

Situation and perspective for Iraq and the world : a tentative of clarification

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The world appears to be suspended to the possible next step in dealing with the Iraqi situation. The arguments for engaging military actions have been put forward forcefully by the United States, while both public opinion and a large number of other countries have expressed themselves in favour of exploring all alternative ‘no-war’ options. The arguments exchanged over the issue have been mixed with a heavy dose of preconception, erroneous views and political calculations. But because the discussion involves a great number of very uncertain or unknown variables, the understanding of the stakes and possible consequences has probably been blurred. While recognizing that TAC does not have any specific or insider information that our customers do not have also, we would like to propose an ‘analytical grid’ for reading the current situation and the likely next steps.

It is important to stress that this exercise does not rest on our own ‘personal’ judgement, even though TAC would like to stress that its current reading of the crisis and the staff’s personal beliefs are very much in favour of avoiding military conflict through all possible means.

Our analysis can be structured around 5 major points:

- The international and geopolitical situation today imposes to recognize two major features, namely the over dominance of the US as the single superpower on one side, the emergence of a new kind of destabilizing factors through terrorist networks as dramatically exposed in September 2001.
- The case for going to war appears overwhelming for the US, with four inter-related motives: the application of pre-emptive strikes against terrorist organizations or countries that can supply them with weapons of mass destruction; the need for the ‘single superpower’ to permanently re-establish its technological / warfare superiority over would-be contenders on the geopolitical scene; the growing realization in US circles that future stability in the Middle East will not be achievable if the Arab world does not ‘structure’ or organize itself around a ‘regional superpower’, which can only be Iraq, and where therefore a friendly regime is absolutely needed; the desire to reshuffle the oil supply cards in the region, especially in the view of possible tensions in Saudi Arabia.
- The massive popular support for a peaceful dealing with Iraq as well as political opposition in many countries including traditional allies of the US may have temporarily cooled the military ardour of supporters of a soon-to-come military operation in Iraq. However, we doubt that this moderation could translate into a radical change of course by the US authorities. From a realistic or maybe cynical point of view, the overall background of a single superpower being pushed in a corner by a coalition of weaker

participants on the world scene is somewhat worrying: any US back-tracking would be considered elsewhere as a first step in 'controlling' the superpower's ability to set the world direction and rules. In that sense, we could argue that, (1) it is likely to be 'strategically unacceptable' to the US, (2) if it happens, it could be seen as an early sign of a major long-term trend of 'destruction' of the world economic and political integration around the US or articulated by US policies and companies (see our comments made in the wake of the September 11 terrorist attacks for a broad historical view on globalisation and economic integration).

- TAC does not have any military specialist in its staff and therefore cannot have any original view on the unfolding of events in case of military action in Iraq. However, the systematic review of external analyses indicate that any scenario has to concentrate on two key types of variables: the duration or length of a conflict, between the onset of operations down to the setting-up of a new government and full surrender by Iraqi forces, on one side, and the possible reactions by 'interested' parties, on the other side. For the first aspect, the separation can be made between 'short and efficient', meaning less than 6 weeks, 'short but more difficult', meaning between 6 and 12 weeks, and 'long and more protracted', meaning longer than 3 months. For the second, it is necessary to distinguish possible reactions by Middle Eastern governments, by Middle Eastern (or Arab / Muslim) populations, by terrorist networks, by European and Asian countries, and finally by oil markets. A simplified matrix crossing these two sets of variables can therefore be a useful tool for analysing possible scenarios. A full table and comments are provided below.
- The interesting side of constructing scenarios does not rest with any ability to put a probability figure on each 'square' of our matrix, but on the results that are common to all scenarios (what we could call the 'anchor points'), and conversely the variables that are radically different in the various scenarios (called the 'risk factors'). We see basically three 'anchor points', namely an expansion of terrorist threats (implying an unstable and uncertain background for world economic and financial developments), a growing divorce between governments and populations in the Middle East (implying higher political risks in the region, and a slowdown in overall democratisation and liberalisation processes), and the downgrading of European prospects, in terms of political weight or economic performances. Conversely, there are clearly two major 'risk factors', namely the oil prices (with a range of 40 \$/bl over to 100 \$/bl during the hostilities), and the US economic growth (from a benign effect compared to the current outlook of 2.5-3.0% GDP growth, to something like a major recession of -3% for 2003).

