

## The Qatar blockade could have geopolitical repercussions

Mushtaq Khan, June 8, 2017

The Saudi-Emirati break in diplomatic and economic ties with Qatar is a very serious development.<sup>1</sup> As is the norm in the Middle East, the manner in which the current standoff plays out, will be driven more by regional politics than economic considerations.

While the international media has expressed surprise at the measures taken against Qatar, the local media in the Kingdom of Saudi Arabia (KSA) and the UAE had been priming their audience (for this standoff) for quite some time. There has been a constant stream of articles expressing concern about Qatar's support for Hamas, its criticism of the Yemen war, its cordial ties with Iran, and its patronage of the Muslim Brotherhood.

In our view, the point of contention is not where these countries stand *vis-a-vis* Iran, but how they responded to the Arab Spring – KSA and the UAE were against the movement, while Qatar accepted and supported it. This fundamental difference lies at the heart of the disagreement.

### The trigger

Mainstream media has reported that the UAE capitalized on a news item in the Qatar News Agency, which alleged that the Qatari Emir had stated that Hamas was a legitimate representative of the Palestinian people, and that President Trump's anti-Iran stance was destabilizing the region. Qatar's state TV channel tried to discredit this news item, claiming its network had been hacked and the article was false. However, this did not deter the Saudi-Emirati alliance from formally announcing the break, and bringing in more countries to follow suit. With two war-torn countries, namely Libya and Yemen, lending their support, along with the Maldives (and now Mauritania), this shows that KSA/UAE are seeking to create as large a boycott of Qatar as they can.

It is clear the KSA/UAE have felt empowered to take this step after the visit by President Trump, who views Iran as the main source of terrorism in the world. Taking such a step has effectively made the GCC (Gulf Cooperation Council) dysfunctional: three members are anti-Qatar, and two have abstained from joining the Saudi-Emirati alliance (Oman and Kuwait).<sup>2</sup>

### The path towards a resolution

Nothing has been formally declared on either side, about how this impasse could be resolved. However, it is clear from the official statements of the Saudi-Emirati alliance, that the change in Qatar's behavior they seek, will not be easy to obtain. The alliance wants Qatar to:

- Renounce its support for the Muslim Brotherhood;
- Stop all support for Hamas;
- Shut down (or strongly censor) Al-Jazeera; and
- Distance itself from Iran.

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<sup>1</sup> More so than in 2014, which was triggered by the conflicting views of Qatar and Saudi on the military coup in Egypt.

<sup>2</sup> It is somewhat ironic that the creation of the GCC in 1980 was triggered by the Iranian Revolution, as a common platform to counter Iran's threat that it would export its revolution to the Gulf. The current split in the GCC is also driven by some members of the Council finding more common ground with Iran.

Basically, KSA wants Qatar to give up its independent foreign policy, and fall in line. Given Qatar's preference for autonomy (and its massive natural gas reserves), it seems unlikely that it will reverse its foreign policy stance, especially after the manner in which the Qatar blockade was implemented.

This is uncharted territory for the region, not because of the underlying issue, but the number of players who have an interest in how this plays out. As of now, there is no clear path towards resolution.

### **Global opinion**

Mainstream media has identified Qatar's support for Hamas and the Muslim Brotherhood as negatives, but world opinion is cautious about taking sides. This can perhaps be traced to the negative perception of Saudi Arabia, and its alleged role in terrorist financing. The repression of Saudi women, and legal proceedings to force the Saudi government to pay damages for 9/11, are issues that keep recurring.

Global opinion may become more focused after President Trump's tweets about Qatar. Against the backdrop of Trump's first overseas visit (where he embraced Arab dictatorships; alienated his European allies; sold arms to KSA and scolded EU members for not paying enough for NATO), Trump's tweeted support for the action taken against Qatar, will not help the Saudi-Emirati alliance. Given the respect (or lack thereof) that President Trump generates globally, public opinion will continue to work against this alliance.

