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December 22, 1975

To: Members of the Executive Board
From: The Secretary
Subject: Qatar - Staff Report for the 1975 Article VIII Consultation

Attached for consideration by the Executive Directors is the staff report for the 1975 Article VIII consultation with Qatar.

This subject will be brought to the agenda for discussion on a date to be announced.

Att: (1)

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Department Heads

INTERNATIONAL MONETARY FUND

QATAR

Staff Report for the 1975 Article VIII Consultation

Prepared by Staff Representatives for the 1975 Consultation with Qatar

Approved by A.K. El Selehdar and Subimal Mookerjee

December 19, 1975

I. Introduction

The 1975 Article VIII consultation discussions with Qatar were held in Doha during the period November 10-18, 1975. The Qatari representatives were senior officials of the Ministry of Finance and Petroleum, the Ministry of Economy and Trade, the Ministry of Labor and Social Affairs, and the Qatar Monetary Agency. The staff mission also had a meeting with the Minister of Finance and Petroleum. The mission was composed of Messrs. B. A. Karamali, R. C. Barth, and S. Kavar (all of the Middle Eastern Department), N. N. Choudhry (Fiscal Affairs Department), and Miss Helen Jenner (Secretary).

II. Recent Developments

The Qatari economy is characterized by strong dependence on oil revenue and expatriate labor, with income from oil royalties and taxes and government oil sales accounting for about 90 per cent of total government revenue in recent years and expatriate labor making up more than 80 per cent of the labor force. Qatar is a member of the Organization of Petroleum Exporting Countries (OPEC), but among OPEC members its production (about 518,000 barrels per day in 1974) exceeds only that of Gabon and Ecuador. The sharp rise in financial resources during recent years has enabled the authorities to accelerate spending on social welfare and economic development programs and provide aid to friendly countries.

After rising continuously in the ten-year period ended 1973, crude oil production in Qatar declined by 9 per cent in 1974, and the decline accelerated in the first ten months of 1975 with production falling more than 21 per cent below the comparable period of 1974. Whereas the 1974 reduction occurred primarily because of a conscious policy of conservation adopted by the authorities in view of the country's relatively small oil reserves and also the limited absorptive capacity of the domestic economy, the decline in 1975 stemmed from a dispute between the Government and its foreign partners in the operating companies concerning prices.

Notwithstanding the decline in oil production and exports, government oil receipts are estimated to have quadrupled between 1973 and 1974^{1/} with actual cash receipts rising to about QR 6.8 billion^{2/} (constituting more than 96 per cent of total receipts). The increase resulted from changes in posted prices and royalty and tax rates in the course of the year, and from the increase in the Government's ownership share (to 60 per cent) in the two operating companies^{3/} effective January 1, 1974. The growth in total expenditures in 1974 did not match the large increase in total receipts, and the government budget recorded an overall surplus in excess of QR 4.0 billion. Current expenditures increased by more than 50 per cent in 1974, to a level of QR 1.6 billion, reflecting mainly increases in administrative expenditures and aid to foreign countries, while capital expenditures rose by 170 per cent, to QR 0.7 billion, reflecting increased outlays on infrastructure and public utilities.

The growth in overall demand during 1974 appears to have outstripped the increase in the availability of real resources to the Qatari economy, and evidence of that is provided by the reported sharp increases in domestic prices and wages. While the rise in government domestic expenditures has provided the major expansionary stimulus, the resultant boom in trade and construction activity has been accompanied by a rapid expansion in bank credit to the private sector. Money and quasi-money rose by 35 per cent in 1974, compared to 17 per cent in 1973. The Qatari economy which relies heavily on imports of foreign labor and goods to satisfy its domestic requirements experienced growing pressure on resources as a result of physical bottlenecks which hampered the inflow of goods, and the general tightening up of the labor market in neighboring Arab countries; price increases in 1974 were in excess of 25 per cent.