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	duration / success		
	4 to 6 weeks : "Benign Case"	6 to 12 weeks : "Intermediate Case"	>3 months : "Worst case"
	Quick and decisive US military victory / limited civilian deaths and little, if any, collateral damage or loss of key infrastructure	US military victory but moderate casualties (both sides) with serious collateral damage to Iraq infrastructure + some aspects of Iraq's oil facilities	US military victory but long / heavy casualties (both sides) and collateral damage and infrastructure / costs escalate sharply
Post-war Iraq	Pro-American - democratic - regime with presence of American troops for at least 18 months : transitional government (opposition parties + Kurd and other minorities)	Transitional - democratic - regime with presence of American troops for at least 18 months / low-level civil tensions / urban warfare in some areas	Protracted military resistance : defence by loyal Iraqi forces + Iraqi urban warfare = internal civil conflict likely. Break-up of the country and possible extension to Turkey, Iran and Syria
Reactions in the Middle-East : governments	Overall support / but Saudi Arabia and Iran very sensitive	Rising political tension in the region / Israel might be drawn into the conflict	Instability in the Middle-East (war with Israel likely) / Israelo-Palestinian conflict ; threat on Saudi Arabia ; refugees policy in Syria, Jordan, Turkey. Spread of the conflict outside Iraq
Reactions in the Middle-East : population	Strong vocal opposition but limited action / unrest	Vocal opposition reinforced by large demonstrations. Possibilities of limited riots / urban violence	Mass demonstration, population uprising / riots - anti-US backlash. Clash with police / government
Terrorist networks	Quick restructuration of networks = no eradication ; risk of acts of terrorism in US, UK or allied countries originating from other muslim countries remains	Terrorist threat more vocal. Likely terrorist strikes in "Allied Arab" countries, Israel and/or Western nations	Terrorist attacks against US and UK interests in the region ; increasing number of "martyr volunteers" and spreading terrorist threat / attacks
Reactions outside Middle-East : Europe	Major issues relate to oil (European and Russian companies versus US majors) and Irak public sector (maintained or privatised ?) ; sharing of reconstruction costs versus contracts	Adverse effects on economic performance. Deepening political tensions within EU	Terrorist attacks likely ; Economic recession ; Deep rift between EU nations ; Slowdown in enlargement process
Reactions outside Middle-East : Asia	Islamic opposition in Indonesia and Malaysia = popular protests likely	Islamic opposition in Indonesia and Malaysia = popular protests likely. Possible attacks against US / western interests	Terrorist attacks likely ; likely recessions (Singapore, Malaysia, Hong-Kong and Taiwan) ; oil importers will suffer (South Korea, India) ; high political tensions in Indonesia / Pakistan
Oil prices	USD 40 during the US attack ; rapid decline in July to USD 22-25	Will OPEP be able to fill the gap ? Likely not Oil prices around USD 30-32 during 3 months Significant world economic slowdown	Oil prices rise to at least USD 45-50 US/world economy in "double-dip" with sharp recession in 2003

At this stage, it is almost impossible to set probabilities to these various scenarios. The common view is that the overwhelming military supremacy by US forces coupled with a massive and concentrated attack on 'nerve centres' of Iraqi defence and a rapid 'man-hunt' on President Hussein, his government and key military personal would be the most appropriate tactics for a quick victory; this outcome would be followed by the setting up of a transitional government including the representatives of opposition parties as well as Kurd and other 'minorities', under some sort of US-led governance. The embargo would be immediately lifted and investment in oil field maintenance and development would see a major and almost immediate boost, with the likely involvement of US majors. US troops would be stationed in the country during the time required for the re-establishment of local police and security forces.

However, the same common view keeps open the possibility of a fierce defence by loyal Iraqi forces, with a high likelihood of urban warfare where the US supremacy loses its strength. Extension of the conflict can be envisaged either through a 'suicide' attack on Israel, or destruction to oil field installations in neighbouring Gulf states. The possibility of significant casualties, both civilian and US military forces, could induce very strong reactions, in the region but possibly also in the US if the conflict were really over 8 to 12 weeks. The question of possible terrorist attacks originating from other places than Iraq in the midst of the conflict is also an open issue.

The above matrix tries to give some elements, even only questions, according to the different assumptions made on duration and reactions. Key conclusions are :

- The probability that the war in Iraq will put an end or give a significant blow to potential terrorist attacks appears extremely slim in whatever scenario. The rationale behind such a statement is (1) terrorist networks and activities are by definition not confined to a geographical area, and the extent of logistic and military support by the Hussein regime to such terrorist groups is at best unclear and not massive. The US attack is and will be perceived as a major provocation against Islamic fundamentalist, especially if there is an extension of the conflict. The only scenario where we would judge that the terrorist threat is significantly lower after than before the conflict would be a quick and decisive victory by the US with very limited collateral damage, immediately followed by an unyielding pressure on Israel to enter a peace agreement with the Palestinian, probably on the lines of the proposals put forward by Saudi Crown Prince Abdullah.; this would require what we can call the 'US strategic vision and genius'. (2) As long as the deep-rooted causes of fundamentalist violence and hatred are not properly understood and dealt with, the prospect of reduced terrorist threat is marginal, since suicide-type of blow and the geographical spread of potential sources of terrorist attack make the 'war against terrorism' a long-haul process.
- The gap between governments and population in the whole Middle Eastern North African and some Muslim Asian countries is due to increase, here again, whatever the form and duration of the conflict. The governments are very significantly constrained by the necessary allegiance to the super-power, which is supporting/protecting them through economic and financial support (e.g. Egypt, Pakistan) or military presence (Gulf states) or economic/trade relations

