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CONFIDENTIAL

September 19, 1983

To: Members of the Executive Board

From: The Acting Secretary

Subject: Morocco - Stand-By Arrangement

Attached for the records of the Executive Directors is the text of the stand-by arrangement for Morocco agreed at Executive Board Meeting 83/142, September 16, 1983.

Att: (1)

Morocco--Stand-By Arrangement

Attached hereto is a letter, with annexed memorandum, dated July 30, 1983, from the Minister of Finance of Morocco, requesting a stand-by arrangement and setting forth:

(a) the objectives and policies that the authorities of Morocco intend to pursue for the period of this stand-by arrangement;

(b) the policies and measures that the authorities of Morocco intend to pursue for the first six months of this stand-by arrangement; and

(c) understandings of Morocco with the Fund regarding reviews that will be made of progress in realizing the objectives of the program and of the policies and measures that the authorities of Morocco will pursue for the remaining period of this stand-by arrangement.

To support these objectives and policies, the International Monetary Fund grants this stand-by arrangement in accordance with the following provisions:

1. For the period from September 16, 1983 to March 15,1985, Morocco will have the right to make purchases from the Fund in an amount equivalent to SDR 300.00 million, subject to paragraphs 2, 3, 4, and 5 below, without further review by the Fund.

2. (a) Purchases under this stand-by arrangement shall not, without the consent of the Fund, exceed the equivalent of SDR 30.00 million until October 31, 1983; the equivalent of SDR 90.00 million until January 31, 1984; the equivalent of SDR 130.00 million until April 30, 1984; the equivalent of SDR 170.00 million until July 31, 1984; the equivalent of SDR 210.00 million until October 31, 1984; and the equivalent of SDR 260.00 million until January 31, 1985.

(b) None of the limits in (a) above shall apply to a purchase under this stand-by arrangement that would not increase the Fund's holdings of Morocco's currency in the credit tranches beyond 25 percent of quota or increase the Fund's holdings of that currency resulting from purchases of borrowed resources beyond 12.5 percent of quota.

3. Purchases under the stand-by arrangement shall be made from ordinary and borrowed resources in the ratio of 1 to 1.2 until total purchases under the arrangement reach the equivalent of SDR 118,074,736 and thereafter from borrowed resources only, provided that any modification by the Fund of the proportions of ordinary and borrowed resources shall apply to amounts that may be purchased after the date of modification.

4. Morocco will not make purchases under this arrangement, other than the initial purchase of SDR 30 million that it may request not later than within 20 days of the effective date of this arrangement, that would increase the Fund's holdings of Morocco's currency in the credit tranches beyond 25 percent of quota or increase the Fund's holdings of that currency resulting from purchases of borrowed resources beyond 12.5 percent of quota:

(a) during any period through April 30, 1984, in which

(1) the data for the preceding calendar quarter within the period of this arrangement indicate that

(i) the ceiling on total net borrowing by the Treasury described in paragraph 9 of the memorandum on economic and financial policy annexed to the attached letter; or

(ii) the ceiling on changes in "fonds réservés" described in paragraph 9 of the same memorandum; or

(iii) the ceiling on total bank credit described in paragraph 11 of the same memorandum; or

(iv) the ceiling on bank credit to the Treasury also described in paragraph 11 of the same memorandum; or

(v) the ceiling on contracting and guaranteeing new nonconcessional external borrowing with a maturity of between 1 and 15 years described in paragraph 14 of the same memorandum; or

(vi) the ceiling on short-term external debt also described in paragraph 14 of the same memorandum

is not observed; or

(2) understandings on additional adjustment measures have not been reached in accordance with paragraph 2 of the attached letter, or having been reached, are not being observed;

(b) during the period after April 30, 1984, until understandings have been reached with the Fund on appropriate policies, and suitable performance criteria have been established in consultation with the Fund, as contemplated by paragraph 2 of the attached letter or, after such performance criteria have been established, while they are are not being observed; or

(c) during the entire period of this stand-by arrangement, if Morocco

(i) imposes or intensifies restrictions on payments and transfers for current international transactions, or

(ii) introduces multiple currency practices, or

(iii) concludes bilateral payments agreements that are inconsistent with Article VIII, or

(iv) imposes or intensifies import restrictions for balance of payments reasons.

