

GCC NEW PARADIGM

Mattia TOMBA

Simona Azzali

Working Paper

**Middle East Institute
National University of Singapore**

June 2018

Introduction

On June 5th 2017 Saudi Arabia, United Arab Emirates, Bahrain and Egypt (the “Quartet”) cut their relations with Qatar. The Quartet decided to withdraw their ambassadors and impose a travel and trade ban. This has caught Qatar by surprise, which did not expect such drastic steps to be taken. Due to the Quartet actions the financial outflows and the costs have been massive for Qatar, but the system can absorb great shocks because of accumulated reserves and the income from the export of gas. The financial burden is nevertheless hitting the state hard, and it will be more and more difficult to sustain the current level of expenditure. So far Qatar has managed to adjust to the new reality mainly thanks to the financial reserves accumulated in the last two decades, the use of networks and an effective PR/lobbying campaign.

The Context

In the last two decades Qatar has been able to develop policies independently from the rest of the GCC. This is because Qatar has a small population, negligible minorities and a centralized state that allows to avoid any ethno-religious tensions affecting some of the neighboring countries. More importantly, massive gas reserves give the country financial strength and the ability to project power. Qatar is the only gas player in the region since its neighbors export mainly oil. Doha’s independent foreign policy includes support of Islamists groups in the region as well as a pragmatic relationship with Iran with whom it shares the biggest gas field in the world. All this runs counter to Saudi Arabia and the UAE’s policy of zero tolerance towards political Islam since the “Arab Spring” started. Additionally, as Qatar is geographically located between Saudi Arabia and Iran, it needs to play a balancing act between them. On the other hand, Saudi Arabia wants to limit the Iranian influence in the region. As such, the Saudis need the GCC to be united to counter the rising influence of Iran, hence they want Qatar to be in line.

So the question is, why has this happened? Qatar has not done anything out of the ordinary to suddenly provoke this situation but previous attempts to pressure Doha have failed. Saudi and the UAE arrived at a saturation point where they could no longer tolerate Qatar’s “behavior” any longer. They also felt support in the current US administration, thus the only solution left was to escalate matters.

Economic and Financial Impact of the Sanctions

There are three main channels through which the sanctions imposed by the Quartet affects Qatar: trade disruptions, lower confidence and tighter financial conditions.

Trade Disruption

In terms of trade, closing borders and connections with Saudi and the UAE had a negative impact on Qatar since roughly 13% of imports to Qatar was coming from Saudi Arabia and the UAE and circa 7% of Qatar’s exports was going to UAE. More importantly, Jebel Ali (UAE) is the trans-shipment hub of the region. Thus, with products being shipped there before distribution across the gulf, the ban forced Qatari distributors to find new shipping routes to import products. The Qatari government acted with immediacy in finding alternative food suppliers from Turkey, Iran and some European countries from the start of the crisis. Qatari distributors have also found new suppliers from other countries in Europe and Asia. The Qatari government partially covered the additional costs of importing items and in some cases contained food price hikes by demanding state-owned distributors not to increase prices, thereby avoiding high inflation in the system.

Lower confidence

The prolonged diplomatic rift has caused a reduction in confidence and a higher risk perception among foreign investors. This could lead to a reduction of investment in the country which comes at a delicate time on the lead up to preparations for the 2022 World Cup. Furthermore, the Qatari government has been obliged to cut many infrastructure and development projects. This will also affect the long-term diversification plans to position the country as a hub for air traffic, tourism, medical services, education, and sports.

Apart from the current sanctions that limits business between Qatar and the Quartet, the crisis has also created an informal boycott where people and companies of one side, i.e. Qatar or the Quartet, tend to boycott products and companies that belong to or have relationships with the other side, hence limiting business opportunities both for local and foreign companies. The result is a decrease of trade and investment in the region.

Tighter financial conditions

The ban caused an initial massive outflow of liquidity, but the impact on banks' balance sheets was mitigated by liquidity injections from the Qatar Central Bank and increased public sector deposits. The sovereign fund played a key role in stabilizing the liquidity and covering increased state expenses.

