

# The Economic Cost of a Nuclear Iran

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## Sanctions and U.S. military force carry risks, but Tehran with a bomb would wreak havoc on global markets.

**A**fter the looming fiscal cliff, the next major challenge facing the United States will be preventing Iran from obtaining a nuclear weapons capability. Living with a nuclear Iran is strategically untenable. Like the fiscal cliff, this is a matter of both economic and national security. Preventing Iran from acquiring nuclear weapons carries various risks, but inaction has its costs, too -- especially to the price of oil and, in turn, to the U.S. economy.

International sanctions against Iran have already restricted its oil exports, reducing global supply and putting upward pressure on oil prices. But a military strike against the Islamic Republic could disrupt the flow of oil in the region, as Iran might retaliate against the West by attempting to close the Strait of Hormuz, through which one-fifth of the world's oil supplies pass.

The disruption of oil flows would have significant economic repercussions. Yet failure to stop Iran's nuclear-weapons program also would have myriad direct and indirect consequences. We led a Bipartisan Policy Center task force -- including former elected officials, military leaders, diplomats, energy analysts and economists -- that examined the energy-related costs of inaction.

Energy markets respond both to actual supply disruptions and to expected changes in supply and demand. A nuclear Iran would raise the likelihood of instability, nuclear proliferation, terrorism and war -- and could thus drive oil prices up without disrupting the flow of oil.

To quantify this price impact, we identified five scenarios that an Iran with nuclear weapons would make more likely: domestic instability in Saudi Arabia, the destruction of Saudi energy facilities, an Iran-Saudi nuclear

exchange, an Iran-Israel nuclear exchange, and the lapse of sanctions against Iran.

To isolate the worst-case scenario for the oil market -- a Saudi-Iran nuclear exchange -- we assessed that the probability of such an event would change from zero today (when neither country has nuclear weapons) to 5% within a year. This could lead to the disruption of 12 million barrels per day, or 13% of current global supply, due to the cessation of exports through those two countries for one year and a partial cessation from their neighbors.

Accounting for this scenario and the others, we calculated the total additional risk premium that an informed oil market might reflect after Iran has crossed the nuclear threshold -- that is, the amount added onto the price of oil due to the possibility of supply disruption. We concluded that even if none of the above scenarios actually came to pass, the collective risk that they could occur would cause significant economic harm:

- Oil prices could rise by 10% to 25% in the first year (or \$11 to \$27 more per barrel). As instability and tensions remain high, so will prices, even rising as much as 30% to 50% (\$30 to \$55 per barrel) within three years.
- Consequently, gasoline prices could jump 10% to 20% in the first year. Within three years, the cost of gas could rise more than 30% (or more than \$1.40 per gallon). Such sustained price increases would have a pronounced negative impact on the U.S. economy.
- U.S. gross domestic product could fall by about 0.6% in the first year -- costing the economy some \$90 billion -- and by up to 2.5% (or \$360 billion) by the third year. This is enough, at current growth rates, to send the country into recession.
- The unemployment rate could also rise by 0.3 percentage points in the first year and by nearly 1% two years later, resulting in some 1.5 million more Americans becoming jobless.

This economic pain could result even if the oil supply is never disrupted. Should Iranian-Saudi, Iranian-Israeli or other tension cause an actual disruption, the resulting economic dislocations could be dramatically worse. They could involve a doubling in the price of oil, gasoline soaring by as much as \$2.75 more per gallon, U.S. GDP plummeting by 8% in one year, and five million Americans losing their jobs.

To be sure, such analysis, no matter how carefully done, involves as much art as science. Its value is in illustrating the range of impacts that could occur, not in predicting any precise outcome.

As American and other policy makers contemplate what it will take to thwart Iran's nuclear ambitions, they must not dwell exclusively on the potential short-term impacts of economic pressure or military action. Over the medium and long term, the economic costs of a nuclear Iran may be no less real and far more enduring.

*Charles Robb is a former Democratic senator from Virginia. Dennis Ross is counselor at The Washington Institute and a former special advisor to President Obama. Michael Makovsky is foreign policy director of the Bipartisan Policy Center. All were members of the center's Iran Task Force, which recently issued the report The Price of Inaction.* ❖

*Wall Street Journal*

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