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INTERNATIONAL MONETARY FUND

Minutes of Executive Board Meeting 19/47-1

10:00 a.m., June 7, 2019

1. Oman—2019 Article IV Consultation

Documents: SM/19/115 and Correction 1; and Supplement 1

Staff: Roudet, MCD; Porter, SPR

Length: 18 minutes

Executive Board Attendance

M. Furusawa, Acting Chair

Executive Directors	Alternate Executive Directors
	K. Obiora (AE)
	K. Carvalho da Silveira (AF), Temporary
	R. Morales (AG), Temporary
	G. Kim (AP), Temporary
	A. Maciá (BR), Temporary
	Y. Zhao (CC), Temporary
	M. Mulas (CE), Temporary
L. Levonian (CO)	
	C. Just (EC)
	P. Rozan (FF), Temporary
	S. Buetzer (GR), Temporary
S. Gokarn (IN)	
	M. Psalidopoulos (IT)
	Y. Naruse (JA), Temporary
J. Mojarrad (MD)	
	S. Geadah (MI)
	H. Etkes (NE), Temporary
	N. Vaikla (NO), Temporary
	S. Potapov (RU), Temporary
	W. Al Hafedh (SA), Temporary
	K.Tan (ST)
	P. Trabinski (SZ)
	D. Ronicle (UK)
	S. Vitvitsky (US), Temporary

G. Bauche, Acting Secretary
E. Tsounta, Summing Up Officer
A. Lalor, Board Operations Officer
L. Nagy-Baker, Verbatim Reporting Officer

Also Present
Legal Department: D. McDonnell. Middle East and Central Asia Department: A. Alreshan, A. Arvanitis, J. Azour, B. Baltabaev, T. Callen, B. Joshi, D. Kargbo-Sical, E. Roos, S. Roudet, A. Sadikov, V. Stepanyan, T. Zhang. Strategy, Policy, and Review Department: N. Porter. Senior Advisors to Executive Directors: W. Abdelati (MI), A. Muslimin (ST),

M. Choueiri (MI), G. Vasishtha (CO). Advisors to Executive Directors: F. Al-Kohlany (MI), M. Coronel (BR), O. Diakite (AF), J. Essuvi (AE), M. Mehmedi (EC), M. Merhi (MI), G. Nadali (MD), F. Rawah (SA), S. Yoe (ST), R. Masood (UK).

1. OMAN—2019 ARTICLE IV CONSULTATION

Mr. Geadah and Ms. Abdelati submitted the following statement:

We thank the staff team for the high-quality work and cordial discussions. The authorities highly value the exchange of views with the Fund, and they hope that the TA requests that were made during the mission will be accommodated especially since fiscal consolidation remains a high priority.

Economic performance improved on many fronts in 2018. Growth picked up, the fiscal position strengthened, the current account balance significantly narrowed, and foreign reserves increased. Private investment remained strong in spite of a slowdown in credit to the private sector. Inflation remained subdued at below 1 percent. Moreover, there was a strong uptick in the employment of Omani nationals in the private sector, and a commensurate decline in public sector employment. These developments reflect gains from diversification efforts, investments in a wide range of areas, and fiscal and structural reforms carried out over the years. Building on these efforts, the authorities are preparing Vision 2040—an extensive long-term strategic vision—and a medium-term development plan for 2021-25, with a focus on economic diversification and job creation within a context of fiscal and external sustainability.

The authorities believe that the ongoing structural reforms, diversification efforts, and the coming online of major infrastructure projects, together with rising domestic confidence, will result in higher non-oil growth than projected by staff. As noted in the staff report, the authorities also consider staff's output projections for the hydrocarbon sector to be too conservative. The staff report accounted for already implemented investment projects only, and not new projects and enhanced extraction techniques, which also generated less favorable DSA results.

Fiscal Consolidation and Debt Sustainability

The authorities plan to continue on their fiscal consolidation path, which will be reflected in a medium-term fiscal plan. The fiscal deficit was more than halved in the past 3 years relative to GDP, from 21 percent in 2016 to 9 percent in 2018, and it is projected at about 7 percent in 2019. The authorities aim to outperform the 2019 non-oil revenue targets without amending the current budget, as formally amending it would take many months. Besides introducing excise taxes, the government is controlling spending including by limits to hiring and a freeze on promotions. As outlined by staff, several fiscal measures are also under consideration, including new excises, a VAT, and further rationalizing spending. The authorities plan to carry out a Public Expenditure Review (PER) with the support of the World Bank, which aims to provide options for short- to medium-term reforms that support consolidation.

Staff's baseline projection of Oman's fiscal position and financing needs is based on declining hydrocarbon production and the WEO's April oil price projections, which are conservative compared with current and recent futures prices. The authorities also expect continued growth in oil and gas production with the coming on stream of two major discoveries. Nevertheless, they agree that additional fiscal savings, beyond those already included in the staff's baseline scenario, should be considered. They recognize the need to address the rise in public debt, and expect it to stabilize at around 60 percent of GDP before declining, partly on the basis of their hydrocarbon production forecasts. However, given the sizable reduction in spending since 2015, the pace of further cuts may need to be calibrated with what is socially feasible. Accordingly, asset sales are being considered to smooth out further fiscal consolidation without raising debt. So far, the authorities sold a 10 percent stake in BP Khazzan, and they expect to generate USD 2.5 billion from the sale of other assets, including Haya Water and Electricity Distribution. The macro-fiscal unit of the Ministry of Finance is preparing medium-term fiscal scenarios, and the Ministry would welcome further Fund input in preparing a medium-term fiscal framework that also considers fiscal risks.

The authorities emphasized that a balanced approach is needed to prioritize high-impact-growth-enhancing investments and to take into account the social impact of key reforms. They would welcome further staff analysis along those lines to guide prioritization. They agree that there may be scope for further streamlining capital spending. With several large projects already finalized or close to completion, the investment program was already being reduced, except in the hydrocarbon sector which is important to expand gas production. Capital spending as a percent of GDP has declined significantly and further reductions are planned.

Monetary Management and Financial Sector Resilience

The exchange rate peg has been an effective nominal anchor. The authorities will accordingly implement fiscal policies and structural reforms to support it. They agree that the weakness in the external position relative to medium-term fundamentals largely reflects the fiscal imbalance. However, the analysis of the external assessment in Annex V shows variations in the model results. The authorities believe the current account gap will be narrowed with continued fiscal consolidation.

Banking sector soundness remains strong. Capital adequacy remains high and rising, non-performance loans are below 3 percent, and profitability is robust. Stress tests carried out by the Central Bank of Oman (CBO)—reported in its financial stability report—point to strong resilience to an increase in global interest rates and other macro shocks. The authorities recently adopted a new resolution framework for domestic systemically important banks. The CBO continues to work on modernizing and upgrading its operations, including the liquidity management framework which will help improve the functioning of the interbank market. Further enhancements of the AML/CFT framework are ongoing.

Private Sector Growth and Employment

Oman ranks well among peers in terms of the business climate and competitiveness. The staff report shows that Oman compares well in terms of infrastructure, business dynamism, and health and labor force skills. In addition, it ranks well in terms of registering property, getting electricity, and starting a business—the latter having improved considerably over the past three years.

Diversification has been a major aim of the government's reform efforts. The Tanfeedh program initiated in 2016 is one of the key initiatives aimed at enhancing the business climate and promoting projects in sectors with the highest potential for diversification, namely tourism, fisheries, mining, manufacturing, and logistics. Recent reforms include the adoption of the commercial companies law, the opening of a commercial arbitration center, and further streamlining licensing processes. The authorities are working on strengthening the insolvency regime, strengthening the credit bureau, reducing obstacles to foreign direct investment, and modernizing the PPP framework.

In the labor market, there has been a marked decline in the public sector employment of Omani nationals and an increase in private sector employment. Among GCC countries, Oman has one of the highest shares of private sector employment and lowest public sector employment for Omani nationals. Nonetheless, the authorities aim to create further incentives for Omani nationals to seek private sector jobs, including through education and training. The labor law under preparation should further help the functioning of the labor market.

Ms. Pollard and Mr. Vitvitsky submitted the following statement:

Oman’s economic vulnerabilities have built up quickly since the commodity price shocks in 2014 and 2015. While we recognize that there has been some fiscal adjustment since 2016 as highlighted by Mr. Geadah and Ms. Abdelati in their informative buff statement, we do not think it is enough. We agree with the staff that a deeper fiscal consolidation is necessary to demonstrate policy credibility and ensure debt sustainability. We broadly concur with the staff appraisal in the Article IV report.

The table on page 4 clearly demonstrates rising vulnerabilities in Oman, with increasing public and external debt, declining buffers, consistent rating downgrades, and widening sovereign risk premia. We agree that debt sustainability is at risk without a large policy correction, as is the viability of the exchange rate peg. Moreover, delaying the adjustment will only make future adjustment larger and more painful. In this regard, we welcome the authorities’ intention to design a consolidation plan and encourage concrete implementation. Several of staff’s specific reform recommendations, including addressing wage bill rigidities and gradually phasing out energy subsides, appear appropriate.

We also support staff’s call to improve fiscal governance and transparency. Given the large public sector and magnitude of the government’s investment program, having reliable and timely budget and financing data is essential. Improving public investment management and procurement practices are also important, which will help reduce corruption and improve souring investor perception.

Additionally, we agree with staff recommendations to reduce labor market rigidities and impediments to private sector growth. Creating more private sector jobs will be essential to absorb new entrants into the labor market. Improving the business climate is key in this regard, and we encourage the authorities to build on the progress of the Tanfeedh program.

