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The Crisis in the Gulf: A Case Study of the Effectiveness of Sanctions as a Tool for Conducting Policy

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Since June 5, 2017, a number of Arab countries, led by Saudi Arabia, Egypt, the United Arab Emirates, and Bahrain, have been enforcing a diplomatic and economic boycott of Qatar. The boycott comprises an array of high-level demands placed on Qatar, which includes ceasing its support of the Muslim Brotherhood; cooling off relations with Iran; closing its state-owned Al-Jazeera network; and removing Turkish forces from the emirate. The disagreement between the countries is reflected in their different positions also regarding the events in Syria, Libya, and Tunisia. The expectation of the "Arab Quartet" was that Qatar would give in quickly. However, like many other countries that have faced economic sanctions, Qatar is also taking great efforts to show that severing relations and imposing sanctions are unlikely to cause significant damage to its economy.

With the world's highest per capita GDP in terms of purchasing power, a government debt that is under control, regular income from oil and liquefied natural gas exports, and hefty foreign currency reserves, there appears to be some logic behind the statements of Qatar's economic leadership that the country can contend with the sanctions. However, in addition to wanting to convey determination, these statements regarding Qatar's economic strength are directed at various financial parties, in order to prevent the flight of foreign capital from Qatari banks. The rapid withdrawal of foreign funds from Qatari banks, which in June forced the country's Central Bank to provide liquidity by eroding 30 percent of its international reserves, demonstrates that efforts to calm the market are succeeding only partially and that the crisis could indeed have a negative impact on the country's economy, as well as on the economies of other countries in the region.

The attempt to curb the capital flight and the decline in the value of the Qatari Riyal in trading outside of the country has led the Qatari leadership to deviate from its usual practice of being vague about the value of the capital held by the Qatar Investment Authority (QIA)

and to state explicitly that the $300 billion held by this fund will enable it to cope with the crisis.

The capital held by the QIA indeed provides Qatar with an extremely effective tool for ensuring liquidity for banks and guaranteeing, for some time, the reliability of the exchange-rate regime. Despite the decline in its reserves, Qatar's total reserves, minus its government debts, still exceeds its GDP. To deal with the fiscal challenges created by the drop in energy prices, Qatar has preferred to rely primarily on raising debt and is doing everything in its power to avoid using its foreign currency reserves. Therefore, liquefying the assets of the sovereign wealth fund is a measure that is inconsistent with the institutional economic strategies of the Qatari state.

The blockade of Qatar's land trade route with Saudi Arabia and its maritime and air trade routes is expected to contribute to a rise in prices. To minimize the impact of the blockade, Qatari leadership have presented trade figures that ostensibly indicate that the country's trade dependency on the four states boycotting Qatar is not very high. However, an observation not related to the make-up of the trade masked the fact that goods from Saudi Arabia, the United Arab Emirates, and other countries reach Qatar via Saudi Arabia, and they are the primary source of consumer products in the emirates.

The blockade against the transport of goods will require Qatar to find alternative sources of import and to change its current trade routes. According to Qatar, this will not be a difficult undertaking, as reflected in its quick increase in imports from other countries. The increase in imports from Turkey, which according to the Turkish media jumped from $36 million in May to $52 million in June, was in the background of the announcement by the Turkish minister of economy that Turkey sought to establish a trade route from its own territory to Qatar, via Iran, which would help reduce transportation costs. Despite Qatar's attempts to highlight the many alternatives offered by the global markets, its imports have decreased by 40 percent in comparison to the same month in 2016. It can be assumed that this steep decline will be mitigated somewhat after the difficulties arising from the change of partners and trade routes are overcome. In any event, the inflation figures released in July indicate that the sanctions have not caused a general rise in prices in Qatar, although food prices increased by more than 2 percent between May and June.

There is a basis to the assessment that Qatar can contend in the short term with the immediate challenges to its economy as posed by the crisis with its neighbors in the Gulf. As long as the sanctions do not harm energy exports, Qatar's primary and regular source of foreign currency is not expected to be affected. Qatar can also increase the flow of the gas it exports, and there is evidence that it intends to do so. However, such a measure would run counter to its plans to reduce the energy sector's role in the Qatari economy. The crisis

may also provide Qatar with an opportunity to seek out alternative markets as a source of needed products and to expand over time the scope of its own production. In addition, as part of its efforts to cope with the embargo, the emirate has decided for the first time to award permanent residency status to professional foreign workers (who will now be able to purchase land and set up businesses in the country without a Qatari partner) and to exempt citizens of eighty countries from needing to acquire a visa; these efforts have costs, however, which can be expected to impact the state's ambitious economic plans. If the blockade does, in fact, result in a steady price increase, the government might very well delay the removal of subsidies, which is a main component in the effort to reduce the government deficit. A rise in inflation is also liable to cause the government to suspend the introduction of a value-added tax, which is planned for member states of the Gulf Cooperation Council (GCC) at the beginning of 2018. In addition, the continued financial pressure could result in the downgrading of Qatar's credit rating, increased costs of government funding, and additional pressure on the Qatar banking system.

Qatar is paying an economic price for the embargo. However, Saudi Arabia is also paying a price—which is likely to increase—and it is not only an economic one. The image of Saudi power has been damaged by its limited ability, thus far, to enforce its authority on tiny (but recalcitrant) Qatar. In the meantime, its relations with major Muslim allies, most notably Pakistan, remain tense due to their "neutral" position in the crisis. Qatar's relations with Turkey have grown closer not only in the economic realm but also in terms of security, as reflected in recent Qatari-Turkish joint military maneuvers. Qatar's relations with Iran, the chief rival of the countries behind the boycott, have also strengthened. These changes in relations between the countries in question are liable to affect the map of alliances in the region for years to come. There is also evidence that banks and businesses in Saudi Arabia and the United Arab Emirates, which were connected to Qatar until the crisis, are suffering losses and exerting pressure on the governments to ease the restrictions. Commercial elements in these countries are also trying to continue sending goods to Qatar via third countries.

Sanctions are known to have the potential of becoming a double-edged sword. The fact that, in this case, the countries leading the economic pressure on Qatar are neighboring economies with similar attributes and have been planning similar structural reforms could make this a particularly relevant issue. The possible delay of the structural reforms—aimed at reducing government dependence on income from the energy sector—could signal to the markets that other members of the GCC do not intent to fulfil their commitment to implement the planned reforms, which are meant to contend with the sharp decline in oil revenuesThe crisis is also liable to impede the ambitious economic integration program, which includes, among other things, connecting the electricity, road, and train grids of the Gulf States—some of which have already gotten underway within the GCC—and to have

an impact on the economic situation in Qatar's neighboring countries. Since the establishment of the GCC in 1981, the organization's member states have come a long way in strengthening their economic integration. Accomplishments in this realm include the almost free flow of capital among the countries and joint investments in infrastructure, such as the Dolphin gas pipeline, which transports gas from Qatar southward to the United Arab Emirates and to Oman. Even at the height of the crisis, the gas never stopped flowing, illustrating the importance of the mutual dependence among the countries.

The crisis can be expected to impair Qatar's growth rate. However, if Qatar succeeds in mitigating the capital flight, the crisis apparently will not result in a severe long-term recession. As most of the costs incurred in retreating from integration in the GCC affect the longer term and will not create immediate pressure on the countries boycotting Qatar, it is reasonable to assume that they also will not play a central role in shaping the policy of these countries during the crisis. These assumptions, however, do not contradict the assertion that continuation of the crisis could have structural effects on the region's economy.