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**Statement by Mr. Prader and Mr. Orynbayev on Oman  
(Preliminary)  
Executive Board Meeting 08/35  
April 21, 2008**

We thank the staff for the well-written paper and Mr. Shaalan for his helpful Buff statement. We commend the authorities for maintaining a prudent macroeconomic policy and making a concerted effort to diversify the economy away from the hydrocarbon sector. We agree with the staff that the moderate but increasing inflation remains a challenge for the authorities. The main sources of inflationary pressures are external, including the high global food prices and the depreciation of the U.S. dollar.

Historically, Oman has had very low inflation, at times even negative. However, inflation has been on an upward trend since 2004 and is now a major concern in the medium-term. The authorities' plan to create a ministerial committee which will study the main causes of inflation is reflective of this concern. Although maintaining the peg to the U.S. dollar is justified, it leaves limited space for exchange rate flexibility. Given this limitation, the staff is right in recommending a stronger fiscal policy to contain domestic demand and inflation. Higher oil prices have resulted in higher revenues which have contributed further to the fiscal surplus. This has enabled the government to implement their ongoing economic reform agenda which is aimed at creating employment opportunities for the rapidly growing young and well-educated population. We note the efforts that are being made to modernize the fiscal sector by preparing for the introduction of value added taxation (VAT). We also note staff's analysis that the VAT would offset revenue losses from ongoing trade liberalization. Given the fact that VAT preparations are well advanced, could the staff comment on the time frame for its introduction? Also, why is it that the authorities want to wait for the U.A.E to adopt the VAT first rather than taking the lead?

We commend the authorities for their intention to reduce gradually the capital expenditures on oil recovery programs and we encourage them to proceed with the privatization of the utilities companies. These reforms would relieve the pressure from the expenditure side of the budget. Reducing subsidies on petroleum products could also entail significant savings.

The staff has rightly emphasized that restraint should be exercised in the growth of wages and transfers. We welcome the authorities' intention to raise the retirement age and to increase employee contributions to the Civil Servant Employees Pension Fund.

We agree that the exchange rate peg should be maintained. However, monetary policy needs to be more effective. In this regard, it is important to improve liquidity management and better align the domestic short-term interest rates with those of the United States.

The authorities are undertaking commendable structural reforms, especially reforms targeted at improving education and training.

Like the staff, we believe that diversification efforts could be supported by a better business and investment environment. It is noteworthy that the authorities are now allowing foreigners to own tourism-related properties. The authorities should also make some legislative changes which would support the Oman – U.S. free trade agreement.

With these remarks, we wish the authorities success.