

Goldman Sachs Exchanges

Middle East risks

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Allison Nathan: Hamas's October 7th attacks on Israel and its response have raised concerns that the ongoing conflict could erupt into a wider regional or even broader war. I'm Allison Nathan and this Goldman Sachs Exchanges.

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Every month I speak with investors, policymakers, and experts about the most pressing macro economic issues for our Top of Mind report, now available on GS.com. On this episode we'll hear from two of those experts from our latest report that breaks down the risks around the Middle East conflict.

We dig into the conflict and how it could evolve and potentially escalate. We speak with Edward Djerejian, former US Ambassador to Israel and Syria and former US Assistant Secretary of State for Near Eastern Affairs. And Emile Hokayem, Director of Regional Security and Senior Fellow for Middle East Security at The International Institute for Strategic Studies.

Djerejian first discusses the significance of the conflict for the region. He believes it'll have important consequences for the political and geopolitical landscape of the Middle East, similar to past major Israeli/Palestinian conflicts. Here's what he said in a recent conversation I had with him.

You have spent so much of your career in the Middle East. And it would just be interesting for us to know how you view the current conflict between Israel and Hamas in terms of its significance for the region.

Edward Djerejian: I think the incident of October 7th has major geopolitical implications that, in my mind, are akin to the situation in October of 1973, the Yom Kippur War. Hamas's attacks on Israeli targets and citizens and

military on October 7th achieved their objectives of killing and taking hostages, which has had a major impact on the Israeli body politic and on the situation and region as a whole.

The October 7th attacks are one of these events in Middle East history that cause shifts in the general political landscape, not only between Israel and the Palestinians, but in the region as a whole. So, it's very consequential.

Allison Nathan: I think as Djerejian as well as IISS's Emile Hokayem to provide some context around what was going on in the region prior to the October 7th attacks. Here's Djerejian again.

Edward Djerejian: History did not begin on October 7th. There is a very important prelude. I think what Hamas was observing with its own calculus in mind was that the Palestinian issue was being relegated to a tertiary status in regional politics. And they saw that this right-wing Israeli government under Prime Minister Netanyahu was continuing the settlement project, which is Israeli settlements continuing to grow in the occupied Palestinian territories.

So, one of the major backdrops of October 7th was the continued expansion of Israeli settlements in the West Bank, the government in Israel also was pushing the envelope on the rights for prayer at the holy mount in Jerusalem where the holy places of Christians, Jews, and Muslims are located. And one of the most important religious sites in Islam is the al-Aqsa Mosque. It's the third most important religious site in Islam after Mecca and Medina. This was causing anxiety amongst Muslims and certainly this is something Hamas put into its calculation before it attacked.

It's no accident that Hamas called their October 7th action the Al Aqsa Flood. They called it the Al Aqsa Flood in order to point out what they saw as Israeli policy was bent on was really mitigating the rights of Muslims in the holy city and the holy sites.

The third thing is that I think Hamas noted political divisions in Israel. The Netanyahu government policies on restructuring the legal order in Israel, reducing the power of the Supreme Court, increasing the power of Knesset, which is the Israeli parliament, has caused a major furor

within Israel. And Hamas noted that the Israeli body politic is divided. That the government is preoccupied with these things. And they interpreted this as internal weakness.

Another factor, I think, in terms of Hamas's decision to go forward on this, they were noting the Biden administration really coming on board with the Abraham Accords and its major diplomatic initiative in the Middle East was the promotion of expanding the Abraham Accords to get Saudi Arabia and Israel to normalize relations. This would be a historic event that would have major, obviously, political and geopolitical consequences. But it was being done in the eyes of Hamas and the opponents of the Abraham Accords to marginalize the core issues of the Palestinians. In other words, this was a pursuit of economic and transactional peace, but not land for peace. Not addressing the core of the Palestinian issue, which is land for peace.

So, they saw this as a growing threat that if this succeeded, movements such as Hamas and the Palestinian cause would be marginalized.

So, I think if you put those all together, you can see that there is a rationale on their part of moving when they did

on October 7th.

Allison Nathan: And here's an excerpt from a recent conversation I had with Hokayem on how the regional dynamics had more broadly been evolving to set the stage for the attacks.

Emile Hokayem: There are a few trends that are worth keeping in mind. One of them is the relative weakening of the core Arab states: Egypt, Syria, Iraq over time, and the rise of the Gulf states, which have emerged as economic, geoeconomic, financial, and political powerhouses.

For the past 20 years, Israel has also emerged as, even before, but especially in the past 20 years, has emerged said a powerful economy and has regionally achieved quite a lot. More integration, normalization deals and so on. So, there are imbalances of power in the region that fueled a lot of resentment.

Allison Nathan: Why October 7th? What precipitated the attacks at that moment?

