "Mr. Secretary, do you expect the Congress to give your administration the authority you have sought to increase CAFE standards for passage of vehicles? If not, why not?" (Laughter.)

SEC. BODMAN: I would say that we are hopeful. We have asked for this authority four years ago in 2002, and didn't get a significant response. There now appears to be – and we're pleased with this – I know the president is pleased with the fact that Congress is very much focusing on energy security as an important topic, and certainly the CAFE standards would be – and management thereof through the technical experts at the Department of Transportation would be an important part of that. And so we remain hopeful. Obviously trying to forecast what the Congress will or won't do is a difficult challenge, but we remain hopeful.

DR. SCHLESINGER: Mr. Minister, we are going to ask you to broaden out beyond energy. "To what extent is the situation in Iraq and Iran affecting oil prices?"

MIN. AL-NAIMI: Well, you spoke earlier about the fear premium, and the situation in Iraq and the whole geopolitics of the Middle East is contributing to that premium, there is no question. There is tension, there is concern as to what's going to happen in Iraq; that is, with respect to Iraq's stability in the future, its ability to invest and produce more oil from its reserves, huge reserves, and the same thing with Iran. And so both countries' situations are contributing to the fear premium significantly, and I believe the reason the price is where it is today is because people are aware that the supply today is not – is meeting the demand and better, but the fear is what's going to happen tomorrow and the day after.

DR. SCHLESINGER: Sam, a comment?

SEC. BODMAN: I appeared on a television program over the weekend with Dan Yergin, and during the program he cited Nigeria, Venezuela, Iraq, Iran, I think Russia, as countries that, for whatever reason, have not been investing, and for varying reasons, depending on the country, have not been investing in developing their reserves, and that, in total, he estimated that the world – that the production of oil that was available on the world market had been reduced by as much as 2 million barrels a day because of that. And based on my own analysis of things, that may be a conservative number. There may be even more oil that is off the markets. And clearly we are in a situation where to a degree, depending on the exact type of product, there is in fact a limitation on supply, and we certainly – as the minister says, we have a perception, in addition to that, of what might happen in the future.

So I'm sure that both the security situation, which has prevented Iraq from exporting as much as had been in the past, and the concerns about Iran and their ability and interest and willingness to invest in their own facilities contribute to it.

DR. SCHLESINGER: Thank you. I believe this next question is probably directed towards you, Mr. Secretary. "Seventy-five dollars a barrel had little impact so far on the economy. What's the maximum price we can tolerate?" (Laughter.) I believe that Minister Naimi has already answered this question, suggesting that that is something we do not want to test. But perhaps you would make some comments on that, Mr. Secretary.

SEC. BODMAN: I work very hard at not making forecasts. Speaking for this country, we have a very strong economy that we're very pleased about. All the numbers continue to be very strong. For many people, however, individuals, individual families in this country where they have not – where they're dealing with gasoline prices in particular that are much beyond anything that we've seen historically, they haven't budgeted for it, and it's a real problem. And that's the reason that we are all as concerned as we are about it.

So the idea of who can afford what, there are many families today in this country that can't afford today's prices, let alone prices that might be created in the future. And so our goal is to do everything we know how to do to deal with this as best we can, and that includes working with our friends in Saudi Arabia who are making very sizable investments in infrastructure so that they can supply and make more oil available to markets. We simply have to collectively work together to try to find ways of taking pressure off of these markets, and we are committed to doing that.

MIN. AL-NAIMI: May I –

DR. SCHLESINGER: Oh, yes indeed.

MIN. AL-NAIMI: You know, Saudi Arabia, as I have said in my remarks, doesn't really want this price, nor do we seek it. And I will give you a number as to what we are doing every year to meet that. We are expending close to \$20 billion a year to increase capacity and maintain what we have. And that's a lot of money for Saudi Arabia to expend yearly on one area. And so we are looking at this program over the next five, maybe 10, years. That's a substantial amount of investment to meet the rising demand and hopefully moderate the price.

DR. SCHLESINGER: This is a question to the minister, but I believe that you may want to comment, Mr. Secretary. "Saudi Arabia is no longer the leading oil exporter to the United States. It ranks fourth behind Canada, Mexico and Venezuela. This trend has been underway for several years and President Bush openly says to reduce oil dependency on the Middle East. So this is the public policy of the United States. Do you, Mr. Minister, call it selective nationalism, protectionism?"

MIN. AL-NAIMI: I'm not going to call it anything. (Laughter.)

This oil market is international. And whether you are first or second or third in any one market is really not that relevant. What is relevant is that we all strive to satisfy the growing demand of the international oil market. We in Saudi Arabia of course would like to be the dominant supplier in all markets. That is our goal, and that is why we are increasing capacity and I believe we will. It will be in all markets. There may be transitory periods where we may fall here or there, but basically our aim is to be the premier, the most reliable supplier of crude oil to the international market.

MR. SCHLESINGER: Mr. Secretary, this may or may not be something you would wish to comment on.

SEC. BODMAN: No, I'm happy to comment on it. In my view, the president is not only my friend, he is a great leader; he is a terrific leader, and part of the way he exercises leadership is to set out goals. And the goal that he has set out for the energy department in particular is 5 million barrels a day of cellulosic ethanol or ethanol to be produced over the next 19 years, by the year 2025.

Now, to put that context, we use 20 million barrels a day of oil, 21 or 2, I guess, today in this country. By that time, in 19 more years, the numbers are expected to increase. So we are dealing with a goal of 5 million barrels a day on a total of let's say 25 or 26 million barrels a day, so it's 20 percent.

The goal is to try to produce that in a fashion that would enable us to have an indigenous alternative supply, and it's simply a matter of trying to take pressure off of the markets and to applied technologies. If we were successful in that, it would in fact account for 75 percent of what we forecast we would then be importing from the Middle East.