As oil sector earnings are channeled into the economy principally through the government budget and as Qatar is heavily dependent on imports, the country's external accounts closely mirror the fiscal position. The sharp rise in petroleum prices in 1974 more than tripled Qatar's earnings from oil exports and resulted in a current account surplus in excess of SDR 1.3 billion. More than 13 per cent of the surplus was absorbed in official aid and lending to less developed countries while 20 per cent was used in other lending and direct investment and about 48 per cent was added to monetary reserves. The remaining element of the surplus consisted largely of errors and omissions presumably resulting from unrecorded defense and oil company imports.

1/ This calendar year comparison is only approximate since the Qatari fiscal year follows the Moslem (Hijri) calendar which is 11-12 days shorter than the Gregorian calendar year. The above reference is based on a comparison of the fiscal years 1393 and 1394 which span the periods February 5, 1973 to January 24, 1974, and January 25, 1974 to January 14, 1975, respectively.

2/ QR 4.76190 = SDR 1.00.

3/ The companies are the Qatar Petroleum Company (QPC) and the Shell Company of Qatar (Shell).

Qatar does not in effect maintain exchange restrictions on current or capital transactions. The import regime is liberal and duties are maintained at very low levels; with few exceptions, there are no licensing requirements on imports or restrictions as to country of origin.

III. Economic Policies and Prospects

1. The oil sector

The decline of production and exports in 1975 resulted from disagreements between the Government and its foreign partners in the operating oil companies regarding the pricing of Qatari crudes. The problem first arose in early 1975 following the reduction in prices in neighboring Abu Dhabi. This caused QPC's foreign partners to seek similar reductions in Qatar under the terms of their buy-back agreement;^{1/} in May, the foreign partner in Shell also requested renegotiation of its agreement. As the negotiations between the Government and its foreign partners reached an impasse, the buy-back agreements were voided, and the production decline accelerated around the middle of the year when both agreements were no longer operative.

Following the OPEC price change effected on October 1, 1975, new buy-back agreements have been reached between the Government of Qatar and its foreign partners in the operating companies. The prices of Qatari crudes have been realigned to eliminate the competitive disadvantage that existed during the first nine months of 1975, and production is expected to increase substantially during the last quarter of the year. It is expected that the average production rate for 1975 will be about 430,000 barrels per day, some 17 per cent below the previous year's rate. On the basis of crude petroleum exports for the first ten months of 1975 and assuming a higher rate of production for the last two months of the year, the staff estimates that the Government's oil revenue for the 1975 calendar year will amount to about QR 6.4 billion (about QR 6.5 billion on an accrual basis), a decline of 9 per cent compared with the preceding year.

As regards the production outlook for 1976, the authorities have reduced QPC and Shell's allowable production by 50,000 barrels per day. The cutback will, however be partly offset by the recent commencement of production from a new offshore field owned jointly by Qatar and Abu Dhabi; Qatar's share from that field's output is expected to average about 10,000-15,000 barrels per day in 1976. Accordingly, assuming no weakening in the demand for Qatari crudes, average daily exports in 1976 are expected to be in the neighborhood of 475,000 barrels per day. Assuming realization of the export projections and the present level of prices to prevail throughout 1976, the staff projects government revenues from oil exports in 1976 at about QR 7.8 billion.

^{1/} This agreement, commonly employed by many oil exporting countries in the Gulf, obligated the foreign partners to purchase back a certain quantity of the Government's share of QPC's production: For more details on the operation of these agreements, see Chapter I of the Recent Economic Developments paper (to be issued shortly).

The Qatari authorities plan to commission an official survey of the country's oil reserves, the findings of which will form the basis of a long-term production policy. As for pricing of Qatari crudes, the Government has generally followed OPEC's decisions on prices. Qatar remains intent on taking over full ownership of the operating companies, but no time frame is envisioned for that action and the authorities are exploring avenues that would allow the retention of some role for the foreign partners in order to keep them interested in efficient production and more exploration.

