Key judgments

- The fall of Mosul to the Sunni jihadi movement ISIS is not only strategically significant in its own right but also takes Iraq from insurgency to at least the brink of civil war.

- That said, despite the amount of ordnance which has now fallen into ISIS’s hands, it is not clear that it has the capacity to wage symmetric war (as opposed to carrying out terrorists attacks) outside the Sunni heartland.

- So, it is too soon to assess at this stage whether there is an imminent threat to Iraq’s main oil producing regions.

A major threat to national unity

“The strategic nightmare of a new Afghanistan in the heart of the Middle East just got a lot closer.”

Financial Times editorial, 12 June 2014

The fall of Mosul, Iraq’s second- or third-largest city, to the Sunni jihadi movement the Islamic State of Iraq and al-Sham (ISIS) is significant for a number of reasons.¹ Notably:

- It underlines that ISIS has the capacity to fight what amounts to a ‘symmetric’ war (as opposed to an insurgency), at least in the Sunni region of Iraq;

- The lack of resistance put up by the Iraqi army may be a reflection not only of lack of support in the Sunni-dominated city for the regime in Baghdad but also of the general ineffectiveness of the country’s armed forces (see below);²

- It has allowed ISIS to capture significant quantities of military ordnance;

¹ ISIS (often referred to as the Islamic State of Iraq and the Levant) emerged four years ago from al Qa’idi in Iraq (AQI). As AQI, it was the principle target of the US ‘surge’ in 2007/8 when it suffered significant military setbacks. However, it has recovered since the US withdrawal and has recently operated to good effect in both Syria (where it controls much of the territory along the countries eastern border with Iraq despite frequent clashes with other opposition groups) and Iraq, with the explicit aim of establishing a caliphate across the two countries and Lebanon. al Qa’idi (which ISIS considers too moderate) cut its ties with ISIS earlier this year after a lengthy power struggle.

In contrast to 2007/8, when the US was able to persuade indigenous Sunnis to turn against AQI, it is now generally considered that there is a good deal of local support for ISIS thanks to what is widely seen as the strongly sectarian approach to governance of prime minister Nouri al Maliki and the bad deal which the Sunnis feel they have had in recent years – see, eg: ‘Fall of Mosul encapsulates tragedy of a failed state’ by Roula Khalaf, Financial Times, 12 June 2014.


See Appendix A-1 for analyst certification, important disclosures and the status of non-US analysts.
It has reportedly allowed 2,000 to 3,000 prisoners to be freed from jail, many of whom may now swell the ISIS ranks which may already number 15,000 fighters;³

It has given ISIS a base from which it is likely to be able to seize the country’s second-largest oil refinery at Baiji (and which may already have fallen), which should provide them with a valuable source of revenue.⁴

The response of the authorities in Baghdad to the threat posed by ISIS has, to date, been far from convincing, in my view. For example, the Financial Times reports that Baghdad rejected offers of help from the Kurdish Regional Government (KRG) to defend Mosul.⁵ And today parliamentarians failed to show up to vote on emergency powers sought by prime minister Nouri al Maliki (with a special session now called for tomorrow).

Such is Baghdad’s apparent lack of faith in the army that Mr Maliki (who is himself protected by an Iran-trained militia) is reportedly recruiting Shia militia.⁶ According to Hayder al-Khoei:

“There are now reports that Shia militia fighters, already fighting alongside government forces, are preparing to move up north to confront ISIS and protect Shia minority communities living in the Sunni-dominated north. Militia recruitment centres have also opened in Baghdad and the south where volunteers are applying in their hundreds to support Iraqi security forces. These efforts, as well as the escalation in sectarian rhetoric, will only add to the sectarian polarization of the current conflict in Iraq. In Baghdad, the government has recognized that the conventional armed forces are unprepared and unwilling to confront the jihadists. In response to this it is increasing efforts to recruit more ideologically-driven Shia militias, who are able to fight an unconventional enemy through unconventional means.”⁷

At best, therefore, I see Iraq as on the borderline of civil war (as opposed to a terrorist insurgency), as ISIS forces in Falluja in particular (just 79km west of Baghdad and under ISIS control since early this year) may be preparing to launch an assault on the country’s capital.