Emile Hokayem: Hamas was facing a difficult internal

debate. Is Hamas about muqāwamah, resistance? Or is it about governance? And if it's about governance, Israel has won because Hamas now is boxed into a small territory. And you have a hard-line faction in Hamas that refused, that said, "Our purpose is much greater than that. Governance focusing on our population should be secondary if not less than that on our agenda. The important thing is muqāwamah, the concept of resistance. So, in a way it was a way for Hamas to assert its identity.

The second factor is that they thought that Israel had been distracted. Distracted by its own domestic turmoil over constitutional reform. That Israel had become complacent. That Israel thought that they had successfully deterred Hamas. Also, importantly from Hamas's perspective, they were looking at the weakening of the Palestinian Authority and say, perhaps it's a time to assert ourselves as the real bearer of the Palestinian cause.

But there is a broader regional environment to consider here. And that Hamas looked at the normalization deals between Israel and the UAE, Israel and Bahrain, Israel and Morocco, and possibly between Israel and Saudi Arabia and said, you know what, the region, the Arabs are moving

away from the cause, at least the governments are. And so, we need to remind everyone that the cause should be central to pan-Arab imagination [UNINTEL]. And that was a way to, essentially, put governments in front of their publics, which remain overwhelming sympathetic to the Palestinian cause.

And then I think there is another element which is Iran feels more confident in the region. Iran has survived the Trump era of [UNINTEL] pressure and then Iran had rebounded in Syria. Bashar al-Assad had essentially won that war. The [UNINTEL] in Yemen had finally come on top of that very brutal civil war. That in Iraq, pro-Iranian factions had come on top of the power struggle there. And Lebanon, where Hezbollah was definitely becoming the dominant force there.

So, in a way, Hamas felt this is a positive regional landscape for it. And that's a time for Hamas to also emerge. So, it's a mix of those factors.

Allison Nathan: We then discussed the end goals of both Hamas and Israel in the current conflict and whether they can be achieved. Hokayem argues that Hamas has already

achieved several of its goals.

What is the end game for Hamas? Have they achieved their goal?

Emile Hokayem: Hamas's goal is to eradicate Israel. I don't think that everyone in the Palestinian territories agrees with it. But this is what Hamas, but also Hezbollah and other groups are aiming for. Beyond that, they've already achieved a number of goals. It has become a lot more difficult for Arab governments to justify their relationship with Israel.

Israel today is struggling in terms of image in a number of places. There is strong support for Israel in many Western countries. But beyond that, there's a lot of criticism of Israel. And by forcing negotiations with Hamas over hostages, Hamas can say we're a legitimate actor. You have to deal with us. And this conflict will shape the perceptions of two generations of Arabs.

This war has placed Palestine back at the center of Arab political psyche and imagination. And there is enough footage of fighting to fuel the anger, perhaps to create a

new cycle of radicalization, a new wave of recruitment, and so on, of possible fundraising. And so, from Hamas's perspective, this did work. They define success very differently from how you would.

You would go and say it's about wellbeing and having cities that are functioning and people having access to services and so on. No. The ultimate goal here is the struggle in and out itself. To keep that flame alive.

Allison Nathan: Djerejian agrees that Hamas has achieved its primary goal ending the marginalization of the Palestinian issue. But he thinks that whether Israel can achieve its goal of destroying Hamas remains an open question.

Edward Djerejian: Hamas achieved their primary goal, to end the marginalization of the Palestinian issue. Now the whole world is talking about and focused on the Israeli/Palestinian conflict. So, whereas the Palestinian issue was put on the margins as a secondary or tertiary matter, it's now front and center in the Middle East. So, they've already accomplished that objective.

Secondly, as an Islamist party with a military wing, they have put themselves as the primary actor in defending the Palestinian cause. And therefore, they've achieved two objectives already. According to the Hamas charter, they are against the existence of the State of Israel. But at the same time, they are part of the larger Palestinian movement, which includes Fatah and the PLO. So, the issue here is that there's a basic division between the PLO and Fatah who recognize the State of Israel, 1988. But that Hamas has not. So, they are promoting their agenda to the forefront by this action.

Israel's stated goal under Netanyahu is the destruction of Hamas. But the question arises, can Hamas be destroyed militarily? And there's much to debate on that because it depends. If you analyze Hamas as not only its terrorist wing, but if you analyze Hamas as also a political movement, it's very difficult to destroy a political movement. We've seen that in our counter terrorism policies since 9/11 with the Taliban, with Al-Qaeda, with Hezbollah, with many groups.

So, the question arises, is Israel capable in its stated policy of destroying Hamas to really achieve that goal through

military means? I leave that as a question mark.

A second goal of Israel is to assure that Gaza does not become a launching pad again against Israel's internal security and its citizens. That it can do by, perhaps, expanding the buffer zone within Gaza against Israel's southern border. By demilitarizing the Gaza Strip. Obviously, another key goal is getting the hostages out.