Logistics

Logistics remains the main problem. Importing goods via sea or land from Saudi Arabia and the UAE is obviously much cheaper than importing by air or longer routes. Jebel Ali in the UAE is the transshipment hub of the region and many products are shipped there before distribution across the Gulf. The Quartet ban has thus forced Qatari distributors to find new shipping routes to import products. An alternative route is via Oman or via Kuwait, but this require longer delivery times and higher costs. For example, goods can arrive to Qatar via sea to Sohar in Oman and then via air to Doha. While the routes via Oman and Kuwait take a few days longer, the unexpected volume of goods to be handled in Kuwait and Oman has caused serious delays, sometimes up to weeks. Qatari companies have been hit twice: (1) the cost of shipping via the new routes is higher; and (2) the delay means a higher working capital that causes an additional financing cost at a time of scarce liquidity in the domestic market.

Consequently, Qatar was forced to speed up operations at the new Doha port. The port authorities have been signing agreements with ports in different parts of the world to establish direct shipping connections to Europe and Asia. An agreement has also been signed between Qatar, Iran and Turkey whereby goods can move via sea between Qatar and Iran and via land between Iran and Turkey. Another agreement was signed with Oman to have a direct air link between Sohar port in Oman and Doha. Qatar is also financing the development of Sohar port in Oman. Sohar is strategically located outside the Strait of Hormuz. Hence, it has a better location than Jebel Ali. While Jebel Ali currently has much better infrastructure and connectivity, Sohar's expansion could over time potentially take over part of the business from Jebel Ali due to its better geographic location.

Energy

There are no sanctions on the Qatari energy sector. The UAE imports 30% of its gas needs from Qatar via a sub-sea pipeline known as the Dolphin project. Qatar has not retaliated by cutting supply while UAE has kept buying from Qatar for its gas supplies. Qatar has a strategic interest in maintaining a constant flow of gas to its clients located mainly in Asia and maintains a strong position in the market. These clients – Japan, South Korea, China and Taiwan -

represent the biggest buyers of LNG in the world and they are critical to providing income to Qatar. However, none of these buyers can provide the security that Qatar craves. In any case, neither Saudi Arabia nor the UAE is keen to bring Qatar's gas exports to a complete halt. Exxon, Chevron, Total and Shell are all involved in the energy industry in Qatar, which represents an important part of their global gas liquefaction capacity. KSA/UAE are well aware of that and they know that imposing sanctions on Qatar LNG exports would trigger retaliation by the US, Europe and Asia. Thus, the energy exports of Qatar, which are the main source of Qatari income, have not been and will not be affected. They will be affected by changes in the gas market and not by the sanctions.

Many countries are trying to lower their carbon profile and gas is less polluting than oil or coal. While this increases the demand for gas, exploitation of existing gas fields and new gas fields are likely to keep gas prices low in the long term. Gas is also competing with renewable energies which are the fastest growing sources of energy.

Qatar had previously imposed a moratorium on the development of new gas fields to keep prices high. However, in April 2017, Qatar removed its moratorium and announced its intent to increase gas production capacity, thus sending a strong message to the market. This is a two-fold strategy based on Qatar's huge and low-cost resources and the knowledge that for many other players the costs are much higher. Qatar's current and future investments, particularly in its north field, will ensure Qatar's readiness with new LNG production quickly coming on-stream when the market improves. Higher Qatari supply and the consequent price pressure will serve to dissuade rivals from developing higher cost gas fields. However, this also creates something of a dilemma for Qatar. Higher supply and lower price expectations may lead to shorter contracts with much higher flexibility in price. A situation that favours the buyers. Shorter contracts and lower prices will probably be the norm for the coming years. This will have implications for Qatar's long-term revenue stream.

Regional Realities

The gas reserves that Qatar relies upon are shared with Iran, who can also pressure Qatar. Currently Iran has limited access to technology and financing and therefore cannot exploit its share of reserves completely. However, it is in Qatar's strategic interest to minimally maintain a working relationship with Iran to continue exploiting the shared gas field. To create the political space it needs to survive, Doha needs to maintain good or at least stable relations with Iran; Doha's ability to accommodate KSA/UAE demands in this respect is limited. For the Saudis and Emiratis, it is clear that Qatar's foreign policy will not change unless its leadership changes. The list of thirteen demands had one purpose and that was to signal to the Qataris that no compromise would be accepted. Doha can expect little, if any, support from the other Gulf states. Bahrain is in the Quartet and Qatar cannot expect limited support from Kuwait despite always having sought to play the role of a neutral mediator. Iran is of concern to Kuwait as it fears that Tehran could easily exploit its 20% Shia minority. The one Gulf country that has been helpful to Qatar is Oman. To date, Muscat has helped Qatar bypass the Quartet's sanctions, benefitting in the process from the additional business coming from Doha since much of Qatar's trade and people movement is now re-routed via Oman. Oman has always sought to maintain good relationships with both Saudi Arabia and Iran. But Oman is one of the least wealthy Gulf states and the succession to the ill Sultan Qaboos is creating uncertainty. Meanwhile in the region Turkey supports Qatar because it allows Ankara to build a presence (including a military presence) in Qatar and offers a market for Turkish companies. Iran is happy to see the GCC divided and to boost its trade with Qatar.

