Anti-Qatar Embargo Grinds Toward Strategic Failure

Gabriel Collins, J.D., Baker Botts Fellow in Energy & Environmental Regulatory Affairs, Center for Energy Studies

“...The experience of the past thus clearly suggests that blockades or embargoes do not always produce the results originally sought when the decision for action was made.”
—Robert A. Doughty and Harold E. Raugh Jr., “Embargoes in Historical Perspective”

Centuries of history reveal a simple strategic truth: embargoes and blockades frequently fail to coerce states into making policy changes sought by the embargoing countries and often create unintended consequences. Embargoing Qatar was a risky decision without a clear endgame that does not appear to have taken into account the ample—and easily accessible—historical records of the many campaigns that have failed, as well as those that succeeded. The reality is that when the target of an embargo or blockade (1) has a small population, (2) is exquisitely well-resourced, (3) is not substantially dependent on the embargoing countries as trade partners for goods that cannot be obtained from other sources, (4) has access to seaborne commerce, and (5) has had significant time and warning to prepare for exactly such a contingency, the action against it will very likely fail to coerce it into making the concessions sought by the embargoers.

Even when the target is vulnerable—such as Saddam-era Iraq—economic embargoes generally take significant time to work. Research by sanctions experts before the first Gulf War suggests that embargoes aimed at achieving “ambitious” goals can take at least two years to succeed, and additional evidence accumulated since then does not undermine their basic conclusion. Many of the same countries embargoing Qatar are also blockading Yemen, and after more than two years they have still been unable to force a decisive strategic resolution, despite intensive use of military force. The evidence suggests that even an embargo lasting multiple years would likely still fail to coerce Qatar into making the concessions desired by the embargoing countries.

The list of 13 demands presented in June 2017 by the anti-Qatar coalition—Bahrain, Egypt, Saudi Arabia, and the United Arab Emirates (UAE), or “the Anti-Terror Quartet” (“the quartet”)—suggests a supremely ambitious set of goals behind the embargo, including “red lines” that touch directly upon Qatari sovereignty and that Doha will almost certainly reject. The stage is thus set for a contest of endurance, one that with every passing month looks more likely to result in favor of Qatar. The embargo and its slow-motion strategic failure have already unleashed consequences that will haunt the region for decades to come, and more effects will become clear as time rolls on.

This issue brief provides evidence of the anti-Qatar blockade’s trajectory from initial shock to emerging strategic failure using actual market data. It also discusses potential paths forward, and the economic and security ramifications of those options.
THE INITIAL SHOCK

A significant portion of the initial shock caused by the quartet’s embargo came through disruptions to Qatar’s food supply, most of which was imported and came by land from Saudi Arabia. These routes were immediately cut off when the embargo began and motivated drastic initial responses, including airlifting dairy cattle to replace milk supplies lost when the Saudis closed the border, as well as shipping food from Iran and Turkey.6

Qatar’s trade patterns bolster its embargo resistance. In 2016, slightly more than 15% of Qatari imports came from the blockading countries, a small enough share that building new trade networks to replace those lost imports in a fairly short time is a realistic possibility (Figure 1).

The “rapid rebuild” thesis is enhanced by the fact that much of what Qatar imports from its neighbors—food and basic material supplies—are highly fungible and can be procured from many other sources. Less easily replaceable goods—such as gas turbines and critical technology components for liquefied natural gas (LNG) liquefaction plants—are sourced outside the Gulf region and generally lie beyond the reach of the anti-Qatar coalition. Of equal importance, Qatar’s key LNG buyers lie outside the Gulf region, and those that can supply advanced technology goods—such Japan, China, and South Korea—all have compelling strategic interests in seeing Qatar remain a stable baseload global energy supplier.

QATAR’S RESPONSE

The embargo’s initial effects on both the personal and economy-wide levels were palpable. Worried residents crowded into grocery stores, while central bank reserves and foreign liquidity declined significantly as depositors from the quartet pulled funds from Qatari banks.7 The average value of properties sold spiked to a near-term high of more than 26 million Qatari riyals (QAR) in June 2017, perhaps reflecting a sellout by wealthy asset owners from Saudi Arabia, the UAE, and other states seeking to reduce or eliminate their real property holdings in Qatar (Figure 2).