Finally, we would be interested in staff views on whether Oman may need some form of external assistance to smooth the required adjustment.

Mr. Just and Mr. Mehmedi submitted the following statement:

We thank staff for the comprehensive report, and Mr. Geadah and Ms. Abdelati for their informative buff statement. While economic activity has started to recover, and the overall fiscal and current account deficits have somewhat improved, downside risks stemming from a sustained drop in oil prices, delays in reforms, and structural impediments weigh on Oman's medium-term growth. Against this backdrop, the authorities should increase fiscal and financial sector resilience. Concurrently, diversifying the economy and spurring a private sector led growth will require a broad set of measures aimed at enhancing the business environment, boosting productivity, and improving education outcomes. We share the thrust of staff's appraisals and advice and would like to provide the following comments for emphasis.

Strengthening the fiscal accounts is essential to ensure fiscal and external sustainability.

While the decline in the fiscal deficit to 9 percent of GDP last year (from about 13.9 percent in 2017) is a welcome development, it is concerning that the non-oil primary balance deteriorated by 2.5 percentage points of non-oil GDP due to higher spending while the gross government debt reached 53.5 percent of GDP. To ensure the sustainability of public finances and put debt on a downward trajectory, the authorities will need to embark on a medium-term fiscal consolidation path and implement concrete and time-bound fiscal measures drawing on staff's fiscal policy recommendations under the illustrative adjustment scenario. In this context, we underscore the importance of reducing the wage bill through natural attrition and phasing out energy subsidies and transfers. At the same time, mobilizing non-hydrocarbon revenue will entail the introduction of excises and VAT without further delay while reducing tax exemptions, and introducing new taxes, including property and personal income taxes. We concur with staff's suggestion that current and capital spending outlays should also be streamlined. At the same time, there are merits in undertaking a public expenditure review (PFR), focusing on the effectiveness of education and health spending, and increasing fiscal governance and transparency. We are wondering whether the authorities are considering to undertake a Public Investment Management Assessment and PFR.

The fiscal framework should be strengthened to reduce procyclicality of spending, reduce fiscal risks and increase fiscal transparency. Taking a medium-term approach to budget planning is critical and would provide a policy anchor based on fiscal and external sustainability considerations. In this regard, the authorities should consider anchoring fiscal policy on a medium-term fiscal framework while delinking spending from oil revenue volatility.

Further enhancing monetary and financial stability requires maintaining the exchange rate peg, while strengthening the financial supervisory and regulatory frameworks.

The exchange rate peg to the US dollar has provided an effective nominal anchor and continues to remain appropriate. Given that the external position is weaker than implied by fundamentals, and considering that exchange rate depreciation would have a limited impact on the current account due to the structure of exports, implementing the fiscal adjustment will be key in closing the current account gap. While positively note staff's assessment that the banking sector is well capitalized, liquid, and profitable, risks stemming from the high asset and deposit concentration and significant interconnectedness should be carefully monitored and the authorities should refrain from relaxing loan classifications. While the supervisory regime has been strengthened in recent years, there is scope to enhance crisis preparedness, emergency liquidity assistance and resolution frameworks. While we appreciate the important strides made in enhancing the AML/CFT framework, we are wondering whether the authorities are preparing a time-bound action plan to address the identified ML/FT risks in the National ML/TF Risk Assessment.

Structural reforms should be targeted at diversifying the export base, boosting competitiveness, improving productivity, and strengthening the SMEs. Given that hydrocarbon exports account for the vast majority of Oman's exports, diversifying the economy will entail the steadfast implementation of structural reforms guided by Oman's Vision 2040 and the Tanfeedh Program. In this regard, improving the business environment, boosting competitiveness, reforming the product and labor markets, and enhancing education outcomes to address the skills mismatch are priority areas of reforms. Given their potential for job creation, the authorities should also deploy measures to support SMEs, including enhancing access to credit.

Mr. De Lannoy, Mr. Psalidopoulos, Mr. Etkes and Mr. Persico submitted the following statement:

We thank staff for the insightful report and Mr. Geadah and Ms. Abdelati for the informative buff statement. Consolidation efforts over the past few years and higher oil prices have successfully reduced Oman's double-digit fiscal and current account deficits to single-digit deficits this year. Nevertheless, risks to the outlook remain tilted to the downside, given the deficits' persistency, tighter financing conditions, and the country's reliance on hydro-carbons. Far-reaching reforms will be needed to enhance private-sector-led sustainable growth. Since we broadly share the thrust of the staff appraisal, the following remarks are provided for emphasis.

Oman managed to sustain the peg of the Rial to the USD for a few decades, even when the fiscal and external deficits rose. Yet, defending this peg may become challenging considering the current fiscal path. In addition, monetary tightening in the USA led to an increase in the policy rate and in bank's funding costs when inflation is low. We wonder whether a peg to a basket of USD and EUR, which would imply a lower policy rate, could be a better fit. A peg to such a basket would also reduce the impact of fluctuations of oil prices on the fiscal deficit given that oil prices in USD and the USD/EUR exchange rate show considerable co-movement since 2005 as recently noted by the New York Federal Reserve Bank (Klitgaard et al, 2019). Staff's comments are welcome.

The authorities' efforts to bolster the financial sector's resilience are important, particularly considering the macro downside risks. We welcome the authorities' progress in enhancing the AML/CFT framework, which helps sustain correspondent banking relations. The authorities recently completed the NRA, which apparently pointed to some gaps to be addressed by the authorities. We support staff's recommendation to the authorities to publish the NRA.

In the long run, it seems that improving the employability of the Omani citizens in the private sector is key to diversify the economy, reduce the large share of public sector employment as well as the large share of expatriates in the local private sector. We note that three of the four most constraining factors to Doing Business in Oman are related to the labor market. Reforms in education and job training, as well as in labor market institutions, would be welcome to strengthen inclusive growth.

Reference: Thomas Klitgaard, Paolo Pesenti, and Linda Wang, "The Perplexing Co-Movement of the Dollar and Oil Prices," Federal Reserve Bank of New York Liberty Street Economics (blog), January 9, 2019.

Ms. Levonian and Ms. Vasishtha submitted the following statement:

We thank staff for a focused report and Mr. Geadah and Ms. Abdelati for a comprehensive buff statement. Despite an improvement in Oman's economic performance in 2018 on the back of higher oil prices, macroeconomic vulnerabilities have continued to rise. Government and external debt have increased further, financing conditions have weakened, external buffers have declined, and some fiscal reforms have been delayed. Against this backdrop, fiscal consolidation and structural reforms to diversify the economy and improve productivity are imperative for ensuring policy sustainability. We broadly agree with the staff appraisal and offer the following comments for emphasis.

Significant additional fiscal reforms are required to strengthen the fiscal and external positions and restore confidence. Despite recent efforts by the authorities to raise non-hydrocarbon revenue and restrain spending, Oman's fiscal metrics have deteriorated further with government debt having tripled in three years. Moreover, public finances remain highly sensitive to oil price and other shocks, as confirmed by staff's debt sustainability analysis. Given that fiscal deficits and the government's gross financing needs are projected to remain large over the medium term, we welcome the authorities' intention to design a consolidation plan and echo staff's call to avoid delays in translating these plans into concrete actions.

Given Oman's pegged exchange rate regime, which limits monetary policy autonomy, and the significant role of the public sector in the economy, the weak fiscal position has contributed to current account deficits remaining wide. We appreciate the analysis presented in Annex VI of the staff report, which finds evidence of significant linkages between fiscal policy and the external position, thus highlighting the crucial role fiscal consolidation can play in facilitating external adjustment.

Accelerating structural reforms is essential for bolstering productivity and competitiveness and achieving stronger growth. Reform efforts should focus on tackling labor market rigidities, improving the business climate, and addressing impediments to private investment. Labor market reforms will need to focus on increasing the employability of Omani nationals in the private sector, in line with staff recommendations. We take note of the authorities' objectives on this front, including providing better education and training. Efforts to reduce the wage gap between the private and public sector will also be important.

We agree that the Tanfeedh program, which was launched in 2016, remains a promising approach to promote diversification and we encourage the authorities to continue to make progress in implementing this reform agenda in a timely fashion.

Mr. Mojarrad and Mr. Nadali submitted the following statement:

We thank staff for a well-written report and Mr. Geadah and Ms. Abdelati for their helpful buff statement.

Oman has made welcome efforts since the 2014 oil price shock to strengthen macroeconomic and financial stability and promote private sector-led growth and employment. However, in a low-inflation environment, growth has slowed down recently and has become more volatile due to fluctuations in hydrocarbons production. It is encouraging to note that fiscal deficit continues to be on a significantly declining trend, the current account deficit has declined to mid-single digits levels and, while declining, external buffers are broadly adequate. The banking sector also appears sound. Nevertheless, public and external debt continue to rise at a fast pace and debt sustainability is at risk. While the authorities have maintained access to international capital markets for large debt issuance, recent deterioration in the financing environment is cause for concern. We share the authorities' view that higher current and futures hydrocarbons prices than assumed in the staff report, as well as new oil sector investments and ongoing non-hydrocarbon sector reforms could help lift medium-term growth and strengthen fiscal and external positions beyond staff projections. Nonetheless, given the mostly downside risks to the outlook, they are encouraged to continue consolidating public finances, strengthening financial sector resilience, and accelerating structural reform implementation. We concur with the thrust of staff appraisal.

