NOT FOR PUBLIC USE

INTERNATIONAL MONETARY FUND

Minutes of Executive Board Meeting 83/141

10.00 a.m., September 16, 1983

W. B. Dale, Acting Chairman

Executive Directors	Alternate Executive Directors
	J. K. Orleans-Lindsay, Temporary
	G. Ercel, Temporary
B. de Maulde	X. Blandin
	J. Delgadillo, Temporary
R. D. Erb	J. C. Williams, Temporary
M. Finaish	
	T. Yamashita
	I. R. Panday, Temporary
R. K. Joyce	M. Casey
A. Kafka	
	G. Grosche
G. Lovato	
	A. S. Jayawardena
Y. A. Nimatallah	J. E. Suraisry
	E. M. Ainley, Temporary
J. J. Polak	
A. R. G. Prowse	
	O. Kabbaj
F. Sangare	M. Camara, Temporary
M. A. Senior	
	A. K. Juusela, Temporary
N. Wicks	C. Taylor
	Wang E.

J. W. Lang, Jr., Acting Secretary
J. C. Corr, Assistant

Also Present

M. Dairi, Division Chief of the Treasury of Morocco. African Department: R. J. Bhatia, Deputy Director; L. M. Goreux, Deputy Director; O. B. Makalou, Deputy Director; A. Basu, E. L. Bornemann, Buu Hoan, E. A. Calamitsis, C. V. Callender, S. E. Cronquist, A. B. Diao, Z. Ebrahim-zadeh, A. G. A. Faria, R. Franco, M. G. Gilman, A. Jbili, J. W. Kratz, M. E. Massourakis, B. R. H. S. Rajcoomar, E. Sacerdoti, D. J. Scheuer, M. Sidibe, D. E. Syvrud, A. C. Woodward. Asian Department: S. Kimura. Exchange and Trade Relations Department: C. D. Finch, Director; S. J. Anjaria, J. A. Clement, E. R. J. Kalter, S. Kanesa-Thasan, M. Nowak, C. Puckahtikom. Fiscal Affairs Department: A. M. Abdel-Rahman, A. Tazi. Legal Department: Ph. Lachman, A. O. Liuksila, J. M. Ogoola. Western Hemisphere Department: C.-J. Lindgren. Advisors to Executive Directors: S. R. Abiad, A. A. Agah, J. R. N. Almeida, C. J. Batliwalla, T. A. Connors, S. El-Khouri, L. Ionescu, H.-S. Lee, Y. Okubo, P. D. Péroz. Assistants to Executive Directors: H. Alaoui-Abdallaoui, H. A. Arias, R. Bernardo, J. Bulloch, M. B. Chatah, M. Eran, V. Govindarajan, H. U. Haque, C. M. Hull, J. M. Jones, W. Moerke, J. A. K. Munthali, G. W. K. Pickering, E. Portas, J. Reddy, Shao Z., D. I. S. Shaw.

1. BRAZIL - REPORT BY ACTING CHAIRMAN

The Acting Chairman stated that the Managing Director had been informed on the previous day that the letter of intent that had been under discussion for some time with the Brazilian authorities had been signed in Brasilia and that it was on its way to Washington. The contents of the letter had been fully agreed between the Managing Director and the Brazilian authorities. He understood from Mr. Kafka that the letter, together with the technical memorandum attached to it, were to be released in Brasilia shortly. The two documents would be circulated to the Executive Board simultaneously with their release in Brasilia. A staff paper on the revised program agreed with Brazil was expected to be circulated in early October with a view to an Executive Board discussion of the issues in the first half of November.

Mr. Kafka said that he would inform the Acting Chairman as soon as he was aware of the release of the letter in Brasilia.

Mr. Prowse asked whether it was not unusual for documents such as those in question to be publicly released before they had been made available to Executive Directors.

The Acting Chairman replied that the procedure had been followed in a number of cases in the past; for example, the documents relating to the stand-by arrangement with the United Kingdom in 1976 had been released considerably before the Executive Board's discussion of them, and the letter of intent in connection with the earlier stand-by arrangement with Brazil had also been released before the Board's discussion.

The Executive Directors took note of the Acting Chairman's remarks.

2. UGANDA - STAND-BY ARRANGEMENT, AND EXCHANGE SYSTEM

The Executive Directors considered a staff paper on a request by Uganda for a stand-by arrangement equivalent to SDR 112.5 million (EBS/83/180, 8/23/83; and Cor. 1, 8/31/83).