New car registrations—a proxy for car sales—also declined sharply in the wake of the blockade, falling from 2.8 per 1,000 residents in May 2017 to 1.8 per 1,000 residents in June and 1.6 per 1,000 residents in July of the same year (Figure 3). These levels are the lowest seen in more than two years and indicate dented consumer confidence, since new vehicles are big-ticket items that often require a household to commit tens of thousands of dollars—a material portion of household disposable income, even in a wealthy society like Qatar’s. Vehicle sales had already been on a gradual downward trend prior to the blockade as the local car market matured and roads became saturated with traffic. Nonetheless, the sharp departure from trend after the embargo was imposed suggests that it has impacted consumer confidence, at least in the short-term.
Announcement of LNG Capacity Expansion

Since Qatar is the lowest-cost global LNG supplier, its July 2017 announcement that it would expand LNG export capacity to 100 million tonnes per year (up from 77 million) was largely a warning shot across the bow of competing exporters. But it also served other strategic purposes by (1) affirming the country’s systemic importance to global gas markets and (2) demonstrating that even in a low price environment, the country’s revenue generation potential would continue to be capable of underpinning its sovereignty and economic capacity to withstand exogenous financial pressures, including embargoes by neighboring powers.

To put the planned capacity expansion into a strategic perspective, consider the following: Qatar plans to expand LNG output by 23 million tonnes per year. At a sale price of $5 per million BTU and with each tonne of LNG containing 51.7 million BTU of energy, this would translate into nearly $6 billion per year in incremental revenue from gas alone. Condensate and natural gas liquids produced alongside the methane would likely add significant additional revenues, since these products are generally more valuable than natural gas on an energy content basis.

In 2016, Qatar imported about $5 billion in goods and services from the countries now embargoing it and exported roughly $5.6 billion of goods and services to them. This suggests in purely economic terms that the incremental revenue gains from the planned LNG capacity expansion could offset more than half of the combined loss of bilateral trade caused by the embargo. The offset effect is enhanced by the fact that a material portion of Qatar’s trade with the embargoing bloc comes through its gas sales to the UAE via the Dolphin Pipeline—the region’s first cross-border gas supply project, which can supply approximately 2 billion cubic feet of gas per day to the UAE. Future demand for Qatari gas could be reduced by domestic discoveries and alternative energy supplies, such as the 2,400 megawatt Hassyan coal power station now under construction in Dubai.
Furthermore, even without an increase in LNG exports, the “lost” trade volumes caused by the embargo do not just disappear. Rather, they are likely temporary disruptions that will be replaced over time as Qatar builds relationships with new trading partners.

MORE SIGNALS OF FAILURE: MARKETS BELIEVE COMMODITY PRICES POSE A MUCH GREATER RISK TO QATAR’S ECONOMY THAN THE EMBARGO

Financial markets recognize Qatar’s fundamentally strong position, and traders are pricing a future that sees Doha successfully resisting the embargo. Credit default swap prices for five-year Qatari sovereign debt (basically, insurance payments in case of default that serve as a proxy for economic stress) spiked in early July 2017 immediately after the embargo was imposed. The cost of insuring $10 million of five-year Qatari debt rose from an annualized rate of approximately $88,000 per year in June 2017 to a high of $125,200 per year in early July 2017. This cost has since fallen back to approximately $102,000 per year (101.89 basis points) (Figure 4).

Yet this upward bump pales in comparison to how markets priced default risk in the wake of the global oil price collapse in late 2008 and early 2009, when it cost as much as $381,000 per year (annualized) to insure $10 million in five-year debt against default. The historical context provided by the credit default swap (CDS) data—particularly when compared to other resource exporter countries such as Russia—reveals three important facts:

1. First and foremost, global investors do not view the Saudi-led embargo as an existential threat.
2. Sudden, sharp commodity price drops impact markets’ perception of Qatari credit-worthiness much more than trade warfare by regional actors.
3. Although default risk is generally inversely correlated with oil price movements in major exporters—even in the event of major commodity price declines—Qatar’s credit risk profile changes much less per dollar decline in oil prices than is the case for other major exporters such as Russia or Mexico.