When Morocco is prevented from purchasing under this stand-by arrangement because of this paragraph 4, purchases will be resumed only after consultation has taken place between the Fund and Morocco and understandings have been reached regarding the circumstances in which such purchases can be resumed.

5. Morocco's right to engage in the transactions covered by this stand-by arrangement can be suspended only with respect to requests received by the Fund after (a) a formal ineligibility, or (b) a decision of the Executive Board to suspend transactions, either generally or in order to consider a proposal, made by an Executive Director or the Managing Director, formally to suppress or to limit the eligibility of Morocco. When notice of a decision of formal ineligibility or of a decision to consider a proposal is given pursuant to this paragraph 5, purchases under this arrangement will be resumed only after consultation has taken place between the Fund and Morocco and understandings have been reached regarding the circumstances in which such purchases can be resumed.

6. Purchases under this stand-by arrangement shall be made in the currencies of other members selected in accordance with the policies and procedures of the Fund, and may be made in SDRs if, on the request of Morocco, the Fund agrees to provide them at the time of the purchase.

7. The value date of a purchase under this stand-by arrangement involving borrowed resources will normally be either the 15th day or the last day of the month, or the next business day if the selected day is not a business day. Morocco will consult with the Fund on the timing of purchases involving borrowed resources.

8. Morocco shall pay a charge for this arrangement in accordance with the decisions of the Fund.

9. (a) Morocco shall repurchase the outstanding amount of its currency that results from a purchase under this stand-by arrangement, in accordance with the provisions of the Articles of Agreement and decisions of the Fund, including those relating to repurchase as Morocco's balance of payments and reserve position improves.

(b) Any reductions in Morocco's currency held by the Fund shall reduce the amounts subject to repurchase under (a) above in accordance with the principles applied by the Fund for this purpose at the time of the reduction.

(c) The value date of a repurchase in respect of a purchase financed with borrowed resources under this stand-by arrangement will normally be either the 6th day or the 22nd day of the month, or the next business day if the selected day is not a business day, provided that repurchase will be completed not later than seven years from the date of purchase.

10. During the period of the stand-by arrangement, Morocco shall remain in close consultation with the Fund. These consultations may include correspondence and visits of officials of the Fund to Morocco or of representatives of Morocco to the Fund. Morocco shall provide the Fund, through reports at intervals or dates requested by the Fund, with such information as the Fund requests in connection with the progress of Morocco in achieving the objectives and policies set forth in the attached letter and annexed memorandum.

11. In accordance with paragraph 3 of the attached letter, dated July 30, 1983, Morocco will consult the Fund on the adoption of any measures that may be appropriate, at the initiative of the Government or whenever the Managing Director requests consultation because any of the criteria in paragraph 3 above have not been observed or because he considers that consultation on the program is desirable. In addition, after the period of the arrangement and while Morocco has outstanding purchases in the upper credit tranches, the Government will consult with the Fund from time to time, at the initiative of the Government or at the request of the Managing Director, concerning Morocco's balance of payments policies.

Kingdom of Morocco

Ministry of Finance

The Minister

Rabat, July 30, 1983

Mr. Jacques de Larosière
Managing Director
International Monetary Fund
Washington, D.C. 20431
U.S.A.

Dear Mr. de Larosière:

1. The attached memorandum sets forth the economic and financial objectives of a stabilization program adopted by the Government of the Kingdom of Morocco for the period from July 1983 to December 1984, as well as the measures the Government has already taken or will take during the period in order to meet these targets. In support of this program, the Government of the Kingdom of Morocco requests the use of International Monetary Fund resources under an 18-month stand-by arrangement in the amount of SDR 300 million.