The US Role

Qatar believes that US support is the key to its survival but there have been conflicting signals from the Trump Administration. The Trump administration, or at least the President personally, does not consider the Qatar crisis as a priority that needs to be resolved quickly.

US interests in the Gulf are: (a) preserving its military assets in the region, (b) maintaining the flow of energy and (c) securing an alliance against Iran. Qatar, KSA and UAE all compete to attract US military assets in their countries. In addition, KSA and UAE have neither the inclination nor ability to stop Qatari energy exports, so this is not a major concern for US. Only Iran can potentially stop the flow of energy at the Strait of Hormuz.

KSA/UAE (and Israel) are part of the US alliance against Iran while, as previously argued, Qatar cannot afford to alienate Iran. This limits Doha's ability to influence the Trump administration, although Qatar is not entirely without assets in Washington DC. The US military bases in Qatar – which are vital for US military operations in the Middle East – are of great concern to the Pentagon. It will not be easy (and from the Pentagon's perspective, desirable) to quickly move the bases elsewhere. As long as the military bases remain, Doha can be assured of minimal support from the US against more extreme actions by the KSA/UAE. Furthermore, Qatar has ramped up its efforts to lobby members of the US Congress aimed at ensuring continuing US support and it is running an extensive PR campaign in the US and globally. In the meantime, the US has used the crisis to extract concessions from the GCC countries, an example being the recent deal to increase the transparency of Qatar Airways and Emirates finances, a win for the US aviation sector. The US has also taken the opportunity to increase arms sales to Qatar, UAE and KSA.

It is presently unclear how internal Washington dynamics will eventually work out. Given US unpredictability, the KSA/UAE may not be able to rely on its support forever. It may well suit President Trump to keep both the KSA/UAE and Qatar guessing as it keeps both sides dependent on the US and vying for Washington's favour.

Qatar International Efforts

Qatar's strategy has been twofold: reaching out to the big powers to gain support for its cause while strengthening its relationship with Turkey and Iran to gain additional levers at the economic, political and military level. Germany aside and to a certain extent Italy, none of the other European countries have been willing to press for a resolution to the dispute. Instead, many have capitalised on the situation to promote their business interests. Since the crisis began, arms deals have been announced with the US, the UK, France and Italy. Russia and China have also exploited the situation by selling arms to Qatar. For Qatar, domestically the intent is to demonstrate that the leadership takes its citizens' security seriously, to boost the reputation of the Emir and to bolster nationalist sentiment. Regionally, Qatar has sought to remind the Quartet that their actions have thus far not impacted Qatar's ties with the big powers and more importantly, Qatar can and will continue to pay for its security.

Qatar has also reached out to China. For its part, the Chinese have not just strengthened their energy, business and security ties with Qatar, but much like the US, retains its security and other links with Saudi Arabia and the UAE. Qatar remains a lucrative market for China's military hardware exports, something that China is keen to sell in a bid to balance its trade with Qatar. For China, as it shifts from coal to gas, it must secure a constant supply of gas while building higher strategic resource reserves. Thus, China will not only help Qatar in securing revenue, but could also provide access to financing. However, there are limits to what Beijing can do for Qatar. China is interested in securing its energy supplies from the Gulf and pushing for a trade increase with the Gulf. Ideally, it wants to achieve that without getting too involved in the dispute. Thus, it's unlikely that Beijing will make any move that upsets KSA/UAE.