Allison Nathan: The key question though is whether a broader war could erupt. Djerejian warns that anything can happen in the fog of war. But he argues that no side currently considers it in their interests to escalate. He says that could change though the longer the war in Gaza goes on.

Edward Djerejian: Once one enters the fog of war, anything can happen. And there could be major miscalculations that can lead to a wider war. Right now, the geopolitical situation is such that Israel does not see an interest in escalation, especially on this northern front with Hezbollah. It does not want to face a two-front war with Hamas and Hezbollah. None of the Arab states want to see an escalation because such instability impacts their

political domestic situation and their economies. Even Iran doesn't see an interest in the war escalating in terms of bringing a larger confrontation with Iran and Hezbollah.

According to some experts on Iranian policy that I've talked to, they advise me that Iran doesn't want to use the Hezbollah card against Israel at this point because it wants to keep the Hezbollah card in play in case of that ultimate option where an Israeli or US attack on Iran is imminent. But if this war in Gaza continues and there are more civilian, humanitarian disasters, will the political pressure build on countries like Iran or groups like Hezbollah and other Arab states to widen the conflict? It's a question. But it's one that really is of utmost importance for the geopolitical stability of the whole Middle East, and really, of the world because if there is a regional conflict, the flow of oil is going to be compromised, especially if Iran is involved. And we're going to see a spike in the price of oil that will have a destructive impact on many economies. And obviously, a destructive impact on American domestic politics because we're going into a presidential election.

Allison Nathan: Given the vulnerabilities to their security, at this point, what's the likelihood that Israel feels

the need to go after other groups that are hostile to it for the sake of its own security?

Edward Djerejian: I think Israel would like to keep its options in place to attack targets at a time and choosing of its own. And right now, I think it is so preoccupied with the major effort in Gaza that it would prefer not to open up a second front itself. But it will open up a second front with the north and Hezbollah if Hezbollah initiates serious attacks on Israel targets.

There have been tactical strikes across the Lebanese-Israeli border. But they've been relatively measured. But unless Hezbollah raises the ante, I think right now Israel would prefer to focus on the War in Gaza and its stated goal of destroying Hamas, rather than open up another front.

Allison Nathan: How concerned are you that the US gets drawn into an even wider conflict?

Edward Djerejian: The major way that the US can be involved is if there is a major escalation in the war and a second front in the north is opened up with Hezbollah and Iran gets involved. One of the reasons that the Biden

administration has sent two [UNINTEL] task forces into the region is as a deterrent to groups such as Hezbollah and to Iran. But also, as a safety measure if the war does escalate for helping evacuation of American citizens from the Middle East. But it could be very negative if the United States had to be dragged into a larger war in the Middle East.

Look at the consequences of the 2003 war in Iraq. That was one of the major miscalculations in American foreign policy in the Middle East. And you saw the consequences, which was not only the destruction of law and order in Iraq, but the rise of ISIS. So, we've just come out of major involvement in Iraq. These wars in Afghanistan. I don't think the American body politic is very eager for the United States to get involved, yet again, in another land war or another major war in the Middle East.

Allison Nathan: Hokayem agrees that no side currently wants an escalation. But he also thinks that could change depending on how the War in Gaza evolves. And like Djerejian, he worries about a potential miscalculation.

What is the likelihood for regional escalation at this point?

Emile Hokayem: The conflict has already widened. There have been almost daily attacks in Iraq, Syria, against US targets because the US is seen as complicit with Israel by Iran-aligned groups. And there has been fighting between Hezbollah and Lebanon and Israel with strikes deep in each other's territory.

And what we see right now is the [UNINTEL] in Yemen essentially joining the fight. They have access to ballistic missiles, cruise missiles, UAVs, and they are strategically located in Bab al-Mandab, a key artery for global trade. And they're ideologically very much aligned with Hamas and Iran. Importantly, they have disrupted maritime traffic. They have boarded ships and so on. So, the conflict in Gaza has already taken a regional character.

Now, the question is whether it will evolve into an all-out war. And here I'm a bit more skeptical. The reason being that those groups want to demonstrate solidarity and support for Hamas, but they also, primarily, want to advance their domestic interests. And so, they're using this crisis to settle scores domestically. And they're using this crisis to primarily harass the US, especially in Syria and Iraq.

The one arena to keep in mind is Lebanon because there Hezbollah is a uniquely formidable partner of Iran. Hezbollah is essentially the ultimate instrument of deterrents and punishment of Iran. It is an extraordinarily competent and skilled militia that has delivered quite well for Iran. But Iran itself seems unwilling to deploy Hezbollah in an all-out war because it wants to keep Hezbollah in case Iran's leadership, Iran's territorial integrity, Iran's command and control come under attack. So, Iran's going to keep them for the big one.

