The Economic Consequences of a War with Iran

Speakers at the Center for the National Interest on September 6, 2011 argued that a war to halt Iran's nuclear program could cause serious spikes in the price of oil and damage the global economy. Geoffrey Kemp, Director of Regional Security Programs at the Center, moderated the discussion, which included remarks by Patrick Clawson, Director of Research at the Washington Institute; Amy Jaffe, Director of the Energy Forum at Rice University; and Suzanne Maloney, Senior Fellow at the Brookings Institution's Saban Center.

Clawson argued that Iranian oil would likely not be taken offline by an attack. The United States probably will not target Iranian oil facilities, as this would be irrelevant to the mission's anti-nuclear goal. Indeed, he suggested, such targeting would be unlikely even in a protracted conflict. Iran, in turn, would avoid export cuts, as it is in their own interest to sustain oil exports to bring in crucial revenues. Clawson added that "strategic thinkers" in Iran must realize that attacking neighbors' facilities or shutting down the Strait of Hormuz would be foolish. The last attempt to impede shipments – during the Iran-Iraq War – caused world powers to intervene to protect the Strait, dealing serious damage on Iran's navy.

These strategic thinkers have influenced key decisions in the past—Iran has a record of not responding militarily, Clawson said, even in the aftermath of serious attacks. This point was disputed by some in the audience, who suggested that Iran's modern leadership would surely retaliate in a major conflict with the United States. Clawson later clarified that the U.S. must not assume that Iran will not attack the Strait—Iranian armed forces regularly practice such attacks and seek technologies that would assist their efforts. However, given the vast superiority of America's naval forces over Iran's, retaliation would likely come through the exploitation of images in the media – such as pictures of ships burning in the Strait – to suggest that Iran had fought to a draw (Iran places a great ideological value on resistance, even when futile). Some participants in the discussion suggested that Iran's capabilities, particularly in areas like underwater special operations, have improved significantly in recent years, and that Iran could also use its heavy trade traffic with Oman or its large expatriate population to provide cover for retaliatory action. Clawson noted that attacks would result in "nervous markets," causing actors to hedge against losses and thus substantially impacting oil prices.

Amy Jaffe argued that it is crucial to determine whether the Strait of Hormuz would be threatened more by war or by a nuclear Iran—though the former has been heavily discussed, the latter might be more serious, as Iran could shut down shipments while backing their decision with the threat of a nuclear attack. This could lead to a permanent risk premium on oil. The impact of a war is no less frightening, Jaffe argued. Though redundancy keeps regional oil facilities largely safe from attack, even brief price spikes caused by investor panic could have destabilizing impacts. Every major oil crisis has ultimately produced a financial crisis, Jaffe claimed, in part because the shallow economies of Gulf Cooperation Council states cannot readily absorb sharp increases in oil revenues. Sovereign wealth fund managers must move new assets abroad into the financial sector, creating market bubbles (the 2007-2008 bubble, for instance, occurred as oil prices rocketed upward). Longer spikes would have broader impacts. Some participants suggested that these economic shocks could also endanger the integrity of the Eurozone.

Jaffe suggested that the impacts on the oil markets can be mitigated by preparation of alternatives and elimination of threats. Attacking Iran would not be a snap decision—it would require months of military planning. This time could be used to store extra oil in reserves outside the Strait, like America's Strategic Petroleum Reserve, other national reserves, and privately-held stocks, while corresponding boosts in production could loosen the market. Producer countries could also develop more stable investment plans for windfall revenues. Once an attack occurs, the U.S. could work quickly to demonstrate to the world that oil flows are safe—Jaffe stated that when this occurred during the 1991 Gulf War, oil prices dropped precipitously. A former senior official from the Reagan Administration concurred, noting that Khomeini had threatened the Strait of Hormuz, and that Reagan's diplomatic corps mitigated the resultant oil spikes by briefing world leaders in advance on the implausibility of this threat. Jaffe suggested that similar actions are possible today, and that further stability can be created by the exploitation of unconventional hydrocarbon resources in America.

However, Jaffe said, this plan requires producers to be able to boost production, and this is not guaranteed, as Saudi Arabia has not always kept its word on oil decisions, and in this case might be unable to: Iran could mobilize Shiite oil workers in places like eastern Saudi Arabia to go on strike, she suggested, preventing the Kingdom from using its excess production capacity. Clawson added that Saudi Arabia's enfeebled leadership might be unable to launch the major initiatives needed to significantly expand production in the Kingdom, and other participants noted the continued rise of demand for oil in the BRIC states. Saudi excess capacity may not be available for long.

The Brookings Institution's Suzanne Maloney expressed a largely negative vision of a U.S. strike, suggesting that it is impossible to predict the nature of the conflict that would result. However, she suggested that Iranian oil production would naturally be impacted, creating a ripple of impacts through the world economy. Iran's trading partners, which include key powers like China, India, and Turkey, would be especially hard-hit. Iran might forcibly transform its own economy to fuel warfare; the cumulative effect of the strikes and the transformation could be mass internal displacements and political turmoil. Maloney also suggested that the Islamic Republic may be stabilized by a war, as it was in the early days of its war with Iraq.

Maloney also argued that Iranian retaliation in Iraq or Afghanistan could impose substantial additional costs on the United States by requiring expanded military operations. Paradoxically, she argued, the least costly war effort may thus be a punishing and extensive strike that causes "regime implosion" as the Iranian government finds itself unable to coordinate or deliver services effectively. Smaller-scale attacks could thus be more costly, as Tehran would be able to initiate a sustained conflict that could more significantly affect energy and financial markets.