(Asia, Pakistan, Gulf states). In the absence of a 'regional power' able to organise the region, the governments have a very limited leeway in exposing an independent foreign policy. But conversely, it is clear that there is a growing anti-American feeling and behaviour in most of the Muslim world, with the likelihood of massive demonstration when the conflict erupts. Even a full and quick victory could trigger large unrest in most of these countries. This would be amplified if the conflict lasted longer, if civilian casualties were high, if Israel were dragged in the conflict, and if there were a geographic extension of military operations. This implies that such governments, whose legitimacy is questionable at best, would be obliged to adopt stronger security policies, move away from democratic rules (with the support of western countries too worried by potential Islamic governments), associated with a possible slowdown in economic integration. Country risk would undoubtedly be higher, except obviously for Iraq. Even under a scenario of a very positive unfolding of events, the likely re-emergence of Iraq as a regional power-broker would induce significant political risks in neighbouring countries, especially if the present US 'protection' is considered as superfluous.

- The weakening of Europe appears likely in each scenario. A quick and efficient US victory would demonstrate Europe pusillanimity in face of 'world problems that only the US can solve'. The divergences of views within Europe would blow up and create long-lasting suspicions and disenchantment, especially within the EU and between EU and would-be-members from Eastern Europe. Conversely, a lasting conflict would precipitate Europe in an economic recession, on the back of a very poor performance in 2001 and 2002. The intensity of cross-relations between Europe and the Middle East (trade, population, cooperation...) makes it a likely 'target' of terrorist threats and deep communal tensions if military operations induced large civilian casualties, with a probable call for a Jihad in developed nations if war lasts more than three months.
- The sheer scale that the various scenarios put on the likely movements in oil prices indicates clearly where the major 'risk factors' lie. A short-lived increase in oil prices up to 40 \$/bl followed by a re-initiation of Iraq crude production capacities, would probably trigger a significant decline in oil prices. In the short-run, an overshooting could be observed (down to 10-15 \$/bl) if it coincides with the seasonal drop in demand and full restoration of export capacity in Venezuela. The 'medium-term' target of 20-25 \$/bl (an equilibrium range that satisfies both oil majors and producing countries, while leaving importing countries under no inflationary or recessive pressures) is however likely after a short period. Conversely, any prolonged conflict, especially if the Iraqi or other countries' production capacity is significantly affected by physical destruction, could push the oil prices above 50 \$/bl (ex-Saudi oil minister Sheikh Yamani has talked about prices above 100 \$/bl); considering the state of the US and world economy today, such an additional shock (notably to the US consumer) would be disastrous, with a very high probability of a 'double-dip' in the US, and possibly a major recession (-3% for GDP, according to the Yale University research) both in the US and worldwide. Asian countries would also be very significantly affected in such a scenario, notably countries that are dependent on the US market as a export destination

(e.g. Korea, Malaysia, the Philippines, China), and those that are large oil importers (Korea again, but also India).

We would like to suggest two very interesting readings on the subject, one by Yale University and the other by the US Center for Strategic and International Studies (CSIS). We would also welcome your comments and reactions at info@tac-financial.com.

“War with Iraq : cost, consequences and alternatives“, William D.Nordhaus, University of Yale, November 2002

This article analyses the economic consequences of war with Iraq and tries to estimate the costs of war as well as the costs of post-war occupation and reconstruction, regarding different military scenarios (“quick victory” or “protracted conflict”). In a second part, the author, William D. Nordhaus, economist at the University of Yale and former economic adviser of Jimmy Carter, focuses on the broad economic impacts : oil markets and the overall economy.

The full version of this study can be found at the following address : http://aida.econ.yale.edu/~nordhaus/homepage/AAAS_War_Iraq_2.pdf

“After an attack on Iraq : The Economic Consequences, Center for Strategic and International Studies (CSIS), November 2002

On November 12, 2002, CSIS sponsored a conference on the economic consequences of an attack on Iraq. The economic analysis was based on three war scenarios, developed by CSIS national security expert Anthony CORDESMAN, who set out a range of possible military outcomes and political repercussions.

In the benign case, there is a quick and decisive victory ; Iraqi oil is off the market for only a short period, there are few adverse political repercussions in the region, and there are no serious terrorist attacks in the US or among allies. In the intermediate and worse cases, there are progressively greater disruptions to oil supply, progressively more adverse political repercussions in the region, and progressively more serious terrorist incidents.

The working papers presented to this conference can be found at the following address : <http://www.csis.org/features/iraq.htm>

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