Deeper fiscal retrenchment, anchored on a medium-term fiscal framework, is essential to reduce large financing needs, ensure fiscal and external sustainability, and bolster confidence. The government's envisioned medium-term consolidation plan should include concrete measures and timelines. While the authorities seem reluctant to amend the 2019 budget law, in view of the time needed for formal approval process, we welcome their intention to overperform budget targets. Revenue enhancement requires moving ahead with VAT in the near term and introducing an income tax on high-income earners and a property tax on expensive properties over the medium term. These should be complemented by measures to contain the wage bill, phase out energy subsidies while protecting vulnerable households, and better prioritize capital outlays. The plans to carry out a public expenditure review in collaboration with the World Bank, as indicated by Mr. Geadah and Ms. Abdelati, would support fiscal consolidation. However, we agree with Mr. Geadah and Ms. Abdelati on the importance of giving due consideration to social feasibility of reforms. In this regard, the authorities' consideration of asset sales to smooth the adjustment process is commendable.

We note the expected revision of the public sector wage grid for new recruits to limit compensation growth and appreciate staff further elaboration. It is also important to strengthen debt management, including by developing a medium-term strategy, and improve fiscal governance and transparency.

The exchange rate peg provides an effective nominal anchor, has delivered monetary policy credibility with low and stable inflation, and has been a major source of investor confidence. We agree that the dominant share of hydrocarbons in exports and the high import content (including labor) of domestic production limit the role for the exchange rate to adjust the external imbalance, which is largely due to the fiscal imbalance. Further substantial fiscal adjustment is therefore needed to close the current account gap over the medium term and support the peg.

The banking system benefits from high capitalization, ample liquidity, robust profitability, and low NPLs. The authorities' stress tests corroborate the resilience of banks to severe solvency and liquidity shocks. However, high asset and deposit concentrations significant interconnectedness, and emerging pressures from real estate and household sectors and domestic liquidity developments pose risks and require close vigilance. We see merit in continued strengthening of regulation and supervision, including to ensure that banks maintain adequate loan loss provisions. We welcome ongoing reforms to enhance crisis management and preparedness and encourage further efforts to modernize the liquidity management framework.

Timely implementation of the authorities' structural reform agenda to improve the business climate, enhance the functioning of the labor market, and encourage SME development remains key to attract private investment, foster economic diversification, and promote growth and job creation, in particular for Omanis. Enactment of the two laws aimed at reducing obstacles to FDI and modernizing the framework for PPPs should help increase competition and enhance private sector participation in the economy. We underscore the need to better align public sector wages and benefits with those in the private sector as well as address the skills mismatch through better education and vocational training. We welcome plans to increase SME access to finance, including by complementing bank credit with alternative channels of financing. Given numerous agencies involved in promoting and supporting SMEs, could staff indicate if the authorities consider consolidating such agencies to avoid likely inconsistency and duplication and ensure maximum impact?

We wish the authorities success in their future endeavors.

Mr. Mouminah, Mr. Alkhareif and Mr. AlHafedh submitted the following statement:

We thank staff for the well-written report and Mr. Geadah and Ms. Abdelati for their informative buff statement.

We welcome the authorities' prudent policies, implementation of structural reforms, and diversification efforts. In this connection, we are encouraged to note that growth picked up in 2018, while the current account deficit narrowed significantly, and foreign reserves increased. Going forward, continued growth in oil and gas production with the coming on stream of two major discoveries and additional fiscal savings should create space for supplementary growth-enhancing investments with greater social impact. In addition, we look forward to Vision 2040 and the medium-term development plan for 2021-25, which will help advance the authorities' objectives of accelerating economic diversification and job creation.

We welcome the significant improvement in the fiscal position due to the policy measures as well as a recovery in oil prices. The fiscal deficit was reduced significantly relative to GDP. We are also reassured by the authorities' commitment to implement further reforms, including new excises, a VAT, and further rationalize spending, which will be steps in the right direction to ensure fiscal sustainability. The emphasis on implementing reforms at a measured pace is also appropriate to alleviate the possible impact on economic activity, job creation, and social outcomes, as underlined by the authorities. We also take positive note of the ongoing efforts to develop medium-term fiscal scenarios to guide fiscal policy and limit debt accumulation.

We agree that the exchange rate peg has served the economy well and remains appropriate, as it has provided the economy with an effective nominal anchor. In this connection, we welcome the authorities' strong commitment to the current exchange rate arrangement. The banking sector remains sound, as demonstrated by high capitalization, low NPL ratio, high loan-loss provisioning, and steady profitability. Banks have also maintained strong liquidity buffers. At the same time, we agree with staff that the CBO should remain vigilant and monitor closely potential vulnerabilities, and that banking sector regulation and supervision should remain robust. We are encouraged by the CBO's planned measures to modernize and upgrade operations, including the liquidity management framework which will help improve the functioning of the interbank market. We also welcome the progress in enhancing the AML/CFT framework.

Finally, efforts should continue to focus on reforms that address labor market rigidities and impediments to private investment and encourage higher productivity to strengthen the resilience of the economy. In this connection, promoting SMEs' development, including by facilitating access to finance, should be a priority to enhance growth and job creation. We are encouraged by the efforts to further streamline licensing requirements, the progress in the areas of commercial law and arbitration, and the initiation of the Tanfeedh program to enhance the business climate. In addition, the emphasis placed on encouraging PPPs and privatization could play a crucial role in enhancing operational efficiency and reducing the fiscal burden.

With these remarks, we wish the authorities further success.

Mr. Ostros and Mr. Vaikla submitted the following statement:

We thank staff for their informative report and Mr. Geadah and Ms. Abdelati for their useful buff statement. Despite the authorities' consolidation efforts, Oman still has large fiscal and current account deficits which create macroeconomic vulnerabilities and weaker financing conditions. The economic outlook is subject to several risks stemming from lower oil prices, challenging external financing conditions, and regional geopolitical uncertainty. Going forward, we urge the authorities to implement a deep fiscal consolidation plan to create buffers against oil price volatility and to put debt on a downward trajectory. Furthermore, we share staff´s view that Oman needs to reduce its dependence on oil, implement labor market reforms, and enhance private sector development to secure sustainable economic development over the medium term. We are in broad agreement with staff's appraisal and would like to offer the following remarks for emphasis.

Large dual deficits risk eroding exchange rate sustainability and may undermine confidence in the fiscal and external sustainability. We welcome that the authorities plan to continue on their fiscal consolidation path and are controlling spending. including by limiting hiring and freezing promotions. However, to safeguard the pegged-exchange rate, mitigate external risks, and secure debt sustainability we encourage the authorities to implement deeper fiscal consolidation. Staff´s proposed consolidation plan would improve the non-hydrocarbon primary balance around 6.5 percent of GDP and would stabilize government debt at around 60 percent of GDP by 2020. We share staff´s view that an ambitious medium-term fiscal consolidation plan must be based on limiting wage growth and phasing out energy subsidies. The authorities should also seek to diversify the revenue base by increasing non-hydrocarbon tax revenues. Furthermore, streamlining capital outlays and strengthening public investment management remains important.

Oman´s financial sector seems robust but monitoring risks is important going-forwards. The financial sector is vulnerable to high asset concentrations and significant interconnectedness. We therefore advise the authorities to identify and closely monitor any emerging pressures on asset quality and any potential build up in financial sector risks. We welcome that further enhancements to the AML/CFT framework are ongoing and encourage to continue with it. We agree with staff that the authorities should not change current provisioning requirements and relax loan classifications. We encourage the central bank to strengthen its liquidity and crisis management and preparedness frameworks to further bolster resilience. We agree with staff that the central bank should avoid discriminatory measures that may limit capital flows and use instead non-discriminatory micro- and macroprudential measures.

Structural reforms are needed to promote private sector development, improve competitiveness, and enhance economic diversification. Boosting private sector development and improving the business environment would reduce dependence from oil and help create new jobs. Promoting SMEs development by enhancing the access to finance is essential to improve growth and job creation in the private sector. Labor market reforms aimed at creating incentives for private sector jobs and to support better education and vocational training are essential in this regard.

Mr. Raghani and Mr. Carvalho da Silveira submitted the following statement:

We thank staff for the well-written report and Mr. Geadah and Ms. Abdelati for their insightful buff statement.

We appreciate the authorities' policy and reform efforts—including diversification—which helped the economy bounce back in 2018 after contracting in 2017. Last year, real GDP growth reached 2.2 percent mostly driven by a surge in oil prices, while inflation remained subdued at 1 percent. Unemployment however remains high, particularly among the youth as labor force growth continues to outpace job creation. We note that measures introduced over the years to improve the fiscal position, coupled with higher oil prices, started to bear fruit as the fiscal deficit continues to narrow, from 13.9 percent of GDP in 2017 to 9.0 percent of GDP in 2018. On the external front, although the current account deficit decreased, it remained relatively large at about 4.7 percent of GDP. International reserves improved slightly to about 5.8 months of imports.

We concur that domestic and external shocks pose important downside risks to the economy. These risks include a slowdown in the pace of reforms, significant fluctuations in energy prices, volatility in global financial markets, and security-related challenges. Looking ahead, to sustain the recovery, we encourage the authorities to speed up measures aimed at strengthening the fiscal and external positions, and advance structural reforms to unlock potential long-term growth.

We broadly agree with staff's assessment and the authorities' policy priorities going forward, and therefore would like to offer the following comments for emphasis.

Advancing fiscal consolidation plans is urgent and of utmost importance to reverse debt dynamics and ensure the economy is resilient to external shocks. Despite a narrowing fiscal deficit, we are concerned that macroeconomic vulnerabilities are rising, with Government debt tripling in three years and buffers deteriorating. Against this background, we agree with staff that additional measures are needed to supplement the envisaged medium-term fiscal consolidation plan. These could entail, in the first instance, finalizing the implementation of the value-added tax (VAT) and gradually cutting back expenditures. In this connection, the plan to perform a Public Expenditure Review (PER) with the support of the World Bank, as underscored in the buff statement, is well appreciated.

