

The contents of this document are preliminary and subject to change.

GRAY/06/732

March 3, 2006

**Statement by Mr. Al-Turki on Islamic Republic of Afghanistan
(Preliminary)
Executive Board Meeting 06/22
March 6, 2006**

I thank the staff for the informative papers and Mr. Mirakhor for his insightful buff statement. The Afghan authorities are to be commended for the remarkable economic performance under the Staff-Monitored Program (SMP). As noted in the staff report, the authorities have continued to pursue prudent fiscal and monetary policies and have made further advances in structural reforms in the face of the country's difficult conditions. As a result, real GDP growth is projected to be robust with lower inflation and improved fiscal and external positions. The challenge before the authorities is to sustain the momentum for broad-based reforms so as to strengthen macroeconomic stability and improve social indicators.

On fiscal policy, the authorities are to be commended for the strong performance during the current fiscal year. Indeed, the overall deficit is expected to be significantly lower-than-expected, which should help build-up cash reserves further. These positive developments reflect the adoption of new tax measures. Moreover, the budgetary process has been strengthened through the adoption of a new public finance and expenditure law and the publication of monthly core budget reports. The authorities' continued commitment to fiscal prudence is also evidenced in the planned reduction in the operating deficit for 2006-07.

Over the medium term, I concur with the staff that the fiscal policy should remain cautious to ensure macroeconomic stability and maintain external imbalances at sustainable levels. The fiscal objectives and targets envisaged under the medium-term fiscal framework (MDFF) are important steps in this regard. To this end, further efforts are needed to increase revenue from the current low level. Here, continued implementation of the current reform plan for the customs and tax administrations is essential. I also share the staff's caution against introducing ad-hoc duty exceptions. The authorities are also encouraged to implement a civil service reform program to contain the wage bill and pensions at affordable levels.

The authorities' current monetary program remains appropriate. However, monetary developments should continue be monitored closely and the Da Afghanistan Bank (DAB) should stand ready to tighten monetary stance as needed to achieve the targeted reduction in

inflation. The intention to introduce new monetary instruments and develop DAB's analytical capacity is a step in the right direction that should help modernize and strengthen the monetary framework. I also agree that the current exchange rate regime has served the economy well.

Turning to the financial sector, I welcome the ambitious program for the modernization and reform of the public banking sector. In particular, I welcome the plan to improve banks' operational efficiency and create an enabling environment for bank lending. Timely adoption of an appropriate legal and administrative framework for the development of private financial institutions is also essential.

On other structural reforms, improving business climate and promoting private sector development are essential for sustained rapid growth and poverty alleviation. In this regard, the authorities' intention to make further progress in restructuring and privatizing state-owned enterprises (SOEs) is encouraging. Strengthening the legal and regulatory environment for private sector activities is also a priority. In addition, continued efforts are needed to eliminate the opium economy. As the staff emphasizes, the government should vigorously implement the programs aimed at reducing the cultivated area and put in place alternative income generation activities.

The current SMP has evidently been instrumental in maintaining macroeconomic stability and building the structural reform momentum, improving the administrative capabilities, and developing appropriate policies that meet the requirements of the country. In this regard, the authorities' intention to move to a more ambitious program is encouraging. Here, I share the staff's view that a PRGF-supported program would help the authorities consolidate the gains that have been made under the SMP.

With these remarks, I wish the authorities further success in meeting the policy challenges ahead.