The Deputy Director of the African Department made the following statement:

> I would like to update the information on exchange rates contained in EBS/80/180 (Table IV, page 51, corrected on 8/29/83).
>
> Since July 1983, the first window rate has depreciated by 10 percent in relation to the U.S. dollar, from U Sh 160 to U Sh 176 per U.S. dollar; by 5.7 percent in relation to an import-weighted eight-country currency basket, nominal effective exchange rate; and by 4.5 percent in relation to the same currency basket after correction for inflation differentials, the real effective exchange rate.

The second window rate has appreciated with the tightening of domestic credit under the new program from U Sh 310 per U.S. dollar in July 1983 to U Sh 270 at present.

When the dual rate system was introduced a year ago, the ratio between the rates at the two windows was equal to 3. It had fallen to 2 six months ago, at the time of the last review, and has now fallen to 1.5.

From July 1 through September 12, 1983, a total amount of $35.5 million has been auctioned at the second window. This corresponds to a $3.2 million weekly average, which slightly exceeds the target set for the 1983/84 program.

The program provided for short-term borrowing by the Bank of Uganda up to $30 million. So far, the Bank of Uganda has borrowed $20 million.

Mr. Sangare made the following statement:

In 1981/82 and 1982/83, the Ugandan authorities successfully implemented two consecutive stabilization programs within the framework of their reconstruction efforts, following almost a decade of abject neglect and total disruption. During this period of adjustment, Directors have had the chance to review extensively the economic situation in Uganda and have become well acquainted with the economic problems facing the country. It was only in February 1983 that Executive Directors considered recent financial and economic developments in Uganda under the mid-term review of the 1982/83 stand-by arrangement (EBM/83/33, 2/22/83).

The Ugandan authorities have gained valuable experience in the last two years and feel that significant gains have been made in the reconstruction of their economy. However, they are convinced that sustained efforts on their part will have to be made as the economic structure, which has been built over these two years, remains weak. The Ugandan authorities also believe that perhaps a crucial stage has been reached where setbacks should not be permitted as this could seriously endanger the progress achieved thus far. In order to safeguard and consolidate these gains effectively, therefore, the authorities submitted a request for drawings in the amount equivalent to SDR 112.5 million, higher than the SDR 95 million proposed in the staff report. It is the view of the authorities that the balance of payments need justifies their request and that the amount requested would facilitate implementation of the program by making foreign exchange more readily available particularly with respect to second window operations. They are nevertheless thankful for the continued collaboration which they have received from the Fund.

Directors will recall from previous discussions that considerable progress has been made in the last two years to stimulate production as real output expanded at the rate of 10 percent for the two consecutive years 1981/82 and 1982/83. This marked growth reflected some significant gains in agricultural production of some essential commodities. At the same time efforts have been made to bring inflation under control--the consumer price index was sharply reduced from about 100 percent in 1980/81 to 25 percent in 1982/83.

As the staff report indicates, fiscal discipline has been restored and the Government's financial position is likewise improving. The overall budget deficit was reduced from 4.3 percent of GDP in 1980/81 to 1.6 percent in 1982/83 and reflected to a large extent a series of measures adopted by the authorities to control expenditure and raise additional revenue, including improved tax administration. The revenue measures introduced during the period included the remittance to the budget of foreign exchange profits arising from foreign exchange auctions. With the implementation of all measures under the program, including those adopted in the fiscal area, the authorities were able to meet all the quantitative monetary targets prescribed in the programs while ensuring that adequate credit was made available to the productive sectors.

In the external sector the overall balance of payments deficit narrowed from $129 million in 1980/81 to $71 million in 1982/83 reflecting, in part, a contraction of the current account deficit resulting from an expansion of export production and demand management. While efforts to diversify and expand the export sector continue to be made, Uganda's balance of payments situation remains weak largely as the result of the severe constraint of limited foreign exchange availability.

As already pointed out, the authorities believe that the foundation down over the last two years remains fragile and will require sustained effort and sacrifice. For example, real GDP, which showed remarkable growth in the last two years, is now estimated to grow by 5 percent. The rate of inflation, at between 20 percent and 25 percent, remains comparatively high. With regard to the budget, the revenue base needs to be expanded and strengthened since exchange profits, which have become an important source of revenue, should disappear with the elimination of the dual exchange rate system. In light of this situation, the authorities have embarked upon the third consecutive adjustment program within the medium-term context, aimed at strengthening economic recovery while being mindful of resuscitating inflationary pressures. They are hopeful that with the successful implementation of all the measures contained in the program, significant improvement in the balance of payments should be achieved in the medium term. These objectives will be achieved by introducing strong measures in various sectors of the economy.