Over the medium-term, preserving fiscal and debt sustainability and strengthening resilience requires fiscal consolidation efforts towards addressing wage bill rigidities, reducing government subsidies, streamlining transfers, rationalizing capital spending in a growth-friendly manner while expanding non-oil revenue sources. Attention should also be paid to containing the negative impact of these reforms on the most vulnerable, monitoring risks from state-owned enterprises and enhancing public sector transparency. That said, we have some reservations on the size of adjustment recommended by staff to improve non-oil primary balance (8 ppts of non-hydrocarbon GDP). Comments are appreciated.

The authorities' commitment to enhancing financial sector resilience is welcome, but continued vigilance against emerging risks is warranted. In this respect, we note with satisfaction that the financial sector is sound; the regulatory and supervisory frameworks are robust; and actions will be taken to detect vulnerabilities associated with the housing sector, global interest rate movements and banking system liquidity. The introduction of the bank resolution framework to address the problem of failed banks in an orderly manner while safeguarding financial stability and public interests, is another step in the right direction. We encourage the authorities to continue improving the anti-money laundering and combatting the financing of terrorism (AML/CFT) framework at both legal and supervisory levels, in line with international standards.

Structural reforms should be pursued to improve the business environment, boost productivity and enhance competitiveness with the view to support growth and employment creation. We see merit in providing space to private sector activities, reinforcing the regulatory landscape, and promoting training programs to tackle skill mismatches and enhance competitiveness. In the same vein, access to technology and finance for small and medium-size enterprises will be helpful.

With these remarks, we wish the authorities of Oman success in their endeavor

Mr. Di Tata and Mr. Morales submitted the following statement:

We thank staff for the comprehensive report and Mr. Geadah and Ms. Abdelati for their helpful buff statement.

Oman’s economic activity has started to recover owing mainly to a rebound in oil prices. Hydrocarbon GDP growth reached 3.1 percent in 2018, while non-oil growth has also picked up moderately to 1.5 percent due to higher confidence following the rise in oil prices. Macroeconomic vulnerabilities continue to rise, however, as external debt keeps growing and some reforms, including the introduction of VAT, have been delayed.

The decline in the overall fiscal balance to 9 percent of GDP in 2018 is welcome, but additional fiscal efforts are needed. The non-oil primary balance deteriorated by 2.5 percentage points of non-oil GDP because of higher spending and non-oil revenue underperformance. Could staff elaborate on how much of the higher fiscal spending could be explained by delayed recording? Gross government debt increased by 7 percentage points of GDP in 2018 to 53.5 percent, with additional government liabilities associated with SOEs (26 percent of GDP) and delayed payments that remain high despite recent declines. Oman’s sovereign rating was downgraded below investment grade by two credit rating agencies and sovereign spreads have widened.

We welcome the government's intention to design a fiscal consolidation plan. Revenue measures should be a key component of this plan, as they would contribute to a faster decline in fiscal imbalances. In this regard, we encourage the authorities to promptly implement the new excise tax on selected products and introduce the VAT. Over the medium term, income and property tax reforms could be added to the policy mix. Key spending measures should include removing wage bill rigidities, phasing out energy subsidies, and prioritizing capital spending, accompanied by decisive steps to improve fiscal governance and transparency. We agree with the authorities and staff that fiscal consolidation should aim at addressing structural weaknesses while limiting the impact on the most vulnerable, and that social impact analyses would be useful to select among alternative adjustment measures.

External buffers have remained stable because of higher oil prices. Oman's current account deficit declined to 4.7 percent of GDP in 2018. Large FDI inflows and government external debt issuance explain relatively stable international reserves, although the external assets of the State General Reserve Fund declined by US$1.6 billion in 2018, partly because of government financing needs. For the medium term, staff projects that government debt may reach 70 percent of GDP by 2024 and that external buffers may decline to 64 percent of the IMF's ARA by the same year. This outlook is worrisome, considering that external risks are tilted to the downside because of the possibility of oil price reversals, higher international interest rates, and lower risk appetite.

We note that the government's structural policies contained in the Tanfeedh program and the forthcoming Vision 2040 plan, highlighted by Mr. Geadah and Ms. Abdelati, may support higher economic growth. These policies include the adoption of the commercial companies' law, the opening of a commercial arbitration center, and streamlining of licensing processes. Although we welcome the increase in the share of Omani nationals employed by the private sector, additional efforts are needed to address the current skills mismatch through better education and vocational training. Moreover, new job opportunities for the Omani youth may not materialize if macroeconomic vulnerabilities were to deteriorate further, quickly reversing recent gains in private sector confidence, which highlights the importance of rebuilding buffers without delay. These endeavors should be complemented with the completion of ongoing reforms to remove legal obstacles to FDI, modernize the legal framework for PPPs, and strengthen the insolvency regime, among others.

On financial issues, we welcome the introduction of a bank resolution framework for domestic systemically important banks. We encourage the authorities to replace the limit on banks' foreign assets (recently raised to 75 percent of banks' local net worth) with macroprudential measures. We agree with staff that prudential measures based on currency exposure or specific risks appear more appropriate. We encourage the authorities to fully implement risk-based AML/CFT supervision and finalize the legal framework in line with the recently completed National ML/TF Risk Assessment.

With these comments, we wish the Omani authorities every success in their future endeavors.

Mr. Moreno and Ms. Mulas submitted the following statement:

We thank staff for its insightful report and Mr. Geadah and Ms. Abdelati for their candid buff statement. We generally share the staff's appraisal, particularly on the need to accelerate fiscal reforms to strengthen the fiscal and external positions and structural reforms to improve the functioning of the labor market and the business environment.

Vulnerabilities remain even in a more positive scenario. According to staff, growth is projected to slow down in 2019 due to contraction in the hydrocarbon sector. However, authorities have a more positive assessment of economic prospects due to the ongoing structural reforms and to the new oil projects. Besides, authorities consider staff's oil price assumptions to be too conservative given the increase in prices over the past months. Staff recognized that these represented upside risks that could result in lower fiscal and current account deficits and improvement in government and external debt trajectories. That said, a more positive scenario estimated by staff—which assumes an oil production at around 1.12 million of barrels per day beyond 2021 and using the future markets oil prices—still envisages a challenging outlook with high fiscal and current account deficits and government debt. Therefore, reforms are paramount as vulnerabilities remain in any scenario.

Fiscal consolidation is needed while protecting the most vulnerable. We agree on the need to foster fiscal consolidation to maintain confidence and ensure external sustainability. Therefore, we welcome authorities' intention to continue their fiscal consolidation path, which will be reflected in a medium-term fiscal plan. Staff underscores that a deep fiscal consolidation is needed and urge the authorities to amend the 2019 budget with view to further reduce the deficit. However, authorities argue that the pace of additional cuts may need to be calibrated with what is socially feasible. Could staff elaborate on the impact of a higher deficit reduction in 2019? We share staff's view on the need to prioritize measures that help limit the impact of fiscal consolidation on growth and place more adjustment burden on those who can best shoulder it. Therefore, we encourage the authorities to consider the additional options proposed by staff, particularly to raise non-hydrocarbon revenue. We also agree on the need to improve fiscal governance, particularly to improve the recording of unpaid bills.

Business competitiveness and labor reforms are key to foster employment creation. The fast-growing population represent a long-term challenge in Oman, as already over 40 percent of the population is under the age of 25. With significant number of youths expected to enter the labor market over the next few years, and given the fiscal pressures that limit public employment, there is a clear need to foster private sector employment. To this end, we encourage reforms that tackle labor market rigidities and impediments to private investment and foster higher productivity. We fully agree with staff to caution against measures that would affect businesses' competitiveness by depriving them from access to critical skills. We also see merits on the proposals to enhance the SME development proposed in the interesting annex VIII.

Mr. Trabinski and Ms. Jorg submitted the following statement:

We welcome the rebound of economic growth, which has been supported by the authorities' policy measures after the 2014 oil price shock to improve the fiscal and external position, expand the nonhydrocarbon revenue base and foster private sector growth. Notwithstanding the favorable economic situation, public debt is still rising, financing conditions are weakening, and vulnerabilities continue to grow. Against this background, we see merit in swiftly implementing the envisaged economic policies and agree with staff that additional reform options should be considered.

Fiscal consolidation remains the key policy priority to strengthen market access and ensure fiscal and external sustainability. As shown in the DSA, public debt sustainability is at risk. Oman's public debt continued to increase last year and is expected to grow further in the mid- to long term. The large external debt and its sensitivity to exchange rate shocks could also put pressure on the exchange rate peg, which has contributed to monetary policy credibility. Furthermore, fiscal challenges have weakened the financing conditions and borrowing costs have increased following a downgrade in the credit rating.

In view of the above, it is important to adopt a medium-term fiscal adjustment plan, including the already planned measures and additional reforms. We agree with government's intention to develop a transparent medium-term fiscal consolidation plan, including reforms to diversify from hydrocarbon revenues, tackle spending rigidities and streamline public investment. We also see merit in introducing the envisaged VAT and additional tax measures to stimulate non-oil revenues. Moreover, policy measures to limit public wage growth and to gradually reduce subsidies and transfers are warranted. These measures should be accompanied by a reduction and a better prioritization of the relatively high public investments to diversify away from oil revenues. Finally, amending the 2019 budget to further reduce the deficit is crucial to underline the determination of the authorities to tackle the fiscal imbalances.

