

BUFF/07/174

December 20, 2007

**The Acting Chair's Summing Up
Iraq—Request for Stand-By Arrangement
Executive Board Meeting 07/111
December 19, 2007**

Executive Directors commended Iraq's overall good performance under the current Stand-By Arrangement despite difficult security and political circumstances. They welcomed the authorities' tight monetary and exchange rate policies, and the maintenance of fiscal discipline. Together with measures to reduce fuel shortages, this policy mix has helped to reduce dollarization and succeeded in sharply bringing down a high rate of inflation. Directors also welcomed the progress achieved in adjusting domestic fuel prices, which has resulted in the elimination of direct budgetary subsidies, with the exception of a small subsidy on kerosene.

Directors noted, however, that Iraq still faces enormous challenges. The difficult security situation and capacity constraints have slowed the execution of the investment program, keeping oil production and economic growth below target. The modernization of financial management of the government and the central bank, and the reform of the banking system, are still at an early stage.

Directors concurred with the main objectives of the new program, which will focus on maintaining macroeconomic stability, facilitating investment and higher output in the oil sector, and advancing priority structural reforms and institution building. By triggering the third and final stage of Paris Club debt rescheduling, the program will contribute to fiscal and external sustainability.

Directors noted, however, that the implementation of the proposed program carries significant risks. Although Iraq's medium-term outlook is favorable, it depends critically on further improvements in the security situation. The unsettled political situation could reduce the ability of the government to maintain fiscal discipline and undertake reforms, while weaknesses in governance in some areas and corruption also remain a concern.

Directors welcomed the priority given in the draft 2008 budget to increasing investment while containing current spending and maintaining fiscal sustainability. They welcomed the amendments to the new pension law to make the pension system fiscally sustainable. Directors urged the authorities to speed up completion of the census of public service employees, in order to computerize the payroll and put the wage bill on a sound footing.

Directors encouraged the authorities to continue the gradual appreciation of the exchange rate and the tight monetary policy stance until annual core inflation is brought down to close to single digit levels. They welcomed the preparatory work to develop new instruments of monetary policy.

Directors stressed the need to accelerate priority structural reforms. They encouraged the authorities to prepare an action plan for strengthening public financial management and to publish the audited fiscal accounts for 2007. Directors welcomed the commitment to develop audit-based restructuring programs for Rafidain and Rasheed banks. They underlined the importance of continuing to refrain from direct budget subsidies on fuel products, except for kerosene, and of developing a periodic adjustment formula for domestic fuel prices. Directors urged the authorities to expand the coverage of metering systems in the oil sector and to ensure that the Committee of Financial Experts will be ready to gradually replace the International Advisory and Monitoring Board as an audit oversight body for the Development Fund for Iraq. They also encouraged the authorities to establish a new legislative framework for the hydrocarbon sector, in view of Iraq's large future investment needs. Noting the importance of improving governance in this sector, Directors welcomed the authorities' intention to put in place a comprehensive metering system and to join the Extractive Industries Transparency Initiative.

Directors welcomed the steps taken in strengthening financial safeguards at the central bank. They urged the authorities to step up their efforts to address all the recommendations of the Fund's interim safeguards assessment report and the Ernst & Young 2006 audit report.

Directors welcomed the authorities' efforts to conclude debt agreements with the remaining official and private creditors. They urged the government and those creditors with which agreements have not yet been signed to expedite the process of providing debt relief on terms comparable to those of the 2004 Paris Club Agreement.

Directors stressed the need to further improve the statistical database.