2. The domestic economy

a. Fiscal developments and policy

In Qatar decisions on budget expenditures constitute the principal government economic policy instrument. Although government expenditures have risen sharply in recent years, revenues have increased at a faster pace with the result that progressively larger budget surpluses have been realized. Between 1972 and 1974 current expenditures increased by more than 125 per cent while capital expenditures almost trebled; on the other hand, revenues went up by almost 500 per cent. The prospects for 1975, however, are for a reduction in the budget surplus to QR 2.5 billion from QR 4.0 billion in 1974 due to the decline in government oil receipts and the increase in overall spending. Current and capital expenditures are likely to increase by 60 per cent and 40 per cent, respectively, in 1975. A striking feature of Qatar's fiscal performance in the last two years is the growing volume of financial assistance to various Arab and Islamic countries; in 1974 such grants and loans amounted to more than 12 per cent of oil revenues and are projected to increase to about 28 per cent of oil revenues in 1975.

At the time of the mission's visit, the 1976 budget was still in the preparatory stage. While revenues are tentatively projected at about QR 8.0 billion (an increase of 25 per cent over the 1975 level), no magnitudes had yet been assigned for expenditures. A spurt in current and capital expenditures, however, is expected mainly reflecting outlays for infrastructure and for a number of government-sponsored industrial projects which were launched in 1975 and are being financed from the budget. These projects, which are capital-intensive and export-oriented, include a natural gas liquids project using associated offshore gas, a petrochemical project to produce ethylene and polyethylene, and a steel plant. Qatar has no formal development apparatus but the Government has taken the lead in launching these large industrial projects. The Government's policy is to assume a 70 per cent share with foreign partners in joint ventures and to sell a limited percentage of its share to private Qatari investors after the completion of the project. As for small-scale industry and trade, the Government encourages the private sector on an ad hoc individual project basis by providing grants, low-interest construction loans and exemption from customs duties.

b. Monetary and credit developments

Domestic liquidity as measured by money plus quasi-money increased by 40 per cent in the first nine months of 1975 as compared with the rise of 37 per cent in the corresponding period of 1974. The high rate of monetary expansion in recent years reflects the expansionary impact of government expenditures and the substantial increase in credit to the private sector. While a breakdown of private sector credit was not available, indications are that the bulk of it was being used to finance imports, construction and speculative land activity.

The Qatar Monetary Agency (QMA) continues to be seriously handicapped by shortages of staff and the lack of office space, and has yet to assume the full range of responsibilities and powers assigned to it by the legislation which set it up in 1973. In view of the development of the banking system and the rapid expansion in monetary and credit aggregates in recent years, the mission stressed the need for the QMA to play an active role in the surveillance of commercial banking operations. The mission also emphasized the importance of a more comprehensive and timely collection of monetary and banking statistics. The Qatari authorities were hopeful that with the planned increase in the size of the QMA's staff and the move into the new quarters currently under construction, the Agency would be able to expand its operations by early 1976. There were 12 commercial banks operating in the country and the authorities did not envisage any further expansion of the banking system in the near future.

c. Wages and prices

Since the Qatari economy relies heavily on inflows of foreign labor and goods, any expansion of domestic activity requires a concomitant expansion of immigrant labor and imported goods. The continued sharp growth in overall domestic expenditures in 1975 coupled with similar developments in neighboring countries precluded a smoother adjustment in the availability of manpower and goods. Accordingly, shortages of both skilled and unskilled labor as well as certain goods appear to have accentuated. In view of the limited port capacity, the waiting period for offloading ships reportedly lengthened from 8 days in 1974 to about 50 days in 1975. The annual rate of inflation during these two years is estimated at between 25-35 per cent reflecting the rise in world prices, higher freight rates, domestic supply bottlenecks and strong internal demand. The Government has taken measures to expand the inflow of labor and goods. An agreement has been concluded with Egypt to facilitate the immigration of Egyptian skilled and unskilled labor, and two new berths are being added to the Umm Said industrial terminal to be used for relieving the congestion of the main harbor in the capital, Doha. As for alleviating the impact of cost of living increases, the Government had granted general pay increases ranging from 10-30 per cent in early 1975 and was subsidizing a number of essential commodities including rice, sugar, wheat, ghee and meat. Rent controls were also instituted in 1974 and electricity and water were being provided at low rates.