Structural reforms to improve the business environment and the labor market are essential to achieve more diversified growth. To move away from public sector growth, the reform progress to foster private investments should be accelerated. This should include initiatives to strengthen the credit bureau and the insolvency regime, operationalize the anti-monopoly center, as well as foster FDI and PPP. To raise competitiveness and create more private sector jobs, we see a need to better align education and vocational training with the labor market. We encourage the authorities to step up efforts to adopt the labor law with the aim to increase labor market flexibility. Such reforms would also contribute to the development of SMEs, which in turn would foster a more diversified economy. Besides that, strengthening public investment management and procurement practices to reduce corruption will be important to improve public-sector efficiency and to invigorate the private sector. Could staff elaborate on any measures that have been taken to strengthen public investment and procurement?

Overall the banking sector is sound, but some vulnerabilities need to be addressed. The authorities must remain vigilant of domestic and foreign risks to financial stability. Reforms, such as the CBO regulation on bank resolution are welcome. To further strengthen crisis preparedness, we encourage the authorities to engage with banks more closely. We agree with staff that an update of the liquidity management framework of the CBO would have a positive impact on the monetary policy transmission mechanism and on the banking sector efficiency in general.

Finally, we encourage the authorities to consent to publish the staff report.

Mr. Sun and Ms. Zhao submitted the following statement:

We thank staff for the comprehensive set of papers and Mr. Geadah and Ms. Abdelati for the helpful buff statement. Despite modestly higher economic growth and the authorities' commendable ongoing reforms, fiscal and current account deficits are projected to remain large. Additional reform measures are therefore warranted to safeguard fiscal and external sustainability, promote development of the private sector, and enhance the economy's long-term resilience to oil prices. As we broadly concur with the thrust of staff's appraisal, we would limit our comments to the following for emphasis.

More ambitious fiscal adjustment is needed to put debt on a downward trajectory. We welcome the authorities' intention to design a consolidation plan and encourage them to lay out concrete measures and timelines. We see the need for a medium-term approach to budget planning to provide a policy anchor based on fiscal and external sustainability considerations. At the same time, possible impact on growth should be mitigated and the most vulnerable group protected. Noting the authorities' concern over the potential adverse impact of fiscal adjustment, we would like to invite staff to shed more light on the possible sequencing of the reforms to garner social support.

Stronger regulation is needed to safeguard financial stability. Notwithstanding sound indicators of financial stability, we encourage the authorities to refrain from relaxing loan classification and provisioning requirements and continue to ensure that banks set aside adequate loan loss provisions. We welcome the authorities' efforts in enhancing the AML/CFT framework, which helps the stability of correspondent banking relationships.

The exchange rate peg provides an important policy anchor and should be maintained. However, the rapid increase of external debt in recent years and its sensitivity to exchange rate shocks highlights the importance of fiscal sustainability underpinning the fixed exchange rate regime.

Accelerating structural reforms is paramount for stronger growth. Labor market and civil service reforms are essential to enhance private-led growth. Improving efficiency of the educational system would boost TFP while reducing the public wage bill. These reforms are also conducive to promoting the development of small- and medium-sized enterprises.

With these remarks, we wish the authorities every success.

Mr. de Villeroché, Mr. Castets and Mr. Rozan submitted the following statement:

We would like to thank staff for their report as well as Mr. Geadah and Ms. Abdelati for their useful buff statement. Macroeconomic vulnerabilities continue to rise, with declining buffers and increasing government debt. Against this background, we encourage the authorities to renew their efforts to enhance fiscal sustainability and economic diversification. We share staff's analysis and recommendations and would like to emphasize the following points:

While we note that Oman still has substantial buffers, we encourage the authorities to accelerate their efforts to bring down the fiscal deficit so as to avoid medium term debt sustainability concerns. In response to staff's recommendations, we welcome the authorities' intention to design a consolidation plan to stabilize the public debt. The stabilization should target the large current outlays (wage bill, energy subsidies), and diversify revenue sources. The implementation of the VAT will be a milestone in this regard. Going forward, we encourage the authorities to put in place progressive tax schemes such as a property tax and an increase on excise taxes on luxury goods. We share staff's assessment that a medium-term fiscal framework, as well as enhanced fiscal governance and transparency, will lead the way to more sound public finance management.

The exchange rate peg continues to serve the economy well; fiscal consolidation in line with staff recommendation should help to bring the external position in line with medium-term fundamentals, as imbalances are corrected;

While we note staff's assessment of the quality of the governance and the stability of the banking sector, underlying weaknesses and risk transmission channels in the financial sector warrant continued attention on regulation and supervision. We welcome the authorities' interest in benefiting from Fund's technical assistance relative to the recovery and resolution framework, and encourage the Central Bank to modernize its liquidity management framework to enhance monetary policy transmission channels.

Diversification and stronger private sector-led growth is key to generate enough jobs for the Omanis. Key steps have been taken by the government. Implementation of new reforms, as well as rolling out of outstanding reforms will be necessary, in particular on the credit bureau, the anti-monopoly sector and the insolvency regime. Reducing obstacles to foreign investment is warranted, and we encourage the authorities to finalize the new framework for PPPs and to reduce obstacles to FDIs. We also welcome plans to reform labor law to improve the functioning of the labor market and increase female labor force participation. Given the emphasis placed on SMEs' development, we would welcome staff's comments on financial inclusion issues, and the potential role of Islamic finance in this regard.

Ms. Mahasandana, Mr. Tan and Mr. Anwar submitted the following statement:

We thank staff for the well-written report and Mr. Geadah and Ms. Abdelati for their candid buff statement. We commend the authorities for their actions to strengthen the fiscal position, stimulate private sector-led growth and employment, and enhance economic diversification. We take positive note that economic activity started to recover, and the overall fiscal and current account deficits have improved to a certain degree. While non-hydrocarbon sector growth, and oil prices and production are projected to increase going forward, we note that the outlook is subject to domestic and external risks, including the twin deficits and heightened regional geopolitical uncertainty. Against this backdrop, we share staff's view that the authorities' key policy priorities are to accelerate fiscal reforms, entrench financial sector stability, and advance structural reforms. We broadly support the thrust of the report and offer the following comments for emphasis.

Steadfast implementation of fiscal reforms is warranted to maintain confidence in the public finance, support the exchange rate peg, and ensure fiscal and external sustainability. We take positive note that significant gains have been achieved in the reduction of the fiscal and external deficits as percent of GDP to single digit levels in 2018 as the authorities continued to raise non-hydrocarbon revenue, curtail spending and accrue benefits from higher oil prices. However, the authorities should remain focus on addressing the fiscal and external imbalances. Deeper and far reaching fiscal adjustment is needed and should be based on reforms to tackle current spending rigidities, limit the impact of fiscal consolidation on growth and place more of the adjustment burden on those who can best shoulder it. Postponing the needed adjustment on hopes that the current more favorable oil prices could be sustained may become costly for economic growth in the event of sharp adjustment. In this regard, we welcome the authorities' intention to design a consolidation plan. We would like staff to update the progress of the authorities' medium-term fiscal consolidation plan. We also would like staff to elaborate their suggestions to the authorities on what kind of fiscal measures needed to support the ambitious adjustment path in this plan. While the key challenge ahead is to translate these plans into concrete and credible actions to ensure the achievement of the authorities' objectives, we encourage the authorities to lay out concrete measures and timelines.

We take positive note that the peg has delivered monetary policy credibility with low and stable inflation. While the exchange rate peg has served the Omani economy well and provided an important policy anchor, given the fast pace of change in global monetary conditions, we urge the authorities to regularly review the suitability of the current exchange rate regime going forward. We would like staff to advice when and under what circumstances the authorities need to consider changing to flexible exchange rate regime? We highlight the authorities' concerns that the analysis of the external assessment in Annex V shows variations in the model results. Staff comments are welcome.

Strong and credible financial supervisory and regulatory framework are warranted to safeguard financial stability. We take positive note that the banking sector remains sound and robust with high capitalization, low non-performing loan ratios and strong liquidity buffers. However, The Central Bank of Oman (CBO) should remain vigilant over developments in the financial sector, including those related to the real estate and household sectors and global financial conditions. We are encouraged by the results of stress tests, carried out by the CBO as stated in the buff statement, point to banking sector's strong resilience against an increase in global interest rates and other macro shocks. Should severe solvency and liquidity shocks occur in the near future, how should authorities respond to eschew negative impact to banks' asset quality and liquidity that could in turn weigh on private sector credit and growth? Staff advice are welcome. We welcome the recent authorities' actions in adopting a new resolution framework for domestic systemically important banks. We positively note the CBO continues work in modernizing and upgrading its operations, including the liquidity management framework which will help improve the functioning of the interbank market and raise banking sector efficiency. Strengthening the central bank's liquidity management and crisis preparedness would strengthen the system's resilience even further. We also welcome the authorities for their ongoing efforts to enhance the AML/CFT framework as a positive step toward financial resilience.

With these comments, we wish the people of Oman every success in their future endeavors.

Mr. Ronicle and Mr. Masood submitted the following statement:

We thank staff for a very clear and comprehensive report, as well as Mr. Geadah for Ms. Abdelati for their insightful buff statement. We agree with the thrust of the staff report.