### **General economic impact**

- Media have documented the Qatari scare about food shortages, since 40% of food items consumed are brought in by road from KSA (in terms of fresh produce, this could be as high as 95% of total consumption). Analysts therefore predict that food prices will rise sharply, as flying in food will increase the cost of transportation.
- Iran has offered to ship food items to Qatar, but Qatar has opted to rely on Turkey. Given the need to manage the fallout from an interrupted supply chain, the Qatari government is likely to intervene to ensure that opportunistic price increases are not allowed.
- UAE's decision to halt shipping from its Jebel Ali Port to Doha, could impede economic activity in Qatar. Construction (which accounts for a large share of Qatar's non-oil economic growth) will be squeezed by the blockade of land and sea routes into Qatar.
- The directive to the citizens of the Saudi-Emirati alliance to leave Qatar within 2 weeks, will also hurt Qatari businesses and corporates, not to mention the social disruption. However, Egypt has not recalled its citizens, which suggests that the quarter million Egyptians working in Qatar are too important a source of foreign exchange for Egypt, which the latter cannot afford to lose.
- Financial transactions between Qatar and members of the alliance are also suffering, but details are vague. One thing is clear, since Qatar is a net investor in the GCC (per capital GDP is the highest in the world), if Qataris opt to liquidate their investments in the UAE, this could trigger a real estate scare in the Dubai.
- Qatar Airways has been hard hit as alliance countries have refused to allow Qatari aircrafts into their airspace. However, with the deep pockets of the government, Qatar Airways is likely to be fully supported till this spat is resolved.

- Trade with Turkey (and possibly Iran) is likely to increase significantly. Since Qatar's GCC neighbors are squeezing the country, it may look north for support, especially as it shares the world's largest gas field with Iran.<sup>3</sup>
- Qatar's exports will hardly be impacted by the blockade. Since the bulk of its exports are hydrocarbons (more specifically natural gas, which is transacted via long-term sales agreements), Qatar's inflow of foreign currency is more robust than other oil exporters in the region. This is a significant source of comfort for Qatar, and also for those who hold Qatari sovereign bonds.

### **Immediate impact on the financial sector**

Qatar's economy is better positioned than its neighbors in the GCC. Its dependence on long-term sales agreements of natural gas to Asia, protects it from OPEC cutbacks and also shelters it from the volatility (and softness) in oil prices. However, Qatar's construction activity is likely to be hit by the blockade, as alternative supply routes will be more expensive. Qatar's economic/financial isolation will also undermine its preparations to host the 2022 FIFA World Cup, which has been driving its ambitious plans for hospitality, logistics and ancillary services to cater for the influx of new tourists.

Qatar's financial sector is a source of immediate concern for two reasons: one, GCC banks have been relying on external borrowings to shore up their deposit base, as government deposits were depleted with the collapse of oil prices; and two, with the external balance turning sharply negative in 2014, GCC countries initially dipped into their sovereign wealth funds (SWFs) but have now started borrowing from global markets. So Qatari banks are facing an acute liquidity shortage, and with Qatari bonds now exposed to the blockade, Qatar's cost of borrowing will increase.

However, long-term Qatari bonds are still better priced than equivalent Saudi bonds. Although the gap has narrowed sharply since June 5<sup>th</sup> (and the market for Qatari bonds is very thin), Qatar's sounder economic fundamentals suggests that even with the isolation, Qatari bonds are likely to perform better than Saudis'. This is because Saudi's economic fundamentals are quite weak – an expensive war in Yemen; the recent spending spree on American arms and Saudi investment in continental US, and a large local population that resents the austerity imposed in recent years. KSA also has to carry the burden of OPEC, which means production cuts (to shore up oil prices) hit the Saudis the hardest.

Qatar does not have these issues. Nevertheless, there is a view that smaller Qatari banks are more dependent on foreign funds, and therefore vulnerable (e.g. Al Khaliji Commercial Bank, Qatar International Islamic Bank, Doha Bank, International Bank of Qatar and Commercial Bank QSC). However, the larger Qatari banks like Qatar National Bank and Ahli Bank are better bets.

With Qatari sovereigns, we feel the government will ensure that its repayment record remains unblemished. Qatar will leverage its ample gas reserves, which make it a key player in a *preferred* energy source.<sup>4</sup> This, alongside its SWF and assets held abroad, is likely to ensure that Qatar remains a safe bet for foreign investors. Despite the standoff with Saudi, Qatar may feel that if it can ride out this period,

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<sup>3</sup> Qatar has been reserved about its interface with Iran, for fear that this could further antagonize Saudi Arabia. However, Qatar knows that along with Russia and Iran, these three countries hold about 60% of global natural gas reserves. In many ways, Qatar's long-term economic interests are much closer to Iran (and Russia) than they are to KSA.