The price spread between Qatar’s 10-year term treasury bonds and 10-year US Treasury bonds also reflects market perceptions of risk. And once again, this metric also supports the notion that crude oil and commodity prices to have a far stronger effect on Qatar’s international financial risk profile than adverse actions by its neighbors (Figure 5).

WHAT IT TAKES FOR AN EMBARGO TO WORK IN THE GULF REGION

The most recent successful use of economic warfare in the Gulf region was the US-led sanctions campaign that helped bring Iran to the nuclear negotiating table and ultimately culminated in the Joint Comprehensive Plan of Action signed in Vienna in July 2015.
The sanctions regime ultimately worked for three fundamental reasons:

1. The US and the EU—whose members are collectively a cornerstone market for Iranian oil—presented a united diplomatic front, and EU members agreed to embargo Iranian crude shipments.

2. Nearly all crude oil traded globally is priced in US dollars, which means that there must be a dollar-clearing function in order for transactions to occur. The “pecunia franca” status of the dollar gave the US enormous jurisdictional leverage and allowed it to cut off dollar-clearing transactions for Iranian oil that touched US soil.

3. The United States’ massive global financial heft—both from the size of its domestic market and its financial power projection through the omnipresence of the dollar in oil markets—allowed it to present buyers of Iranian crude oil and financial institutions that facilitated such transactions with a stark choice: either cease doing business with Iran, or face exclusion from the US and associated portions of the global financial architecture.¹²

Unlike the US, quartet members lack offensive global financial power projection capacity. The recent Saudi anti-corruption actions are prima facie evidence of this, as the Saudis had to apprehend the person first in order to capture the money. In contrast, the US can track, freeze, and interdict financial assets around the world with the alleged perpetrator in absentia. As such, Qatar’s opponents will likely find it extremely difficult to exert offensive financial pressure anywhere beyond the immediate geographic region.

A lack of extraterritorial reach may help explain a recent surge in quartet members’ lobbying activities in Washington, D.C., where successful influence over US legislation could effectively harness American power to serve their own narrow strategic goals.¹³ Some quartet lobbying efforts appear to be influencing certain legislators, as suggested by the text of House Resolution 2712, a.k.a. the “Palestinian International Terrorism Support Prevention Act of 2017.”¹⁴

Quartet lobbying efforts against Qatar are likely to fail. Chairman of the US Senate Committee on Foreign Relations Bob Corker is deeply critical of the quartet’s blockade of Qatar, noting that “when you live in glass houses, you shouldn’t throw stones,” and is unlikely to support Senate passage of House bills aimed at sanctioning Qatar.¹⁵ Sen. Corker has also publicly pledged to block further US arms sales to GCC countries until there is a clear diplomatic path to resolving the crisis.¹⁶ Finally, as with the blockade itself, time is not on the quartet’s side on Capitol Hill either, since additional time provides more opportunities for members of Congress to properly comprehend Doha’s strategic importance to US interests across the broader Middle East. The upside of all this is that despite the dogfight in Washington, Qatari assets and financial activities in Europe, Asia, Australia, and North America are likely safe—even if the quartet seeks to escalate its economic warfare campaign.

FIGURE 5 — SPREAD BETWEEN QATARI 10-YEAR BONDS AND 10-YEAR US TREASURY BONDS VS. BRENT CRUDE OIL PRICES

SOURCEES: Bloomberg, author’s own analysis
When embargoes prove ineffective, this forces the embargoing countries to either back off, maintain an ineffective campaign, or escalate, often using military force. Such an outcome can ultimately undermine the embargoing countries’ diplomatic influence. In the current case, rivalry between Arab neighbors has likely permanently damaged the GCC, creating a large set of strategic openings that Iran can exploit.