We welcome the improvements in some economic indicators last year that was largely driven by higher oil prices. However, we note the assessment from Staff that Oman’s economic vulnerabilities continued to rise last year and are likely to continue to grow. The continued large fiscal deficits over the medium-term, the forecasted debt/GDP ratio of over 70 percent by 2024 are of concern. We welcome the authorities’ plans to continue fiscal consolidation and the level of ambition. Like staff we welcome the government’s intention to design a consolidation plan and encourage the authorities to lay out concrete measures and timelines. We believe it is critical that the authorities implement envisaged measures, both to ensure the fiscal deficit continues to decline and to demonstrate to investors and markets that Oman is committed to fiscal consolidation. This includes the introduction of VAT and spending constraint which will both be critical to reduce the fiscal deficit to 6 percent of GDP by 2021. The authorities should seek to ensure that reforms protect the most vulnerable households and we support the recommendation for social impact analyses of key reforms to guide choices. What measures do staff envisage the authorities should undertake to minimise the impact of the most vulnerable?

We note that gross financing needs are projected to almost double over the medium-term, which emphasises the importance of taking action in the near-term to reduce longer-term risks. We recognise the authorities concerns about the social feasibility of reforms, and encourage them to take steps to raise public awareness of the need for reform (e.g. through effective public communication) to help build widespread support for measures. Against the backdrop of credit rating downgrades, it is important that the authorities are cognisant of potential risks to the external financing conditions and seek to continually bolster investor confidence. This highlights the importance of the medium-term fiscal consolidation plan and the need for it to be credible; we strongly welcome the planned Public Expenditure Review, supported by the World Bank and welcome any ongoing discussions between the authorities and staff about potential technical assistance. We support staff’s recommendation that the authorities publicly lays out an ambitious adjustment path. Alongside this, we welcome staff’s emphasis on the importance of improved fiscal governance and transparency to limit budget overruns and payment delays. Finally, we welcome the authorities’ request for technical assistance. Can staff outline what work is being undertaken or planned?

We agree with Staff and the authorities that the exchange rate peg has been an effective anchor for the economy but note the change in language on the exchange rate peg compared with last year's Article IV, with greater emphasis given the statement it 'remains appropriate, as long as the other policies are also supportive.' While previous Article IVs mentioned the need for other policies to support the continued fixed exchange rate, this text places a stronger emphasis on the necessity of supportive policies. To what extent, if any, do staff think things have materially changed in this aspect?

The reliance on oil revenues also emphasise the importance of the authorities' plans for diversification as a means to put the economy on a sustainable footing. Such reforms should provide the stimulus to stronger growth. Job creation remains critically important with 15,000 new job seekers expected to enter the labour market every year. Labour market reforms remain crucial element of the solution in the medium-term to boost Oman's competitiveness and reduce pressure on the public sector wage bill.

Mr. Gokarn and Ms. Dhillon submitted the following statement:

We thank staff for the Article IV report and Mr. Geadah and Ms. Abdelati for their informative buff statement.

Supported by rising non-hydrocarbon activity and higher oil prices, economic activity has been recovering with a pickup in growth, a strengthened fiscal position, increase in foreign reserves and employment gains. Nonetheless, the outlook is faced with downside risks from a challenging external environment and regional uncertainty. We note the divergence, with the authorities having a more optimistic outlook, including for the non-oil growth, than projected by staff. Moving ahead, we would urge the authorities to build on the pace for strengthening the fiscal position, enhancing private sector-led growth and employment and promoting diversification. We broadly support the thrust of the report and offer the following for emphasis.

Fiscal Consolidation and Debt Sustainability

The authorities' efforts for reducing fiscal deficit and the planned Public Expenditure Review are reassuring. But, more will need to be done for revenue mobilization, deeper fiscal adjustments, rationalization of spending and new taxes. A delayed fiscal adjustment could affect business confidence, external financing costs and prospects for debt sustainability. The buff underscores the sizable reduction in spending since 2015, and that the pace of further cuts may need to be calibrated with what is socially feasible and has emphasized a balanced approach bearing in mind the social impact of key reforms. Staff’s deeper analysis to guide prioritization has been suggested. We invite staff comments on this.

Monetary Management and Financial Sector Resilience

We agree that the exchange rate peg has been an effective nominal anchor. However, the weaknesses in the external position relative to medium-term fundamentals will need to be bolstered by continued fiscal consolidation and this has been well acknowledged by the authorities. On the banking sector, we align ourselves with staff for robust regulation and supervision to maintain the resilience and the profitability of the financial system. The authorities’ efforts for further enhancements of the AML/CFT framework must be prioritized.

Private Sector Growth and Employment

Finally, pro-business reforms including those for promoting foreign direct investment, SMEs and PPPs could significantly increase trade and investment. Job creation is an important challenge, given the high youth unemployment rate. Against this backdrop, the authorities’ ownership of and efforts to enhancing the business climate and diversification, including in manufacturing, logistics, and tourism, is timely and relevant. The buff mentions that the authorities aim to create further incentives for Omani nationals to seek private sector jobs and the labor law under preparation would further help the functioning of the labor market. Could staff elaborate on the elements of the labor law and its anticipated impact?

With these comments, we wish the authorities the best in their endeavors.

The Acting Chair (Mr. Furusawa) made the following statement:

Since the 2014 oil price shock, Oman has undertaken a range of policy efforts. Directors’ gray statements welcome the fiscal consolidation and the structural reform measures the authorities have taken over the past few years. Directors noted that despite the recovery in oil prices, vulnerability continues to rise; government and external debt continue to rise; the buffer is declining; and the external environment remains challenging. Directors have therefore emphasized the need for deeper fiscal consolidation to ensure fiscal and external and exchange rate sustainability in a growth-friendly manner. They also encourage the continued structural reforms to enhance labor market flexibility, build human capital, and enhance the business environment.

Mr. Geadah made the following statement:

On behalf of my Omani authorities and my colleagues in the office, I thank the staff for the engaging and constructive discussions. This includes presentations during the mission and the sharing of preliminary analytical work. We also appreciate the follow-up on various technical assistance (TA) requests, including on revenue mobilization, medium-term budget planning, and national income accounts. I would like to comment on two broad issues that are a priority for the authorities. These were also raised in gray statements.

The first is fiscal consolidation. This is a very high priority for the authorities. To give an example of the adjustment so far, the non-hydrocarbon primary deficit, which is not affected by fluctuations in oil production or prices, has declined by 15 percent of non-oil GDP over the last four years. Most of the adjustment so far has been through spending cuts and almost half of this has been through cuts in current spending. Plans for capital spending, with many projects having been completed, have been significantly pared down as well. This can be seen in the fiscal projections. What they call several projects are now projected at 1.7 percent of GDP in the medium term, compared to 5.4 percent of GDP in last year's report. Meanwhile, tax revenue is also projected to be moderately higher over the medium-term than in last year's report. The authorities plan to raise it further, including through new excise taxes and a VAT.

A few Directors noted that high expenditures reported in 2018 reflect the lag in reporting spending that was undertaken in the previous year. The authorities will be making further efforts to record spending in a more timely fashion.

A second important issue is the development of the non-oil economy. The authorities are focused on economic diversification and job creation with fiscal and external sustainability. Oman has initiated a broad range of diversification measures, and those took on greater importance after the decline in oil prices with the Tanfeedh program. As a result of these efforts, Oman ranks well among peers in terms of the business climate and competitiveness, which should help support private sector growth and the small- and medium-sized enterprise (SME) sector in particular. Thank you.

The staff representative from the Middle East and Central Asia Department (Mr. Roudet), in response to questions and comments from Executive Directors, made the following statement:[1]

> The staff has provided written responses to the questions raised by Directors in their gray statements. I would like to take this opportunity to focus on a few key themes. Some Directors inquired about the merits of more flexible exchange rate for Oman. The staff is of the view that the current peg to the U.S. dollar remains appropriate. Indeed, the peg has been particularly effective in delivering monetary policy credibility as well as low and stable inflation. A more flexible exchange rate regime could help smooth the impact of oil price fluctuations on the external and fiscal position. However, the still-low degree of economic diversification and, hence, the low non-hydrocarbon export base, as well as the high reliance on foreign labor, the cost of which is essentially priced in U.S. dollars, are significantly reducing the potential benefits of exchange rate flexibility as a stabilization tool in the face of shocks. A more flexible exchange rate would also require a new monetary policy anchor and policy framework, particularly in the case of a float, something that would take time to develop.
>
> Since there was a specific question about the merits of a basket of currencies as an anchor, I will add that two quantitative analyses prepared by Fund staff in 2011 and 2013 corroborated this assessment, concluding that while a limited degree of exchange rate flexibility and monetary autonomy would help reduce macroeconomic volatility, these gains would only be very modest. Over the longer-term, as the economy diversifies, and more nationals are employed by the private sector, these benefits would increase.
>
> Questions were also raised by some Directors on the sequencing of fiscal reforms and the need to address the potential social impact on the most vulnerable. The key challenge for the authorities is to find a balance between tackling fiscal and external vulnerabilities while maintaining social consensus. The adjustment strategy recommended by the staff aims at balancing these considerations, first, by proposing a reasonable pace for reforms. While fiscal consolidation will have costs for short-run growth and possibly job creation, the cost of inaction will also be high. The staff is of the view that short-run costs would ease over time as dividends from structural reforms bear fruit.

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[1] Prior to the Board meeting, SEC circulated the staff's additional responses by email. For information, these are included in an annex to these minutes.

As discussed in the report, the magnitude of the adjustment recommended by staff over the medium-term is not unprecedented, both in Oman and in the Gulf Cooperation Council (GCC).

Second, the balance between these various considerations is also achieved by focusing on reforms that tackle underlying public finance weaknesses. The increasing government expenditure over the past decade was particularly large and biased toward rigid current expenditure, and its gradual reduction relative to GDP would carry a smaller growth cost. Revenues are still highly undiversified and heavily susceptible to oil price fluctuations. Against this backdrop, staff believes that a balanced approach to the composition of adjustment that tackles underlying spending and revenue weaknesses would help limit adjustment costs.