<sup>4</sup> Compared to oil, natural gas has several advantages: it is a cleaner energy source and is not hampered by a supplier's cartel. Furthermore, unlike oil and the challenge posed by US shale, there are no alternatives to natural gas. Also, the very nature of gas exports creates a strong long-term relationship with buyers (natural gas cannot be stored, and transportation is very specialized). This creates a political relationship between the supplier and the buying country, which is more stable than the oil politics that the world has experienced.

and build its relationship with Turkey and Iran, it may be able to retain its foreign policy independence while others in the GCC grapple with domestic and global discontent.

### **Old issue – new dynamics (Terrorism & Trump)**

KSA is driven by an existential fear of Iran, while the UAE (which perhaps instigated this blockade) is threatened by the Muslim Brotherhood. President Trump, who is famously erratic, may view his alliance with KSA/UAE as a way to prove his anti-terrorism credentials (and to appease Israel). By siding with an ailing Saud family, Trump believes he will be able to solve a 50-year old Arab-Israeli problem, and formulate a “solution” for the festering Palestinian problem. As far as President Trump is concerned, the optics may be more important than the substance or sustainability of this solution.

The more President Trump sides with the Saudis, the more firmly will Qatar be pushed into the Turkey/Iran camp. US and Saudi policy thinking may be as follows: increase the pressure on Qatar and it will buckle, and accept Saudi demands. The US may also factor in its largest regional military base in Qatar, as additional pressure. However, Qatar may view the blockade as a threat to its sovereignty and its gas infrastructure, and may see a full-blown Saudi invasion as a distinct possibility.<sup>5</sup>

In all this, one cannot ignore Iran and its ability to influence events in the region. Both Kuwait and Oman did not join the Saudi alliance, partly because they could not afford to take sides against Iran. With Turkey’s Erdogan comfortable with the philosophy of the Muslim Brotherhood (and likely to leave NATO and downgrade its alliance with the US and the EU), Qatar may feel that with the backing of Turkey, Iran and the implicit support of Russia, it could stay the course and eventually help reshape the Arabian Peninsula.

This means there will be a fair amount of turmoil in the Middle East in the near term. The battle-lines are clearly drawn, with both sides claiming to be fighting terrorism:

- For many decades, Turkey has considered Kurdish militants to be terrorists;
  - Syria also considers its Kurds to be terrorists, and is claiming that the US is allied with these terrorists;
  - Iran claims that ISIS is a terrorist group created and funded by the Saudis;
  - Saudi fears Iran’s regional ambitions. But it also faces a real threat in the form of ISIS, which has taken root in the Kingdom and seeks retribution;
  - Israel fears Iran, and considers Hamas to be a terrorist group;
  - The UAE and Egyptian Field Marshall Sisi, view the Muslim Brotherhood as terrorists who could overthrow their governments;
  - The US and NATO are fighting a losing war against the Taliban in Afghanistan (*known* terrorists). Now it appears ISIS (definitely a terrorist group) has also taken root there;
  - Then you have the Houthis, who the Saudis consider to be terrorists, and they are waging a full war against them in Yemen;
  - Then we have the terrorists in Libya, who are being bombed by the Egyptians; and
  - Finally, we have President Trump, who wants to wipe out all terrorists off the face of the earth.
- Since the Qatar blockade is well beyond the GCC’s political ambit, the outcome of the issue will be determined outside the GCC.

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<sup>5</sup> President Trump’s campaign comment that the US should have taken over Iraq’s oil reserves in 2003, cannot be lost to the Qataris.

## Impact on Pakistan

The most immediate impact of the Qatar blockade will be on inward remittances. If the blockade morphs into a regional stalemate (and positions harden on both sides), economic activity in the entire GCC is likely to suffer, which in turn will negatively impact Pakistan's BoP via the inflow of worker remittances. In our view, the Saudi gamble will surely slow the pace of economic reforms and growth in the entire region, while the economic isolation of Qatar will not allow Pakistan to maintain its workers in the country. However, we do not see either the Saudis or the Qataris specifically targeting Pakistan, which would surely have been the case if Pakistan had taken sides in the standoff.

Pakistan will, however, be impacted by the economic wellbeing of the UAE, specifically Dubai. It is a known fact that Dubai is a destination of choice for many Pakistanis to place their wealth, as a place to reside and the large number of professional Pakistanis based in Dubai. If the exit of Qatari investment from the UAE triggers a real estate scare in Dubai, or if the frontline status the UAE has taken in the standoff, draws Dubai into the ambit of regional terrorist activities, the repercussions for expat Pakistanis in the UAE could be quite significant. Although this would dampen Pakistani affinity towards Dubai, it could trigger reverse capital flight into the country, which would help our external sector.