2. The attached memorandum also indicates the performance criteria of the program for the remainder of 1983, which relate to (a) net borrowing by the Treasury, (b) total bank credit, (c) net bank credit to the Treasury, (d) external debt contracted, guaranteed or authorized by the Government, and (e) the foreign trade and exchange system. Before November 30, 1983, the Government of the Kingdom of Morocco will hold a first consultation with the Fund to assess the results of efforts to obtain financing of the 1983 and 1984 balance of payments deficits and will reach understandings with the Fund on required additional adjustment measures. In the course of this review, the Government will also reach agreement with the Fund on the fiscal policy to be reflected in its 1984 Budget Law and on suitable quarterly performance criteria for 1984. Before August 30, 1984, the Government will hold a second consultation with the Fund on the progress of the program and on exchange policy. A third consultation will take place before November 30, 1984, during which the Government will reach agreement with the Fund on the fiscal policy to be reflected in the 1985 Budget Law and which could subsequently serve as a basis for another stand-by arrangement.

3. The Government believes that the policies described in the attached memorandum are adequate to achieve the objectives of the program. However, it will take any additional measures that might become necessary for this purpose. Furthermore, Morocco will consult with the Fund in accordance with the policies of the Fund.

Sincerely yours,

/s/

Abdellatif JOUAHRI
Minister of Finance

Memorandum on the Economic and Financial Policy of the Kingdom of Morocco

I. Introduction

1. Despite the recession on world phosphate markets and the impact of the drought prevailing since 1980, economic activity in Morocco picked up in 1982, as reflected by a growth rate estimated at 5.6 per cent. In addition, the overall Treasury deficit (adjusted for changes in "Fonds réservés": domestic bills awaiting payment) was reduced from 14.5 per cent of GDP in 1981 to 12.5 per cent in 1982, while the inflation rate was brought down to 10.6 per cent. However, largely because of the decline in phosphate exports, high interest rates, and the sharp appreciation of the U.S. dollar, the current account deficit of the balance of payments remained extremely high, representing 12.9 per cent of GDP, and the overall balance of payments deficit amounted to SDR 325 million, or SDR 118 million more than in 1981. During the year, the Government introduced a number of recovery measures, including increasing some taxes, reducing current expenditure as projected in the Budget Law, raising the prices of petroleum products, as well as water, electricity, and transport tariffs, increasing interest rates, adjusting the exchange rate, and liberalizing the trade and the exchange system. These measures were taken under the program supported by a stand-by arrangement with the Fund dated April 26, 1982.

2. Despite this improvement, financial disequilibria are still cause for concern. The economic and financial situation has recently deteriorated because of exogenous factors, in particular the continued recession in the phosphate sector and the world economy as a whole, but also because of a pronounced acceleration in capital expenditure, which exceeded that projected in the program. This expansion occurred in anticipation of external receipts which were not realized. In addition, the burden represented by the external debt, which has risen to over 70 per cent of GDP, has become unsustainable. Service on this debt is estimated at about 42 per cent of export earnings and transfers in 1983 as against 34 per cent in 1982. In the absence of adjustment measures, the current account deficit could amount to SDR 1.9 billion in 1983.

3. In view of the above and the external financing outlook, the Moroccan economy must undergo a major adjustment in a relatively short time in order to restore financial equilibria and to maintain a satisfactory and lasting rate of growth. This adjustment should principally relate to total consumption, which now amounts to about 91 per cent of GDP. The adjustment strategy, designed in the context of a medium-term framework, is aimed mainly at reducing the resource gap from 14 per cent of GDP in 1982 to less than 3 per cent in 1987. Such a reduction would be compatible with maintaining an investment rate of 20 per cent of GDP, allowing for an average rate of economic growth of about 3 per cent.

4. Private and public consumption will be affected by an austerity policy in several areas, in particular employment, national education, prices, incomes, the budget and exchange matters. The Government has thus already revised the investment program to reflect the financial situation. This strategy will be accompanied by an appropriate monetary policy.