Finally, the staff has highlighted in its policy recommendations the importance of ensuring that the burden of adjustment is shared in an equitable way. This is a prerequisite to maintain support for continued reform efforts. To do so, the staff has suggested several options, both for revenue and expenditure reforms. On the former, the staff has suggested moving toward more progressive taxes over the medium-term, and on expenditure reforms, the staff has recommended tackling current spending rigidities as a priority to give enough room for growth-enhancing investments. It has also highlighted the importance of conducting social impact analysis of key fiscal reforms to help design proper protection mechanisms for the most vulnerable. Upon request, the staff could provide support to the authorities in this endeavor. The Fiscal Affairs Department, for instance, has provided TA in some of these areas in other countries.

There was also a question on the potential need for external financial support. The government has thus far been able to access international capital markets at reasonable costs. The staff’s baseline projections assume continued market access, and should the financing environment deteriorate, fiscal and external buffers would provide some cushion. Against this backdrop, the authorities have not indicated to the staff any desire to seek external assistance.

Before I end, let me thank the authorities for the hospitality and constructive engagement, as well as Mr. Beblawi, Mr. Geadah, and Ms. Abdelati for their support.

Mr. Trabinski made the following statement:

We thank the staff for a good report and Mr. Geadah and Ms. Abdelati for their insightful buff statement. We commend the Omani authorities for their reform effort after the oil price shock in 2014. Despite the economic rebound, vulnerabilities are growing, and the economy faces considerable structural challenges. We encourage the authorities to intensify their efforts to ensure fiscal and external sustainability and to improve the business environment. We issued a gray statement, so let me just underline the following three points.

First, like other chairs, we are of the view that fiscal consolidation is the key policy priority. In this context. It is crucial to adopt a transparent medium-term fiscal consolidation plan, including the already planned measures, as well as additional reforms. Moreover, to underline the authorities' determination to tackle fiscal imbalances, we see a strong need to amend the 2019 budget.

Second, and following up on the staff's response to Mr. Just's question on the public financial management assessment, we would like to encourage the authorities to consider the option of undertaking a Public Investment Management Assessment (PIMA). As we have seen in other country cases, the Fund's PIMA is an efficient tool to improve fiscal sustainability and strengthen public financial governance.

Third, we welcome the progress made by the authorities in fighting against money-laundering and financing of terrorism. However, we agree with Mr. Ostros, Mr. Di Tata, Mr. Sun, and others that ongoing efforts to enhance the Anti-Money Laundering and Combating the Financing of Terrorism (AML/CFT) framework are crucial not only to ensure financial resilience but also to stabilize correspondent banking relationships. Furthermore, we see a need for the central bank to finish the implementation of a risk-based AML/CFT supervision. To foster transparency, we support the staff's recommendation to publish the main findings of the National Risk Assessment.

Mr. Al Hafedh made the following statement:

I just wanted to highlight that we support Mr. Geadah's emphasis on the pace of implementation being appropriate considering the diversification efforts and the continued growth in oil and gas investment returns.

Finally, we commend the Omani authorities for their efforts on the structural reforms implementation and wish them further success and prosperity.

Mr. Geadah made the following concluding remarks:

I have a few quick points. First, I would like to thank Directors for their views and advice, which I will relate to my Omani authorities today.

Second, on the summing up, I hope the summing up can reflect the good progress that Oman has made over the last few years.

Third, I would like to mention this was Mr. Roudet’s first Article IV consultation to Oman. I hope he stays on as mission chief, especially given the discussion we had earlier this week about mission chief turnover, which is more of a general issue.

The Acting Chair (Mr. Furusawa) noted that Oman is an Article VIII member, and no decision was proposed.

The following summing up was issued:

Executive Directors agreed with the thrust of the staff appraisal. They welcomed steps taken over the past few years to enhance private sector growth, reduce spending growth, diversify government revenue, and improve the business environment. They noted that economic activity had started to recover last year and that the fiscal and current account deficits improved. Notwithstanding these efforts and the recovery in oil prices, Directors indicated that Oman’s public and external vulnerabilities have continued to grow. Given the challenging external environment and regional uncertainty, Directors thus called for a deeper fiscal adjustment to maintain confidence and ensure fiscal and external sustainability, coupled with continued structural reforms to diversify the economy, improve productivity and enhance private-sector-led growth.

While welcoming the authorities’ plans to continue with fiscal consolidation, they called for an expeditious introduction of VAT and measures to adjust government expenditure. They also encouraged the authorities to lay out and implement an ambitious medium-term fiscal adjustment plan, based on reforms to tackle current spending rigidities, streamline public investment, and raise non-hydrocarbon revenue, while prioritizing measures that limit the impact on growth and place more of the adjustment on those who can best shoulder it.

Noting the importance of enhancing fiscal governance and transparency, Directors also suggested that a formal medium-term fiscal framework would help anchor fiscal consolidation and limit implementation risks. In that context, the authorities' plan to carry out a Public Expenditure Review with the support of the World Bank would be useful.

Directors concurred that the exchange rate peg to the US dollar had delivered low and stable inflation and remained appropriate. With external buffers, albeit currently adequate, projected to continue to decline, Directors noted that the recommended fiscal adjustment would be key to bring the external position more in line with fundamentals, bolster external sustainability, and support the currency peg.

Notwithstanding strong financial sector soundness indicators and ongoing efforts to further strengthen its resilience, Directors called for continued attention to regulation and supervision and further efforts in enhancing the AML/CFT framework, which would help support correspondent banking relationships.

Directors commended the ongoing implementation of the *Tanfeedh Program* with a focus on economic diversification and job creation. They encouraged further reforms to address labor market rigidities including by better aligning public-sector compensation with that of the private sector and by addressing skills mismatches through higher quality education and training. They also encouraged further SME development including through better access to finance, to raise productivity.

It is expected that the next Article IV consultation with Oman will be held on the standard 12-month cycle.

APPROVAL: April 24, 2020

JIANHAI LIN
Secretary

Annex

The staff circulated the following written answers, in response to technical and factual questions from Executive Directors, prior to the Executive Board meeting:

Fiscal policy and debt sustainability

1. ***We would be interested in staff views on whether Oman may need some form of external assistance to smooth the required adjustment.***

- The government has thus far been able to access international capital markets at reasonable costs. Staff's baseline projections assume an increase in funding costs due to both an upward trend in global rates and a higher risk premium. Should the financing environment deteriorate even more, fiscal and external buffers (in the order of 26 percent of GDP, and over 110 of the Fund's ARA metric, respectively) would provide some cushion. Against this backdrop, the authorities have not indicated to staff any desire to seek external assistance.

2. ***We are wondering whether the authorities are considering to undertake a Public Investment Management Assessment and PFR.***

- Staff is not aware of any plans by the authorities to undertake a public investment management assessment (PIMA). The authorities have indicated their intention to carry out a Public Expenditure Review (PER) with support of the World Bank.

3. ***We note the expected revision of the public sector wage grid for new recruits to limit compensation growth and appreciate staff further elaboration.***

- The authorities' plan is to restructure the civil service wage grid to allow for entry-level hiring at lower grade than under current rules. At unchanged recruitment policy (volume effect), this would allow for a reduction in total public sector compensation.

4. ***Could staff elaborate on how much of the higher fiscal spending could be explained by delayed recording?***

- Staff has not been able to obtain the full breakdown of spending booked in 2018 but executed in previous fiscal years. At the same time, there also appears to be some expenditure that was executed in 2018 but not yet booked, which also complicates the assessment. Against this backdrop, staff has called on the authorities to ensure timely availability of reliable and comprehensive budget execution and financing data, avoid off-budget spending, and improve the recording of unpaid bills.

5. ***Could staff elaborate on the impact of a higher deficit reduction in 2019?***

- Staff recommended that the authorities amend the 2019 budget with a view to reduce the deficit to signal the government's determination to tackle vulnerabilities. Staff prepared an illustrative scenario where budget spending on goods and services and capital expenditure is reduced by 0.3 and 0.2 ppts of non-hydrocarbon GDP, respectively. Using multipliers of 0.3 and 0.7 for current and capital spending (consistent with the recent literature on GCC countries), respectively, this would entail a reduction of non-oil growth in the order of 0.2 percentage points this year compared to staff's baseline.

6. ***Could staff elaborate on any measures that have been taken to strengthen public investment and procurement?***

- Regarding public investment management, the authorities have indicated to staff that they have made significant efforts to prioritize investment projects that have a high impact on growth and help foster economic diversification. Staff is not aware of recent reforms to strengthen procurement practices but recommended this as an area of reform to foster higher public-sector efficiency.

7. ***Noting the authorities' concern over the potential adverse impact of fiscal adjustment, we would like to invite staff to shed more light on the possible sequencing of the reforms to garner social support.***

8. ***Staff's deeper analysis to guide prioritization has been suggested. We invite staff comments on this.***

9. ***What measures do staff envisage the authorities should undertake to minimise the impact of the most vulnerable?***

10. ***We would like staff to update the progress of the authorities' medium-term fiscal consolidation plan. We also would like staff to elaborate their suggestions to the authorities on what kind of fiscal measures needed to support the ambitious adjustment path in this plan.***

- The key challenge for the authorities is to find a balance between tackling fiscal and external vulnerabilities while limiting the impact of adjustment on the economy and maintaining social consensus. The adjustment strategy recommended by staff aims at balancing these considerations, based on a reasonable pace of reforms, a focus on tackling underlying public finance vulnerabilities, and a due regard to social feasibility.