## Conclusion

What is playing out in the Gulf is perhaps more significant than most people realize. At stake is how the Arabian Peninsula will evolve in the near future. Our argument is based on a set of hypothetical developments, which suggest that while the Qatar blockade may have been triggered by differences in how the Arab Spring was perceived in the GCC, the repercussions of this standoff could change how the region interacts internally, and externally.

The manner in which the Qatar blockade was implemented, and the rhetoric used against Qatar, implies that it is facing an existential threat. President Trump's tweets are raw and provocative, and add to the prevailing uncertainty. Global opinion on the blockade is hard to gauge at this point, but prominent journalists have spoken out harshly about the double standards that Saudi has adopted to criticize Qatar's actions. Furthermore, the following factors don't help the alliance's cause:

1. The Qatar blockade has stopped the inflow of food, which reveals a degree of callousness.
  2. The UAE and Bahrain governments have threatened to jail residents for sympathetic social media comments regarding the plight of the people living in Qatar. This cannot help.
  3. President Trump's unpopularity, and his supportive tweets about this blockade, will further sway global opinion against the alliance. And,
  4. The rag-tag Saudi-Emirati alliance is also an issue. For the Maldives, Mauritania, Senegal and Djibouti to target Qatar for its alleged support for terrorist groups, comes across as returning a favor.
- Despite the selectivity with which CNN and BBC are covering the Qatar blockade (i.e., focus on political negotiations, and not the social disruption created by the shortage of food, or how internet-using GCC residents are being intimidated), the print media and internet are highlighting the issue more comprehensively, and in the process, painting the Saudi alliance in a negative light.

With this backdrop, and domestic pride in its foreign policy, the Qatari government may feel it is best to weather out the blockade, rather than conceding to Saudi demands. If Qatar is able to hold up, it will improve its global standing as a small country that refused to be bullied by larger neighbors.

The other key factor that is changing the tone of the relationship between Saudi and Qatar, is the high-level discussions between Iran and Turkey about the fate of Qatar, and their sympathy for its plight. This itself is revealing, as Turkey and Iran are on opposing sides in the Syrian conflict. Turkey has stepped in to fly food into Qatar, which means that Qatar has an alternative route for its survival. With Turkey and Iran united in their concerns about Kurdish separatists (which pits them against US interests), and the growing spread of ISIS, both countries have an interest in weakening KSA. They could also view an extended Qatar blockade as being to their advantage – they may calculate that Saudi's poor global image, dwindling financial resources, suppression of Saudi Shias, the expensive/unpopular war in Yemen, and the comfort they take from President Trump, are key factors that could weaken the Kingdom.

As the multipolar coalitions fall into place, several things could happen: (1) Qatar could announce its decision to withdraw from the GCC; (2) Turkey could withdraw from NATO (for its own reasons); (3) Turkey could also enter into a strategic partnership with Iran; and (4) Qatar's growing trade ties with Turkey and Iran, could evolve into a security arrangement to deter a possible invasion.<sup>6</sup> If these things happen, Qatar will have to tell the US Centcom to surrender its base and leave Qatar.<sup>7</sup>

Although this will be strongly opposed by the US (as well as Saudi Arabia and Israel), it could become a very public standoff (thanks to a tweeting Trump) where global opinion could influence the closed-door negotiations about the fate of Centcom. Rival global players have always had reservations about US military bases overseas; what is different now, is global awareness (and interest) in the issue, and a US electorate (not the establishment) that may be willing to concede ground to rival powers, in return for greater focus on the continental US.

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<sup>6</sup> Many would argue that only after the Iranian Revolution, did the US start focusing on Saudi Arabia; some claim that the US decision to anchor its military presence in Qatar, is linked to its gas reserves, as well as a check against Iran. There is a chance that the leadership in Saudi Arabia and the US will contemplate a military invasion of Qatar (under some false pretext), which the Qataris are aware of. While this may force Qatar to capitulate and tow the Saudi line, it could also push Qatar to seek a security agreement with Iran and Turkey, perhaps with the support of Russia (and, implicitly, China).

<sup>7</sup> This scenario may seem too fantastic to contemplate. However, since regional players are now involved in this standoff (and positions have hardened), Trump's misguided leadership has created an opportunity whereby US surrogates have perhaps pushed the issue to a point of no return. As things stand, Qatar does feel threatened, and both Turkey and Iran (with subtle support from Russia), provides an alternative bulwark for regional stability in the Middle East. This gives regional players an opportunity to force the US into pulling back its military presence in the Middle East.