The chances of a negotiated settlement appear low for the foreseeable future. The blockade against Qatar is on the wrong end of powerful diplomatic and strategic dynamics and is likely to weaken as time progresses. Yet escalating pressure against Qatar also does not seem a realistic option, since moving the embargo from its current footing into a bona fide blockade backed by military force would likely trigger a strong reaction from Washington. The September 28 meeting between US Secretary of Defense James Mattis and Emir of Qatar Sheikh Tamim bin Hamad Al-Thani at the Al Udeid Air Base highlights Qatar’s strategic importance to American interests and also carries important symbolic weight, given Mattis’ apparent influence with President Donald Trump. Likewise, Al Udeid remains deeply enmeshed in the fabric of US air campaigns in the region, with video footage from November 2017 showing a B–52 bomber taking off from the base to bomb heroin production facilities in southern Afghanistan.

Financial markets recognize Qatar’s fundamentally strong position, and traders are pricing a future that sees Doha successfully resisting the embargo.

From this point, the embargo could remain in place for years and Qatar could very likely withstand the effects with decreasing impact each year as it increasingly emphasizes economic relationships outside the Gulf region. For instance, Qatar is net self–sufficient in steel production (including rebar critical for construction as it prepares for the 2022 World Cup). Likewise, the new Hamad Port—capable of storing enough cereal grains to satisfy multiple years of local consumption, able to handle more than 3.5 million 40–foot shipping containers per year, and able to accept 1.7 million tonnes per year in general cargo—is already replacing import trade that formerly came by land from Saudi Arabia and by sea from the UAE.

To the extent that incremental supplies of cement, certain steel products, and other goods may be needed for World Cup 2022 and other projects, seaborne supplies procured from India, Iran, and Turkey—among other potential partners—can very likely fill any gaps left by the cessation of land shipments from Qatar’s neighbors.

The embargo is now passing from the phase in which original motivations mattered into a new realm that is much more about hard, cold, long–term consequences. As the anti–Qatar coalition’s campaign grinds on, these consequences will begin to reveal themselves more fully.

We do not know how the embargo will culminate and precisely what the long–term consequences and ramifications will be. But past uses of economic warfare demonstrate a range of unpleasant and unanticipated surprises ranging from the loss of influence of a failed embargoe, to potential domestic political instability, to escalation as one or both sides seek to break out of a strategic stalemate. As the embargo continues, diplomatic and political relationships between many Arab countries will likely suffer further damage, and Iran’s relative influence in the region will likely rise as a result. The ultimate consequences of increased Iranian influence across the region remain debatable, but from the perspective of the countries embargoing Qatar as well as that of the United States, this is clearly an unintended consequence.
ENDNOTES


10. For reference, 100 basis points equal 1 percentage point. To demonstrate how basis points translate into dollar amounts when assessing credit default swap payments, 100 basis points or 1% of $10 million is $100,000.


14. The text of the bill can be found at https://www.congress.gov/115/bills/hr2712/BILLS-115hr2712ih.pdf.

As the embargo continues, diplomatic and political relationships between many Arab countries will likely suffer further damage, and Iran’s relative influence in the region will likely rise as a result.


17. Consider, for instance, the 2003 invasion of Iraq, which came after more than a decade of sanctions and an embargo maintained through multiple channels, including periodic military force, failed to coerce Saddam Hussein into renouncing Iraq’s weapons of mass destruction development programs.


19. See, for instance, “The BUFF Load And Go From Al Udeid Air Base,” https://www.youtube.com/watch?v=ICAGUVxJXGU.


ACKNOWLEDGEMENTS

The author thanks Nosa James for research assistance and support of this analysis, as well as two Middle East experts who offered commentary.

AUTHOR

Gabriel Collins, J.D., is the Baker Botts Fellow in Energy & Environmental Regulatory Affairs for the Baker Institute Center for Energy Studies. He was previously an associate attorney at Baker Hostetler, LLP, and is the co-founder of the China SignPost™ analysis portal. Collins has worked in government and as a private sector global commodity analyst and investment advisor, authoring more than 100 commodity analysis reports for both private clients and publications.