- On the proposed pace of adjustment, while it will have costs for short-run growth (as documented in the report) and possibly job creation, staff is of the view that these would ease over time as dividends from structural reforms bear fruit.

- On the focus of reforms, the increase in government expenditure over the past decade was particularly large and biased toward rigid current spending, and its gradual reduction relative to GDP should carry a smaller growth cost. Revenues are still highly undiversified and heavily susceptible to oil price fluctuations. Against this backdrop, staff believes that a balanced approach to the composition of adjustment that tackles underlying spending and revenue weaknesses and creates space for high-impact growth-enhancing investment, would help limit these costs.

- Staff has highlighted in its policy recommendations the importance of ensuring that the burden of adjustment be shared in an equitable way, a prerequisite to maintain support for continued reform efforts. To do so, staff has suggested several options, both for revenue and expenditure reforms. On the former, while it has recommended advancing VAT introduction as a priority (given the investment already made by the authorities and the regional context), it has also suggested moving towards more progressive taxes over the medium term. On expenditure reforms, staff has recommended tackling current spending rigidities as a priority, to give enough room for growth enhancing investment. Staff has also highlighted the importance of conducting social impact analysis of key fiscal reforms. This will help design proper protection mechanisms for the most vulnerable—for example compensation schemes to protect low-income households from higher electricity and water prices. Upon request, staff could provide support to the authorities in this endeavor. FAD, for instance, has provided TA in these areas in other countries.

- The authorities are currently in the process of preparing their medium-term consolidation plan. The latter has not yet been shared with staff.

11. ***We have some reservations on the size of adjustment recommended by staff to improve non-oil primary balance (8 ppts of non-hydrocarbon GDP). Comments are appreciated.***

- Staff's recommended adjustment aims at striking a balance between addressing mounting macroeconomic vulnerabilities and limiting the impact of fiscal adjustment on the economy. The suggested consolidation of the order of 8 ppts of non-hydrocarbon GDP is to be implemented gradually over a 5-year period. Staff has also suggested ways to limit the impact of consolidation on growth and social outcomes. In addition, the proposed magnitude of adjustment appears feasible. In particular, it is not out of line with past episodes of relatively large adjustments in Oman and more generally in the GCC (see for example footnote 3 on page 11 of the staff report).

12. ***Finally, we welcome the authorities' request for technical assistance. Can staff outline what work is being undertaken or planned?***

- In recent years, IMF staff has supported the authorities' reform efforts with technical assistance in various areas. These have included assistance in developing a medium-term fiscal framework and in preparing the tax administration to introduce VAT and excise taxes. The authorities have recently requested further TA to review the organization of the tax administration. The request is being considered by FAD.

Financial sector, monetary, and exchange rate policies

13. ***We wonder whether a peg to a basket of USD and EUR, which would imply a lower policy rate, could be a better fit. A peg to such a basket would also reduce the impact of fluctuations of oil prices on the fiscal deficit given that oil prices in USD and the USD/EUR exchange rate show considerable movement since 2005 as recently noted by the New York Federal Reserve Bank (Klitgaard et al, 2019). Staff's comments are welcome.***

14. ***We would like staff to advice when and under what circumstances the authorities need to consider changing to flexible exchange rate regime?***

- Staff is of the view that the current peg to the U.S. dollar remains an appropriate exchange rate regime for Oman. Indeed, the peg has been effective in delivering monetary policy credibility as well as low and stable inflation.

- A more flexible exchange rate regime, such as a peg to a basket, could help smooth the impact of oil price fluctuation on the external and fiscal position. At the same time, however, the still low degree of economic diversification (and hence the low non-hydrocarbon export base) and the high reliance on foreign labor (essentially priced in US dollar) are significantly reducing the potential benefits of exchange rate flexibility as a stabilization tool in the face of shocks. In addition, in the case of a peg to a basket, monetary policy in Oman would still be constrained by the policy stance in the relevant countries—the currencies of which are used in the basket.

- Two quantitative analyses prepared by Fund staff in 2011 and 2013 corroborated this assessment, concluding that while a limited degree of exchange rate flexibility and monetary autonomy could help reduce macroeconomic volatility, these gains would likely be modest. These studies also showed that alternative pegs would not bring significant welfare benefits and would be less practical. Over the longer term, as the economy diversifies, and more nationals are employed by the private sector, these benefits may increase.

15. ***While previous Article IVs mentioned the need for other policies to support the continued fixed exchange rate, this text places a stronger emphasis on the necessity of supportive policies. To what extent, if any, do staff think things have materially changed in this aspect?***

- Over the past few years, staff has noted that other macroeconomic policies need to be supportive and consistent with the fixed exchange rate regime. However, with macroeconomic vulnerabilities having increased over the past few years, it has become more important to adjust the fiscal stance to bolster fiscal and external sustainability and in support of the US dollar peg.

16. ***We highlight the authorities' concerns that the analysis of the external assessment in Annex V shows variations in the model results. Staff comments are welcome.***

- The authorities were broadly in agreement with the main conclusions of the external sector assessment, namely that the external position is weaker than implied by fundamentals, largely reflecting a fiscal imbalance. Mr. Geadah's BUFF statement highlights the variation in the model-based results to estimate the current account gaps and exchange rate valuation. Indeed, the two current account approaches—consumption-based (or external sustainability) approach and the EBA-light approach—point to substantial current account gaps, while the real exchange rate model point to a small undervaluation. However, in the case of Oman (and indeed in the case of many oil exporters of the region), staff has traditionally considered the external sustainability approach more suitable, because it relates directly to concerns related to intergenerational equity. At the same time, the fit of the other models has been poor.

17. ***Given the emphasis placed on SMEs' development, we would welcome staff's comments on financial inclusion issues, and the potential role of Islamic finance in this regard.***

- Based on recent staff analysis[2], Oman has one of the lowest gaps in access to finance for households in the GCC region. However, there exists substantial room to increase financial inclusion relative to the advanced economies, with notable gaps for the youth, females, and SMEs.

- The authorities have taken several measures to enhance financial inclusion. In 2017, the CBO introduced a mobile payment system that also facilitated access to finance

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[2] https://www.imf.org/en/Publications/Policy-Papers/Issues/2018/12/04/pp120618gcc-how-developed-and-inclusive-are-financial-systems-in-the-gcc

for underbanked segments of society. The CBO also supported the opening of more bank branches and Islamic windows in conventional banks (see below). The planned reforms to enhance the coverage and user base of the credit registry will also help better assess credit risk and increase access to finance along with the ongoing efforts to maintain sound correspondent banking relationships. To support SME financial inclusion, the CBO has set a 5-percent SME lending target in banks' loan portfolio. The state-owned Oman Development Bank provides subsidized SME loans, in addition to the Al-Raffd Fund, which funds start-ups.

- Islamic finance can indeed play an important role in enhancing financial inclusion by increasing the supply of financial intermediation, particularly to segments of society that do not consume conventional finance products. Islamic finance institutions have grown at a rapid pace in Oman over the past decade. There are now two full-fledged Islamic banks, and conventional banks also have Islamic windows. The assets of Islamic banks grew by more than fourfold over the past five years, crossing 12 percent of total banking sector assets. The number of branches of Islamic banking entities also rose sharply over this period, from 32 to 76.

18. ***Should severe solvency and liquidity shocks occur in the near future, how should authorities respond to eschew negative impact to banks' asset quality and liquidity that could in turn weigh on private sector credit and growth? Staff advice are welcome.***

- The Central Bank of Oman's stress tests indicate that the banking system would be able to withstand severe solvency and liquidity shocks. This means the large loss-absorption buffers and comfortable liquidity position, which partly reflect Oman's sound regulatory and supervisory environment, would likely limit the impact of severe shocks on banks' ability and willingness to continue extending credit in the face of a shock. However, it would not be surprising to see lower credit growth in the face of a severe shock, which may reflect both demand and supply factors. With both fiscal space at risk and monetary policy guided by the US dollar peg, the authorities would only have limited scope to react in these circumstances, hence underlining the importance of building buffers and maintaining a sound financial system in good times.

19. ***While we appreciate the important strides made in enhancing the AML/CFT framework, we are wondering whether the authorities are preparing a time-bound action plan to address the identified ML/FT risks in the National ML/TF Risk Assessment.***

- Following completion of the technical national risk assessment (NRA) work, Oman's national AML/CFT committee is expected to adopt the NRA this year. In response to a committee’s request, IMF staff assisted authorities, in January 2019, in developing plans for responding to the issues identified in Oman's NRA, including brainstorming over the main components of a national AML/CFT strategy and action plan. The committee plans the establishment of a national AML/CFT strategy, including time-bound actions, next year.

Structural policies

20. ***We welcome plans to increase SME access to finance, including by complementing bank credit with alternative channels of financing. Given numerous agencies involved in promoting and supporting SMEs, could staff indicate if the authorities consider consolidating such agencies to avoid likely inconsistency and duplication and ensure maximum impact?***

- The authorities acknowledged that consolidating the number of SME support agencies, particularly in view of the duplicating functions, and redeploying resources to where they are needed the most would generate efficiency gains in the strategy to foster SME development. However, they did not commit to specific reforms on this front.

21. ***Could staff elaborate on the elements of the labor law and its anticipated impact?***

- Based on the original draft labor law, which was prepared in consultation with the World Bank, the labor market reform should help reduce labor market rigidities. The key provisions are aimed at strengthening the dispute resolution mechanism, increasing female labor force participation, and facilitating collective bargaining agreements. That said, the draft law has been pending for the past several years and may still experience significant changes before being enacted. This makes assessing the impact of the reform difficult at the current juncture.