One of the key elements of the program include the unification of the dual exchange rate system that has been in operation for about one year. When the Executive Board reviewed the 1982/83 program in February, Directors noted that considerable progress had been made toward narrowing the range between Window I and Window II despite some teething problems encountered during the initial stage. Several Directors felt that a rapid further depreciation of the official exchange rate at Window I might have strong inflationary and disruptive effects. The Ugandan authorities are indeed very aware of this fact, as intensification of inflationary pressures could seriously endanger the progress already achieved. During the last staff mission to Uganda, an accelerated timetable of unification was agreed upon. My authorities would like to emphasize that the timetable should be seen as a target rather than a deadline. They feel that it would be unrealistic not to take into account a number of considerations, including, for example, the evolution of the second window rate mentioned in the staff report.

In order to minimize the danger of rekindling inflationary pressures as a result of the accelerated timetable, the program allows for foreign exchange to be made more readily available at Window II although it is anticipated that the total amount will remain inadequate in relation to demand. This points to the need for increased inflow of external resources. In the meantime some technical improvements have been initiated to improve the operation of the weekly auctions by, among others, requiring holders of import licenses to secure foreign exchange through official channels; undertaking prompt verification of importation of goods; and strengthening customs surveillance. Furthermore, the Government's purchase of foreign exchange will be limited to 30 percent of the total amount sold in weekly auctions, and the second window rate will be applied.

The recovery program initiated in 1981/82 has been progressing satisfactorily and the authorities are hopeful that implementation will be completed as scheduled. In particular, efforts aimed at improving capacity utilization in industry are being stepped up through rehabilitation of the capital stock. Furthermore, spare parts and raw materials will be made more readily available under the second IDA reconstruction credit. This scheme is designed to benefit both private and public sector enterprises, some of which have already been identified in consultation with the World Bank.

In the agricultural sector, development programs are being accelerated with a view to strengthening and expanding production for export. In support of these efforts, producer prices of a number of these crops came into effect in May and July 1983 and included increases for cotton of 50 percent, coffee of 60 percent, tea of 150 percent, and cocoa of 166 percent. The authorities are hopeful that in the case of coffee, their increased quota of 138,000 tons under the International Coffee Agreement will be met.

In the fiscal area the authorities have set to reduce the overall budget deficit from 22.9 percent of total expenditure--or 1.6 percent of GDP--in 1982/83 to 17.6 percent--or 1.5 percent of GDP--in 1983/84. Total expenditure growth will be limited to 51 percent and revenue is projected to rise by 62 percent, reflecting in part, a substantial increase in revenue from coffee exports as well as an increase in import duty receipts from non-oil imports arising from exchange rate actions. Exchange rate profits, though declining with progressive unification of the dual system, are expected to yield U Sh 8.2 billion in 1983/84. On the expenditure side, the projected increase is, in part, to meet the expanded development program, 72 percent of which is to be financed through foreign aid. The rise in debt servicing is a result of further depreciation of the exchange rate at the first window, and the increase in recurrent expenditure is partly to accommodate a 50 percent wage increase in the public sector effected in July 1983. This wage increase is to provide some incentive to public employees whose real wages have been greatly eroded through successive devaluations of the shilling and high rate of inflation. With regard to public enterprises, a comprehensive study to be undertaken with the assistance of the World Bank is expected to start this month. When completed, it should provide a useful basis for initiating structural reforms which are being contemplated by the authorities.

Monetary and credit policies are aimed at containing the depreciation of the exchange at Window II while reducing pressure on domestic prices. Accordingly, the growth of domestic credit and money supply will be limited to 19.1 percent and 10.5 percent, respectively, a considerable reduction from the growth rates that prevailed in 1982/83 and also lower than the growth in nominal GDP. Interest rate policy will continue to be implemented in a flexible manner. In order to make them more attractive than treasury bills, deposit rates were raised by 2 percentage points. At the same time, it became necessary to adjust lending rates by the same amount. Further efforts are being made to improve banking infrastructure to facilitate the mobilization of financial resources. The Libyan Arab Uganda Bank was reopened on June 10, 1983 and with the assistance of USAID, the authorities are examining the possibility of reviving the operations of the Cooperative Bank.