II. Program for 1983-84

5. The Government has adopted, in the context of a medium-term outlook, a stabilization program covering the second half of 1983 and all of 1984. The principal objective of this program is to limit the current account deficit to SDR 1.2 billion (approximately 9 per cent of GDP) in 1983 and SDR 850 million (less than 7 per cent of GDP) in 1984. These estimates, which do not take into account new exceptional resources, are based on the assumption that the terms of trade will deteriorate by 5 per cent in 1983 and improve in 1984. For 1983, exports should increase only slightly in value terms because of a slack in world demand for phosphates, while the value of imports should decrease by 11 per cent. Taking into account external debt amortization of SDR 810 million in 1983 and SDR 1 billion in 1984, as well as the external assistance already lined up, the overall balance of payments deficits for 1983 and 1984 are expected to amount to SDR 600 million and SDR 1.2 billion, respectively. To cover these deficits, the Government intends to seek, in addition to Fund assistance, exceptional assistance from friendly countries and other sources of funds, including commercial banks. To meet these objectives, the Government has drawn up the policy described below and adopted specific measures under the program for 1983; additional measures to be taken in 1984 will be determined in consultation with the Fund when the 1984 Budget Law is prepared at the time of the first review of the program.

6. For the past several years the Government has endeavored to stabilize prices by pursuing a policy of price controls and subsidies. This policy has encouraged consumption and has placed a progressively larger and more unpredictable burden on the budget. The Government has decided to reduce the subsidies, even to eliminate them for certain products, and at the same time to review subsidy-granting practices and deregulate certain controlled prices. As a first stage of this new policy, on July 31, 1983 the Government announced increases ranging from 18 per cent to almost 70 per cent in the prices of block sugar and sugarcube, edible oils, butter and high-quality flour (farine de luxe), virtually eliminating the subsidies on these products. In addition, the prices for fertilizers, electricity, and water and harbor fees have been raised by similar amounts. Furthermore, the Government has decided henceforth to grant only a fixed per-unit subsidy of DH 1.42 per kilogram of granulated sugar. Expenditures on subsidies will be reduced even further in 1984 by limiting the per-unit subsidies to a maximum of DH 1.30 per kilogram of granulated sugar and DH 0.50 per kilogram of low-quality flour (farine nationale). As for petroleum products, on July 31, the Government announced a 6 per cent average increase in prices and a reduction in the discounts available to some petroleum consumers, thereby eliminating the subsidies. The Government will also be examining the present system for marketing these products with a view to deregulating prices completely by June 30, 1984. In order to ensure that there will be no subsidies during the program period, before the new system is put into place the Government will take, if necessary, additional measures including further price adjustments to fully reflect future cost increases. Already the Ministry of Energy has

the authority to increase prices within a maximum range of 5 per cent without recourse to the central pricing commission." Moreover, the Government is planning to deregulate the controlled prices for certain items, including coffee, beverages, sanitary products, cardboard, paper, and spare parts, and for services relating to merchandise transport, etc.

7. The policy of using producer prices to encourage agricultural production will be continued. Although these prices are sufficiently remunerative for the 1982/83 crop year, they will be reviewed before the next crop year in order to encourage domestic production, in particular of cereal grains and sugar, so as to decrease imports of these products. In any case, policy in this area will be re-examined in the course of a forthcoming review of the program with the Fund.

8. A reform of the national education policy, taking into account the recommendations of the national panel and the World Bank, is now being implemented. The Government will take the following measures during the program period: (i) beginning in September 1983 (the start of the school year), the new students concerned will receive scholarships in lieu of stipends (pré-salaires), reducing the budget burden by half; (ii) in the 1984 Budget Law, the Government will announce more selective eligibility requirements for scholarships, which will apply to those awarded beginning academic year 1984/85; and (iii) the recruitment of new teachers will be limited to about 15,000 in 1983 and 8,000 in 1984. Furthermore, in order to contain budgetary outlays for national education and improve its effectiveness, the Government, in consultation with the World Bank, will examine before the end of 1983 the Bank's other recommendations and the timetable for implementation.