3. The external sector

a. Balance of payments prospects and policies

A persistent current account surplus has been a feature of Qatar's external accounts in recent years. Current and prospective developments indicate that while this surplus can be expected to decline from the 1974 high level, it will remain sizable for some time. The value of oil exports will decline in 1975 to about SDR 1.4 billion on account of the decline in the volume of exports, the recent increase in export prices (effective October 1, 1975) being too small to offset the contraction in volume. Oil exports are projected to increase in 1976 to about SDR 1.8 billion. Imports which grew by 37 per cent in 1974 are projected to more than double in 1975 to about SDR 0.4 billion on the basis of

provisional data from the trading partners. The launching of several large capital-intensive projects in 1975 will contribute to a further enlargement of the inflow of goods in 1976 and 1977, but the growth of normal consumption imports will be constrained over the near term by the small population base and the present bottlenecks in the import channels. The services and private transfers account which has been persistently negative in recent years will continue to be so but the growth in the account will be limited as the increase in the major outflows namely oil company profit transfers and remittances by foreign workers will be partially offset by increases in earnings from Qatar's growing foreign assets.

The net current account surplus is projected at about SDR 1.0 billion in each of 1975 and 1976. About one third of the surplus in each year is expected to be utilized for grants and loans to less developed countries (mainly Arab and Islamic). Nearly 50 per cent of the surplus would again be channeled to investment and reserve asset acquisitions in the developed countries. The residual will mainly be accounted for by unreported inflows of defense purchases and oil company materials, which are reflected in the errors and omissions item.

b. Reserve policy

The strategy underlying the Qatari Government's choice of foreign asset holdings has been one of asset diversification and the spreading of exchange risks. Assets are held in a number of foreign countries and holdings range from gold to short-term bank deposits, bonds, equities, and real estate. Bond holdings range from the short-duration variety to the medium-term ones, none being of more than ten years' maturity, and all are either direct-government or government-guaranteed obligations. About 55 per cent of the Government's foreign assets in 1974 were held in bonds and equities while about 40 per cent were in the form of foreign currency deposits with banks in the major European financial centers. Shifts in the composition of holdings are generally effected through new investments or by very gradual small sales so as not to affect security prices or exchange rates. Net foreign monetary assets of the Government and the banking system, which amounted to about SDR 1.0 billion at the end of 1974, are projected to increase by about SDR 0.3 billion in 1975.

c. The exchange system

Since March 19, 1975, the exchange rate for the Qatar riyal has been linked to the SDR on the basis of its par value, corresponding to QR 4.76190 per SDR. Qatar's intervention currency is the pound sterling. From March 19, 1975 to October 18, 1975, the QMA established a daily middle rate which corresponded exactly to the SDR/sterling rate communicated by the Fund. Since October 18, 1975, the QMA has set the daily middle rate for the riyal at approximately the upper boundary of the 2½ per cent margin. The Qatari representatives explained that this effective revaluation relative to the pound sterling was in response to the recent appreciation of the U.S. dollar relative to the SDR and in order not to depreciate the Qatar riyal relative to the Bahraini dinar and the U.A.E. dirham which had remained pegged to the dollar at the time Qatar changed the link of the riyal from the dollar to the

SDR. The mission brought to the Qatari representatives' attention the fact that on several days after October 18, 1975 the QR/sterling selling rate was in excess of the 2½ per cent upper margin. The Qatari representatives assured the mission that in fixing the rates henceforth they would ensure that the buying and selling rates remained within the applicable margins.

IV. Staff Appraisal

The economy of Qatar has benefited greatly from the increased availability of financial resources brought about by the growing volume of exports of petroleum up to 1973 and the higher prices since then. Since the late 1960s the Government has sought to broaden the country's economic base by establishing a number of industrial projects and by encouraging agricultural and fishing activity, but the level of economic activity remains crucially dependent on the revenue from exports of crude petroleum. The increase in government revenues has made it possible to expand government spending on social welfare programs and for economic development, provide increasing amounts of financial assistance to other countries, and accumulate foreign assets.