In the external sector, the current account deficit in the balance of payments is to increase somewhat mainly on account of the rise in imports associated with the development projects and other special foreign aid programs. As a result of transportation difficulties experienced in the shipment of coffee exports, a situation that imposed a difficult cash flow position for the Bank of Uganda at the beginning of the 1983/84 program, short-term borrowing has been allowed and is to be repaid by June 1984. However, a ceiling of $20 million has been placed on such borrowing up to the end of 1983. In the meantime disbursements of official development assistance are expected to increase by 22 percent in 1983/84.

With regard to external arrears, significant progress has been made to reduce the outstanding balance. In the period between June 1982 and March 1983 these arrears were reduced from $158.2 million to $58.9 million through cash payments and rescheduling. The authorities are determined to eliminate all outstanding arrears according to the original timetable. In order to improve overall management of the external debt, a Special External Debt Management Office has been created in the Bank of Uganda, and Fund technical assistance has been sought to help with its establishment.

The staff agrees that the measures taken by the authorities are adequate to achieve the objectives of the program. The authorities have indicated that they will be prepared to take additional measures should it become necessary. Accordingly, I would like to request Directors to approve the draft decisions appearing on page 30 of EBS/83/180.

Extending his remarks, Mr. Sangare emphasized that the size of the program was an important issue. The staff proposed that Uganda should be allowed to draw an amount equivalent to 126 percent of Uganda's present quota, whereas the authorities wished to be allowed to continue drawing the maximum 150 percent of quota. The major source of foreign exchange for Window II had been drawings on the Fund, and in fiscal year 1983/84 Uganda was expected to make repurchases amounting to about SDR 46 million. The Ugandan authorities believed, therefore, that, if they were to make available a sizable amount of foreign exchange through Window II and if the Window II exchange rate was to decline to levels that would not generate inflation, they would need the requested resources. He hoped that, taking into account Uganda's small quota and the country's difficult situation, Directors would support the request.

Mr. Williams said that he supported the proposed decision on a stand-by arrangement equivalent to SDR 95 million and the decision on exchange measures. The request for drawings of 150 percent of quota was an example of how maximum access limits could be perceived as targets or norms by members. The staff and management had acted appropriately in reducing the size of the program to take into account the probable length of the Fund's involvement with Uganda. In the period from 1983/84 to 1986/87, 58 percent of total debt service payments would be to the Fund.

Given the long-term structural problems facing Uganda, it would be more appropriate if the Ugandan authorities sought more financing from sources that provided long-term development assistance.

He agreed with the staff appraisal, Mr. Williams continued. The authorities' perseverance in their adjustment efforts had been successful in many respects, and they should continue those efforts. It was particularly welcome that, since July, more transactions had taken place at Window II than at Window I. He commended the authorities for their decision to shift all but two types of exports and all noncash imports to the second window. There was a specific commitment to unify the two rates and he urged the authorities to do so as early as possible, preferably before the end of the program period.

Commenting on pricing policies, Mr. Williams welcomed the recent producer price increases because they would continue to stimulate the productive sector. He invited the staff to comment on the adequacy of producer prices in both regional and international terms. Did the staff believe that prices would continue to be adjusted flexibly and in a timely fashion? The increases in the prices of petroleum products were also welcome; they should be adjusted to reflect fully changes in import costs based on realistic exchange rates. At the previous Executive Board discussion of Uganda, his chair had questioned whether the lack of competition had allowed some consumer prices to be kept artificially high. Perhaps the staff or Mr. Sangare could comment on recent developments regarding the prices of consumer goods, both imported and domestically produced.

He could support the recent decision to increase the wages of civil servants by 50 percent, Mr. Williams remarked, particularly as the proportion of wages and salaries to total current expenditure was relatively low and compensating savings would be found. However, any change of that magnitude raised questions. It was imperative that future wage adjustments in the public sector should take due account of productivity and of income movements in the productive sector so that the internal terms of trade favored the productive sector. Interest rates continued to be negative in real terms in spite of a recent increase, thereby acting as a disincentive to savings and to domestic resource mobilization. He urged the authorities to correct that policy as soon as practicable. Arrears had been reduced substantially between June 1982 and March 1983. Perhaps external arrears could be completely eliminated earlier than the two years indicated in EBS/83/180.

Mr. Taylor commented that the continued progress of the Ugandan economy in the recent period of rehabilitation was encouraging. The two preceding stand-by arrangements had succeeded in reducing external payments arrears and improving the balance of payments situation. He fully agreed with the staff that "the catalytic element in the improvements recorded in the past two years has been the adjustment of the exchange rate and the freeing of most domestic prices" (page 27 of EBS/83/180).