And I think Iran, at the moment, assess that the War in Gaza is not yet the big one. But importantly, what matters is what happens ultimately in Gaza and the West Bank. If the fighting there escalates significantly, if Hamas is, indeed, at the verge of extinction, perhaps the calculus will change into Iran because they'll feel if one of our allies can be destroyed so massively, then perhaps our credibility is at stake. And if we don't do anything, then Israel will, in turn, feel the opportunity to go after other of our partners. And this will become extremely dangerous for Iran itself.

The decision I would argue is very much Israel's at this

point. Does Israel feel that once it has, and if it manages to destroy Hamas, will it assess that it has to turn its focus on the others immediately because it never wants to risk a repeat of October 7th?

Allison Nathan: How concerned are you about a miscalculation here?

Emile Hokayem: I think the potential for miscalculation is significant. You can have made a strategic decision not to escalate and still be entangled in escalatory spiral.

Allison Nathan: Finally, I asked what it will take for the conflict to end. Djerejian believes that the only solution is a political solution involving land for peace. But he argues that the strong leadership required for this is currently lacking on all sides.

So, how can this all end at this point?

Edward Djerejian: I don't think there should be any scenario, and I use the word "should," be any scenario that goes back to the status quo pre-October 7th. These policies have failed. There are frameworks in place that can be

revised, revitalized to show a pathway forward.

We've had some successes. We've had Jimmy Carter broker the Israeli-Egyptian Peace Treaty in '79. We had the Madrid Peace Conference. That led to the Israeli-Jordanian Peace Treaty that resulted in a framework for peace that still is existent, if it is to be taken up by leaders on all sides. But there has to be some sort of consensus on the principles of what an Israeli-Palestinian agreement can look like on the key issues involving security, land for peace.

Land for peace is essential. Under UN Security Council Resolutions 242 and 338, which have been the principle international basis for negotiations on Arab-Israeli and Israeli-Palestinian peace, that is an essential component of any movement forward.

We have to get away from the illusion that you can solve the Palestinian problem through economic bridges or through investment bridges. We have to get back to the negotiating table on the basis of land for peace. And the two-state solution, which seems like an illusion right now. But it is the only approach that would allow for a democratic Jewish state to be living in peace and security

besides an independent Palestinian sovereign state.

Allison Nathan: But haven't there been opportunities for the two-state solution in the past that have been rejected?

Edward Djerejian: Yes, many of those have failed. For example, in the Camp David Accords, Yasser Arafat felt that he could not make the decisions on Jerusalem without getting a consensus from the other Arab countries, especially Saudi Arabia because of the religious implications of any deal. And on the Israeli side, there've been through the years Israeli initiatives for peace. One was done by Prime Minister Olmert. But that fell apart for many reasons. But both sides have made compromises on the principal approach of land for peace during the course of negotiations since 1967.

In order to do that and get there, in my eyes, there's going to have to be elections would would allow for a credible Palestinian government to come to power that could negotiate peace. And on the Israeli side, elections to bring forth a credible Israeli government that has a national consensus in Israel to make peace with the Palestinians.

I was involved in the path going towards the [UNINTEL] peace conference and negotiations as ambassador to Syria dealing with President Hafez al-Assad. When I first went to Damascus, he wouldn't even mention the word, Israel. He called it a Zionist entity. But by the time we left in three years, under strong direction from then President Bush 41 and Secretary of State Baker, Assad was talking about Israel as a state and joint direct negotiations with the State of Israel.

And on the Israeli side, we had a strong [UNINTEL] prime minister, Yitzhak Shamir who did not want to really go into territorial compromises. But we convinced him. But we had a strength of determination. And we had credibility in leadership.

I do not see that now. There is not a strong Palestinian leadership and Netanyahu is in a very vulnerable position. The coalition that he has forged with right wing groups tie his hands in a major way for what he can do and not do now.

Allison Nathan: Hokayem for his part believes that a stable outcome for the region is out of reach, not only

because of the current situation, but also because Middle East conflicts are inherently difficult.

What does a stable outcome in the region look like? And is that achievable?

Emile Hokayem: We know on paper what a stable outcome would look like. Whether it's achievable is a different matter. A stable outcome is a situation where you do have a two-state solution and Palestinian no longer attracts all the passions and emotions of the region. In the process, Iran itself is defanged [?].

But it's not only about that. It's also about figuring out what a regional security architect that includes Iran could look like. The paths to that solution seem quite fantastical at present. The Middle East conflicts are really hard. They are about land. They are about identity. They are about ideology. And so, sadly, what I see in months and years ahead is more conflict, more regional instability.

And importantly, the externalities, the second order effects of these conflicts directly impact the world in the form of migration and refugees, in the form of terrorism and trans-

national dynamics.

Allison Nathan: We'll keep a close eye on how the conflict could unfold from here. I'll leave it there for now.

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