**Civil war threatens oil**

This is potentially important from an immediate market perspective, bearing in mind that civil war is the one thing which has destroyed oil output since the start of the ‘Arab Spring’ in 2011, ie in Libya, Yemen and (albeit with the help of EU sanctions) Syria. So, it is understandable that Brent futures have ticked up by around USD 2pb today (albeit still leaving Brent in the lower half of the dominant USD 105-120pb price range, for now at least).

On the other hand, ISIS has still to demonstrate the capability to carry out more than isolated terrorist attacks in the Shia-dominated oil producing areas in the south. So it is not clear at this stage that Iraq’s oil output is at risk from civil war, if this can indeed be categorised as such; and it is hard to say how close we may be to this happening.

As for immediate risk to oil exports, for sure there are big fields in the Mosul area. But there is little active commercial exploitation. And the nearby Kirkuk-Ceyhan pipeline has been out of action since March thanks to terrorist activity. So, low.

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³ See, eg: ‘ISIS defies repeated efforts to destroy its capability’ by Erika Solomon, Financial Times, 12 June 2014.
⁴ ISIS already part-funds itself through oil it controls in Syria.
⁵ See: ‘The nightmare emerging in Iraq’, Financial Times, 12 June 2014. Kurdish forces, long seen as a bulwark against Sunni insurgents have reportedly taken over control of the disputed (between Kurds and Sunnis) city of Kirkuk from central government forces today which reportedly fled.
⁶ See, eg: ‘Army lacks grit to stem militants’ by Borzou Daragahi and Geoff Dyer, Financial Times, 12 June 2014.
⁷ ‘ISIS attack in Iraq has nationwide security consequences’ by Hayder al-Khoei, Chatham House Expert Comment, 12 June 2014.
Outside assistance?
I have been asked by a number of clients whether I think the US could look to bolster the Iraqi army on the ground, ie through the re-insertion of ground troops. Special forces and advisors/trainers aside, I think it unlikely. Based on a recent opinion poll conducted by the Pew Research Center, US public opinion would not be supportive, even if President Barack Obama were willing. Furthermore, and to quote Hayder al Khoei again:

“The current jihadist onslaught leaves the United States in an awkward position. With US-made military vehicles and weapons being paraded by jihadists in Mosul, policy-makers will be questioning the effectiveness of providing Baghdad with even more military hardware that may end up in the hands of the very people they want to defeat.

Iraqi security officials have asked for missile-equipped drones in the past and the US has consistently refused these requests. Now, however, the US may be more willing to offer such equipment. However, many in Baghdad are frustrated at the slow speed of American military assistance.”

Nevertheless, I do expect to see an intensification of US drone activity out of Djibouti targeting ISIS. And I wouldn't totally rule out US air strikes in support of Iraqi ground forces, especially if ISIS were seriously to threaten Baghdad.

That said, as Mr Khoei also notes, Baghdad may find more support coming from Iran, in addition to significant numbers of IRGC personnel already in Iraq, and Russia (ie as is the case for backing for the Bashar al Assad in Syria where the deployment of Hizbollah fighters has tilted the military balanced back towards the regime, albeit not decisively).

Best case scenario?
Acknowledging that the situation on the ground in Iraq today is clearly very fluid and therefore unpredictable, I think the best case likely scenario in the near to medium term would be as follows:

- The army, reinforced by Shia militia, prevents an ISIS break-out from the Sunni heartlands in the northwest of the country;
- The KRG and its forces retain a firm grip on Iraqi Kurdistan (and complete a de facto annexation of Kirkuk); and
- Nevertheless, ISIS consolidates its position in the Sunni region of Iraq (and contiguous parts of Syria) and continues to use it as a base for terrorist attacks in other parts of the country.

Quite where this would leave Mr Maliki in Baghdad as he looks to build a parliamentary majority coalition there in the aftermath of his party’s plurality in the 30 April general election is far from certain (see: ‘Politics and markets’, 28 May 2014, page 10). But it does appear to me that, as things stand, Iraq is sliding from failing to failed state, with a non-negligible related risk of civil war.

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8 Ibid.
Appendix A-1

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