9. Among the principal causes of the external disequilibria is the impact of the large, and persistent budget deficits. Since 1979, these deficits have exceeded 10 per cent of GDP. In the absence of new recovery measures, the deficit for fiscal year 1983 could amount to DH 16 billion (16 per cent of GDP). The program aims at a sizable reduction of the deficit (adjusted for changes in the "Fonds réservés"), limiting it to DH 8.75 billion for the full year as against DH 11 billion in 1982. To this end, the Government submitted to the House of Representatives a draft amendment of the 1983 Budget Law, which was adopted on July 29. The amendment included changes in the amounts of outlays and resources recorded in the original Budget Law with a view to substantially improving the balance of the current budget and to adjusting capital expenditure. On the revenue side, the new measures include the introduction of an exit tax as well as increases in the rates of some taxes and levies. These consist basically in raising the basic rate of the tax on goods from 17 per cent to 19 per cent, restructuring certain registration fees and stamp duties, and increasing the additional tax on income /Contribution de la Solidarité Nationale/. It is estimated that these measures will yield an additional DH 450 million (or 0.5 per cent of GDP) for the remainder of 1983. A saving of DH 1,280 million in current expenditure (or 1.5 per cent of GDP) will result from the following measures: foregoing the

creation of 19,107 jobs, eliminating vacated positions, cutting expenditure on material, reducing charges communes including subsidies to public enterprises, and reducing the subsidies on consumer goods in accordance with the new policy described in paragraph 6 above. Budgetary appropriations for capital expenditure have been reduced by DH 5.1 billion (or 27.5 per cent), thus limiting payments to DH 8 billion for the entire year. This reduction will be achieved by rescheduling commitment appropriations in all sectors and by spreading the project execution schedule over a longer period than initially planned in the Budget Law. As a performance criterion, total net borrowing by the Treasury (defined as the sum of foreign grants, net external borrowing, net bank credit to the Treasury, net domestic borrowing from sources other than banks, the claims of enterprises and individuals on the Treasury, and changes in "Fonds réservés") will not exceed DH 6.70 billion for the period from January to September 1983 and DH 8.75 billion for 1983 as a whole. These ceilings will be reduced by an amount equivalent to any net debt relief relating to interest payments. Also as a performance criterion, the stock of "Fonds réservés," which amounted to DH 3.5 billion at end-1982, will be reduced by no less than DH 1.8 billion by end-September 1983 and DH 2 billion by end-December 1983.

10. For fiscal year 1984, the Government will limit the Treasury deficit to less than 6 per cent of GDP, excluding any possible relief in interest payments on the external debt as defined in paragraph 9. Although the exact details of the next budget law will not be known until the fourth quarter of 1983, the Government will limit hiring to about 10,000 jobs and will eliminate the positions of retirees. The budget will also reflect the subsidy and national education policies described in paragraphs 5 and 8 above. Moreover, in the context of the tax reform, the Government will submit draft bills concerning the general income tax and the corporate income tax for approval by the House of Representatives, together with the draft Budget Law for 1984. The Government also intends to introduce the VAT during the next fiscal year, and will set up the administrative machinery for levying this tax beginning July 1, 1984. The Government will consult the Fund and reach agreement on fiscal policy as part of the first review of the program.

11. With the assistance of the Fund staff, the monetary authorities are now examining a reorientation of monetary policy. The objective of this reform will be to enhance the role of the money market in the allocation of resources; central bank intervention should be carried out largely through the market. This will make it possible to ease the direct control on credit and interest rates and to make more active use of traditional monetary instruments, including monetary reserve and liquidity ratios and open market operations. Initial implementation of this reform began in 1983 and will be continued gradually beginning in 1984. In the meantime, the monetary authorities will continue to control the expansion of credit by using the existing mechanism of encadrement of credit to the economy or