The president is fully aware that oil is fungible. It is bought and sold by the private sector. Happily the federal government, the – I'm sure my friends at Exxon Mobil are happy that the federal government is not involved in deciding where they buy oil or where we buy oil. It's done by the private sector. We are pleased with that situation. The president is fully aware of that. But the goal is there that we are trying to create this 5-million-barrel-a-day industry, if you will, and to do the research for it. That is the goal, and so I'm – I think it's nothing more than that.

DR. SCHLESINGER: Thank you.

For Secretary Bodman, “the idea of achieving energy independence is given lip service,” it says here, “on both sides of the aisle in Congress and in the media. Is this policy goal realistic or even advisable for the United States?”

SEC. BODMAN: I think – the words – I think John used the word, “interdependence.” If you go back through the numbers that I just gave, if we are at 5 million barrels a day, if we are successful – and that remains to be seen if we will be successful in developing ethanol to the extent that has been mentioned over the next 19, 20 years, that we will still be using both imported and domestically produced oil and natural gas in very significant quantities.

So I think that the words tend to be used by leadership as a way of conveying a message that we are seeking – that we are seeking to deal with a situation in which families in this country and around the world I presume, but certainly in this country, which are the families I worry about, are feeling great pain, many of them; not all, but many. And I'm acutely aware of that.

I was on an airplane last week on the way back from Doha and talked to the stewardess on the airplane, and she was very plaintive in her – what the impact of oil prices, gasoline prices were having not only on the company that owned the airplane that she worked for but also her own personal life and her ability to pay the bills, and so forth. So it was – there is a lot of adjustment going on. There is a lot of pain. That is part of what our situation is, and it's a way of trying to provide an answer to those folks that I believe is understandable.

DR. SCHLESINGER: “Mr. Minister, did you and do your colleagues at Saudi Aramco live in fear that the United States will achieve energy independence?”
(Laughter.)

MIN. AL-NAIMI: Now, the answer is no. (Laughter.)

But let me – and I think Saudi Arabia has been very consistent in what we have said all along. We welcome a number of things. One, we welcome conservation, and we should start conservation in this building; it's freezing. (Laughter.) So, secondly, I believe it's beneficial for the world to have – at least to begin research for an alternative fuel, at least a fuel that can go hand in hand with hydrocarbons.

At some point, I don't know whether it's the next 50 years, 100 years, or 30 years, we are going to need an alternative, and I hope we can find it by 2025. It looks like a very ambitious goal. And I don't think independence is the right word; I think we have used interdependence, and that will continue to be the case.

DR. SCHLESINGER: “Mr. Minister, what are the main obstacles in the current energy security debate and how to overcome these obstacles?”

MIN. AL-NAIMI: Well, number one obstacle is shed your fear. You shouldn't be fearful of running out of oil tomorrow. That is number one. I think the other obstacle is to convince producers all over to invest. I think that is still something that is not happening. I mean, a lot of countries are investing, Saudi Arabia and many of the GCC countries, of Africa. I think there is a substantial investment but there needs to be more in that area. And then the other thing is to continue with useful dialogue that we have had between or among producers and consumers. That has changed. I think if you look at the amicable atmosphere that the dialogue is conducted, you find there is a lot of lessening of the obstacles between the two parties.

DR. SCHLESINGER: We have just five minutes left. Could all three of you please discuss your view of peak oil theory – I've just left five minutes for this – (laughter) – and how it might be changing. Thank you. Mr. Minister?

MIN. AL-NAIMI: You know my opinion of what this theory – whatever it is. I believe yesterday we saw an example of what can be done. I believe there are at least 14 trillion barrels of reserves in the world, seven (trillion) of which are conventional and

probably seven (trillion) so-called non-conventional. And if you look at what has been produced, maybe a trillion, maybe a trillion plus. With advance in technology, I believe our ability to recover more of the 14 trillion is there. And so my opinion of the theory is it is – what should I say? I think I have called it many different names. (Laughter.) But don't worry about it.

DR. SCHLESINGER: Sam?

SEC. BODMAN: Well, the theory is, I think, accurate insofar as any theory. And that is eventually – as the minister has said, eventually, we're going to run out of oil. We will have produced that which we can. We've seen, for example, in the United States – we have seen production decline. And we had peak oil in our country – in the lower 48 anyway – 1980 roughly?

DR. SCHLESINGER: 1970.

SEC. BODMAN: 1970, thank you. Well, I was within 10 years. That's pretty good for me. (Laughter.) And we have been declining since there, and so that's the theory. I mean, the question is, how do you apply that on the worldwide basis? And I am comfortable that the nations that supply our country – both OPEC and non-OPEC nations – are making every effort to make oil available to the marketplace. They are simply doing everything that they know how to do to make it available. And I scrutinize that. I work hard. I travel. I read, and I am comfortable that the minister is correct that so-called peak oil, when you look at it on a worldwide basis, is some years off.

DR. SCHLESINGER: The peak oil theory was developed by King Hubbert, a geologist based upon his geological observations. It is absolutely sound insofar as it went. It left out development of technology, the availability of near-oil substitutes such as the tar sands, and notably that rising prices increase what could be recovered commercially. But within the context that King Hubbard put forward, it is correct.

As the minister indicated, he hopes that sometime in the next 25 years that we will find an alternative. And I think that we must recognize that there are limitations ultimately with regard to oil supply and that we should not assume that this bonanza manna from heaven will be always available in the form of conventional oil.

That brings us to 10:30. Ladies and gentlemen, would you remain in your seats while Minister Ali Al-Naimi and Secretary Bodman depart? They have a bilateral, and we promised that they would be out of here by 10:30.

(Applause.)

(END)