The increased injection of oil export receipts into the domestic income stream by the Government and the accompanying boom in private sector activity appear to have strained supply capabilities as strong inflationary pressures developed in both 1974 and 1975. The Qatari economy is heavily dependent on external sources for its domestic consumption and investment needs and for the supply of skilled and unskilled manpower. Despite the absence of financial constraints, the flow of goods and services encountered various physical bottlenecks and the strong internal demand led to the buildup of inflationary pressures. The Qatari economy still lacks much of the required modern infrastructure and additional expenditure is required to improve and expand the communications network, the power generation system, the water desalinization plants, as well as for providing the educational, health, and housing facilities for the indigenous and immigrant population. Moreover, the Government's efforts to diversify the production structure and reduce the dependence on petroleum extraction activity will require major expenditures which will add to the strains on the internal distribution system and the labor market.

The problem facing the Qatari authorities is how to balance the pressures of increased aggregate demand with the resource availabilities, without subjecting the economy to inordinate inflationary pressures. Tackling the problem mainly from the supply side requires efforts to ease the physical inflow of goods as well as expanding domestic production capabilities in the agricultural and industrial sectors. While Qatar's limited resource base, manpower constraints, and the small size of its market would appear to preclude the development of import-competing industries and necessitate concentration on petroleum and gas-related projects, it may be advisable at least to develop some capacity in respect of building materials and some small-scale industries. Also, increased emphasis would have to be placed on domestic vocational training in order to increase the utilization of the domestic population, reduce the reliance on foreign labor and diminish the possibilities of future social

tensions. Tackling the problem from the demand side would require financial adjustment rather than physical adjustments, but this is complicated in the case of Qatar by the deficiencies in the institutional controls. Efficient management of the growth of public sector spending would require the formation of a coordinating body within the Government to establish expenditure priorities and oversee implementation of programs and projects. Currently, the government apparatus is hampered by shortages of senior staff inasmuch as government activities have expanded in too short a period without the accompanying organizational adjustment. Controlling private demand obviously requires the active role of a properly functioning central bank and its absence is a notable shortcoming at present.

Fund Relations with Qatar

Qatar became a member of the Fund on September 8, 1972 with a quota of SDR 20 million, of which SDR 5 million was paid in gold. The national currency, the Qatar riyal (QR), was issued by the Qatar Monetary Agency beginning on May 19, 1973 with a gold value equivalent to 0.186621 gram of fine gold. It replaced the Qatar/Dubai riyal which had been issued in 1966 with an equivalent gold content. An initial par value for the riyal of 0.186621 gram of fine gold per QR 1 (or SDR 1 = QR 4.76190) was established on June 14, 1973. At the same time Qatar availed itself of wider margins. On June 4, 1973, Qatar formally accepted the obligations of Article VIII, Sections 2, 3 and 4 of the Fund Agreement. In March 1975 Qatar discontinued the peg of its currency to the U.S. dollar and linked the riyal to the SDR at the rate of 4.76190 riyals per SDR, using the pound sterling as intervention currency through the establishment of daily buying and selling rates. Qatar is not a participant in the Special Drawing Account and has not made use of the Fund's resources but the riyal is used in Fund transactions with operations carried out, and holdings valued, on the basis of a representative rate for the riyal. As of November 30, 1975, the equivalent of SDR 8.0 million had been used in Fund transactions and the Fund's holdings of riyals amounted to 34.7 per cent of quota.