by using the other monetary policy instruments. In 1983, total bank credit (defined as the sum of net bank credit to the Treasury and claims of enterprises and individuals on the Treasury including import deposits, plus credits to the economy excluding claims originating abroad) will not exceed DH 49.6 billion during the period from end-June to end-September and DH 50.7 billion for the period from end-September to end-December. Net bank credit to the Treasury (defined as the sum of gross borrowing from the Bank of Morocco, banks' deposits with the Treasury excluding import deposits, banks' holdings of government securities, and any use of funds in respect of the counterpart of purchases from the International Monetary Fund, minus the Treasury's current account and the cash balances of government accounts) will not exceed DH 26.5 billion during the period from end-June to end-September and DH 26.2 billion during the period from end-September to end-December 1983. As a reference, total bank credit and net bank credit to the Treasury at end-May 1983 amounted to DH 46.2 billion and DH 25.2 billion, respectively. These ceilings will allow an annual increase in credit to the economy of about 15 per cent in 1983 compared to almost 21 per cent in 1982. Taking into account the above-mentioned targets for the balance of payments, these ceilings would result in an increase in the money supply of 17 per cent as against an estimated increase of 14 per cent in GDP. The quarterly credit ceilings for 1984 will be established in consultation with the Fund during the first review of the program. Pending the implementation of the new monetary policy mechanism in 1984, the Government intends shortly to simplify the interest rate structure by eliminating the minimum rates for export credits, while the maximum rates for nonrediscountable credits will be raised by one point. To provide an incentive for transfers from Moroccan workers abroad, the interest rate on their demand deposits with Moroccan banks will be set at 8 per cent.

12. Consistent with the provisions of earlier programs, a flexible exchange rate policy was adopted in 1980, and in the period through May 1983 the dirham was depreciated by 17 per cent in effective nominal terms against the currencies in the basket. The Government will continue to pursue a flexible exchange rate policy during the period of the program.

13. In order to encourage exports, the procedures for granting export licenses required for some products were made more flexible in 1983, in particular by enabling banks to approve these licenses on the authority of the Exchange Office. Other measures to improve export performance, in particular by reforming the system of effective protection for export-oriented firms and industries producing import substitutes, are now under discussion with the World Bank in connection with a loan. The import system, after having been liberalized extensively under previous programs, was made more restrictive earlier this year in order to deal with the shortage of foreign exchange. However, the Government has recently eased these restrictions considerably. Thus, in May 1983 a number of imported items (equivalent to 20 per cent of total imports) were reclassified from List B (restricted imports) to List A (unrestricted). Altogether, the products virtually free of import restrictions represent about 60 per cent

of all imports. The Government intends to liberalize the system further in the near future with a view to restoring the 1982 levels by end-July 1984. The first step toward this goal, involving the liberalization of about 10 per cent of imports, will be carried out under the 1984 import program. In addition, the coverage of the system of advance import deposits, which had recently been expanded, will be reduced. The deposit rate will be reduced from 25 per cent to 15 per cent of the value of the imports by end-September, to 10 per cent in early 1984, and to zero by July 1, 1984.

14. The external debt, including government and government-guaranteed debt plus short-term debt of SDR 950 million, totals about SDR 10 billion. The debt service ratio has been estimated at 42 per cent for 1983 and 45 per cent for 1984. In view of the heavy debt service burden, for the remainder of 1983 the Government will not contract, guarantee, or approve for public enterprises any new nonconcessional loans with a maturity of between 1 and 15 years, with the exception of contracts amounting to about SDR 200 million which are now at the signing stage. The short-term debt will be held to its end-June level of SDR 950 million through end-December 1983. These limits do not include borrowing for purposes of refinancing or restructuring 1983 external debt maturities, which will be incorporated into the financing plan mentioned in paragraph 15 below. Appropriate limits for 1984 will be established during the first review of the program.

15. As mentioned in paragraph 5 above, the Government intends to establish a financing plan for the 1983 and 1984 balance of payments deficits which involves recourse to Fund assistance, concessional loans and grants, and the rescheduling or refinancing of the debt. Consequently, the Government will shortly be contacting friendly countries and other donors, including banks, to clarify the details of these financing arrangements. The objective of this plan will be to improve the debt profile and to minimize the problems of servicing the debt in the years to come. The Government will consult with the Fund on the outcome of the steps taken in this area during the first review of the program, and will reach an understanding with the Fund on a satisfactory financing program, and reach agreement with it on the additional adjustment measures required to eliminate the remaining deficit.

16. During the period of the stand-by arrangement, the Government will not impose restrictions on payments and transfers for current international transactions, enter into any bilateral payments arrangements with Fund members, or introduce multiple currency practices. In addition, the Government will not introduce new or intensify existing restrictions on imports for balance of payments reasons.