Conclusion

So far Qatar has been successful not only in managing the financial, economic and logistical problems that the sanctions have created, but also in its public relations campaign. Qatar has definitely improved its position and generated international sympathy, also exposing some Saudi and UAE actions through leaks in the news. However, these successes can fade if Doha does not secure strong security guarantees, which at the moment can only be provided by the US. Neither the KSA nor the UAE are under pressure to end the sanctions. Qatar's strategy of supporting Islamists, Iran and Turkey, while maintaining close relationships with Europe and the US, has been in place since the rule of its previous Emir. Qatar seems determined to maintain this strategy which its present leadership sees as a matter of survival.

Qatar can hold out against the sanctions for years to come. The fact that it has not yet been forced to accede to demands has convinced some Qatari officials that survival is possible, even outside the (largely dead) GCC. The present Emir of Qatar is unlikely to change policy under pressure as doing so will make him appear weak and lead to challenges from other sections of the extended Royal family. The Qatari hope is that some support from the US and Europe, coupled with regional support from Turkey and Iran, can ensure long-term survival.

As things now stand, it would appear that the impasse will continue unless one side or another gives in, or internal changes occur in Qatar. However, Qatar's diminishing reserves, the high budget required to maintain self-sufficiency and a weak gas price, will limit and gradually degrade Qatar's ability to hold out.

Ironically the GCC was created after the Iranian Revolution to counter new security threats that the change of leadership of Iran created, whilst the current rise of Iran is contributing to call into question the integrity of the GCC. Even if ties are restored among Gulf countries, the escalation of events in 2017 has created wounds that are difficult to heal in the short-medium term. The GCC could become a less effective and more fragmented organization with bilateral relations, like Saudi-UAE and Qatar-Oman, becoming predominant versus the traditional consensus-building.

. . . .

References

<https://www.reuters.com/article/us-usa-qatar-airlines/qatar-agrees-to-financial-disclosures-in-spat-with-u-s-carriers-idUSKBN1FJ2NT>

<https://www.reuters.com/article/us-gulf-qatar-boeing/qatar-signs-12-billion-deal-to-buy-f-15-jets-from-u-s-idUSKBN19531Y>

<https://www.reuters.com/article/us-russia-qatar-military/qatar-russia-sign-agreements-on-air-defense-supplies-idUSKBN1CV11E>

<https://www.reuters.com/article/us-gulf-qatar-italy/qatar-seals-5-billion-euro-navy-vessels-deal-with-italy-idUSKBN1AI1VS>

<https://www.reuters.com/article/us-qatar-uk-military/qatar-to-buy-24-typhoon-jets-from-uks-bae-systems-idUSKCN1BS0UQ>

<https://www.reuters.com/article/us-france-qatar/french-defense-minister-hopeful-for-fighter-jets-armored-vehicle-sale-to-qatar-idUSKBN1DU0VQ>

<https://thediplomat.com/2017/12/qatar-parades-new-chinese-short-range-ballistic-missile-system/>

<http://foreignpolicy.com/2018/02/06/qatars-ramped-up-lobbying-efforts-find-success-in-washington/>

ABOUT THE AUTHORS

Mattia Tomba is a Senior Research Fellow at the Middle East Institute.

He is a multi-disciplinary investment professional with a track record of investments and acquisitions in different asset classes, sectors, and geographic areas. He has extensive experience in evaluating, negotiating, and structuring direct investments globally across all parts of the capital structure, in public and private markets.

Mattia previously worked for Qatar's sovereign wealth fund (Qatari Diar), where he managed an equity portfolio and worked on large private equity and real estate transactions worldwide. Prior to that, he was part of the Goldman Sachs Group and was involved in the portfolio management and strategic planning of large European real estate acquisitions.

Mattia began his career with the Private Wealth Management team of Merrill Lynch. He graduated from the Fletcher School at Tufts University (Boston) with a MA in International Affairs and from Bocconi University (Milan)/Science Po (Paris) with a BS in Business Administration.

Mattia also sits on the Advisory Council of the Centre for Sovereign Wealth and Global Capital at the Fletcher School (Tufts University).

Simona Azzali is a researcher in urban studies at the Dept. of Architecture, National University of Singapore. She holds a PhD in Urban Planning and Design from Qatar University/University College London and BSc and MSc degrees in Design from Politecnico di Milano. Her academic interests are primarily related to Doha and other cities in the Gulf region, sustainable urbanism, liveability and sustainability of open space, mega-events and their impact on the built environment, and urban regeneration. She has also been active in design consultancy since 2000.

.