Qatar - Basic Data

Area and population

Area	4,000 square miles
Population	180,000 (1973 estimate)
Per capita GNP	SDR 2,556 (1973 estimate)

IMF data

Date of IMF membership	September 8, 1972
Currency	Qatar riyal (QR)
Par value	0.186221 gram of fine gold corresponding to SDR 0.21
Quota	SDR 20 million
Special Drawing Account	Qatar is not a participant
Fund holdings of Qatar riyals (11/30/75)	34.7 per cent of quota

	1971	1972	1973	1974	Forecast 1975
<u>Petroleum sector</u>					
Crude oil production (million barrels)	156.6	176.5	208.1	189.2	157.0
Crude oil exports (million barrels)	156.2	176.3	208.2	186.7	155.2

(In millions of Qatar riyals)

Government finances^{1/}

<u>Revenues</u>	945.1	1,230.4	1,663.7	7,114.3	6,689.0
Oil revenues (net of production costs)	837.5	1,104.3	1,559.8	6,848.2	6,450.0
Other revenues	107.6	126.1	103.9	266.1	239.0
<u>Expenditures</u>	689.8	958.6	1,571.5	3,026.9	4,234.0
Current expenditures	474.5	698.7	1,047.3	1,582.9	2,514.0
Of which: Grants to foreign governments and institutions	(--)	(26.8)	(357.0)	(509.0)	(1,000.0)
Capital expenditures	169.3	227.5	248.8	676.5	970.0
Net lending and equity participation	46.0	32.4	275.4	767.5	750.0
<u>Overall surplus</u>	255.3	271.8	92.2	4,087.4	2,455.0
	1971	1972	1973	1974	Sept. 1975

Monetary survey (end of
period)

(In millions of Qatar riyals)

Money	237.0	345.4	412.8	560.6	808.8
Quasi-money	225.8	318.6	364.2	485.0	650.6
Government deposits	64.6	20.2	45.1	146.9	85.1
Credit to the private sector	262.4	332.7	503.4	752.5	1,130.2

Qatar - Basic Data (concluded)

	1971	1972	1973	1974	Forecast 1975
(In millions of SDRs)					
<u>Balance of payments</u>					
Oil exports (f.o.b.)	254.0	346.3	501.5	1,620.2	1,415.0
Other exports and re-exports (f.o.b.)	11.6	15.7	14.9	30.7	77.0
Imports (f.o.b.)	-86.7	-102.0	-130.8	-179.6	-378.0
Services and private transfers	-80.2	-116.1	-169.5	-154.2	-114.0
Current account balance	98.7	143.9	216.1	1,317.1	1,000.0
Official transfers and loans to less developed countries	-9.7	-4.3	-71.4	-176.3	-383.0
Other loans and investments	...	-24.5	-13.0	-265.0	-152.0
Other capital (including net errors and omissions)	-18.7	-54.8	-104.7	-244.9	-178.0
Monetary movements (increase in assets -)	-70.3	-60.3	-27.0	-630.9	-287.0
<u>Net foreign assets (end of period)</u>	<u>256.6</u>	<u>316.9</u>	<u>343.9</u>	<u>974.8</u>	
Government	183.2	228.8	252.8	823.8	
Monetary Agency	19.8	21.4	29.3	54.2	
Commercial banks	53.6	66.7	61.8	96.8	
	<u>1971</u>	<u>1972</u>	<u>1973</u>	<u>1974</u>	<u>1975^{2/}</u>
<u>Percentage change in selected indicators</u>					
Crude oil production	18.5	12.7	17.9	-1.9	-21.4
Crude oil exports	18.1	12.9	18.3	-10.3	-21.9
Total government revenue	63.1	30.2	35.2	327.6	-6.0
Total government expenditure	36.7	39.0	63.9	92.6	...
Money	20.0	45.7	19.5	35.8	44.9
Quasi-money	20.8	41.1	14.3	33.2	27.7
Credit to the private sector	22.2	26.8	51.3	49.5	52.6
Government foreign assets	38.9	38.3	14.6	288.0	...

1/ Fiscal years referred to as 1971, 1972, 1973, 1974 and 1975 are the Hijri (Moslem) years 1391, 1392, 1393, 1394 and 1395 ended on February 15, 1972, February 4, 1973, January 24, 1974, January 14, 1975 and January 3, 1976.

2/ Percentage rates of changes used for 1975 are: for oil production and exports, actual first ten months of 1975 compared with first ten months of 1974; for government revenue, projected figure; for money, quasi-money, and credit to private sector, end of September 1975 compared with end of September 1974.