The example of Uganda showed that external adjustment could be achieved without serious inflationary consequences; it deserved to be widely noted. However, sustained structural adjustment clearly would be needed if the economy was to regain significant levels of growth. Further Fund support would probably be necessary after the proposed stand-by arrangement. Given that need, the staff correctly argued that it would be prudent to limit the present arrangement to less than 150 percent of quota, a judgment that was no reflection on Uganda's record of cooperation with the Fund, which had been excellent.

Because the adjustment effort in Uganda had been taking place within a medium-term framework, Mr. Taylor continued, it was not too early to consider the format that future Fund support might take. His chair had often argued that countries that were short of economic management expertise would not normally be appropriate candidates for extended arrangements. However, if the third stand-by arrangement with Uganda was successfully implemented, there would be evidence that Uganda was developing the kind of track record that would make an extended arrangement a realistic proposition. If the authorities wished it, an extended arrangement embodying appropriate supply-side measures might be an appropriate way forward, assuming the successful implementation of the proposed stand-by arrangement and that the quota increase would allow adequate net purchases by Uganda. The two proposed reviews would be key indicators of progress under the program; they would need to be considered carefully. At the time of the first review in February 1984, his chair would be particularly mindful of the need to adjust public utility tariffs and domestic energy prices.

He supported the general thrust and objectives of the proposed program, Mr. Taylor stated. The current account deficit was projected to increase during the program period, which would normally be seen as a weakness, but which appeared reasonable in light of the expected rise in imports to be financed by foreign aid. It was appropriate that efforts should be directed to improving the rate of utilization of existing aid commitments. He invited the staff to say whether slow absorption had been a reason for the expected shortfall in imports in 1982/83. The balance of payments was expected to be in a healthy overall surplus by 1986/87, while the current account deficit was likely to remain about SDR 100 million. It should be borne in mind that between 1985 and 1987 Uganda would be called upon to make substantial repurchases of earlier Fund drawings, a fact that underlined the need to keep up the momentum of adjustment.

The performance of the agricultural and agroindustrial sectors would be most important, Mr. Taylor added, not only with regard to domestic employment prospects, but also because of the contribution they could make to an improved export performance. It would also be important to continue concentrating on the diversification of the agricultural sector through reduced dependence on coffee. The aim of increasing noncoffee exports by at least 50 percent in 1983/84 was welcome. Given those objectives, the measures announced in the June budget appeared timely and appropriate, and he welcomed the substantial increases in producer prices and the decision to transfer exports other than coffee and cotton to the second window to provide adequate export price incentives. The staff believed that price incentives would ensure fulfillment of the export quota for coffee in 1983, a most desirable objective because the quota for 1984 would be fixed in relation to 1983's production level.

Preparations for the reunification of the exchange rate should be made during the period of the new arrangement, Mr. Taylor considered, by transferring transactions to Window II while depreciating the Window I exchange rate. A significant appreciation of the second window rate ought to be avoided if it appeared likely to stimulate parallel market activity. However, to the extent that an appreciation of the Window II rate reflected tighter domestic credit, it would be acceptable. The technical improvements introduced in the auction procedures at the second window and the constraints on government demand for foreign exchange at the depreciated rate were welcome. He invited the staff to provide information on the level of the parallel exchange rate and the amount of parallel market activity.

While increasing the availability of foreign exchange for auction at the second window, the authorities proposed further tightening of domestic credit expansion and monetary growth, Mr. Taylor noted that policy should help to reduce demand for foreign exchange and, together with the continuation of a flexible interest rate policy, would help to counter the inflationary pressures stemming from the second window rate. Within the constraints of their monetary policy, the authorities were to be commended for proposing to expand credit to the private sector, thereby facilitating the renewal of bank finance for industrial activity in the economy. The authorities were also to be congratulated for their success in reducing the overall budget deficit. Every effort should be made to meet the fiscal targets under the present program. The wage increase of 50 percent was justifiable in the circumstances on the grounds that real wages had previously been so low as to provide little incentive to work. However, the wage increase made it all the more important that the planned restraint of other current government expenditures should be vigorously pursued.

The outlook for external debt and arrears payments had been much improved by successful completion of the previous stand-by arrangement and the consequent Paris Club rescheduling, Mr. Taylor remarked. It was appropriate that the design of the program should take account of intended repayment obligations because, apart from the substantial Fund repurchases that would fall due, the grace period under the first Paris Club rescheduling ending in June 1986. He welcomed the ceilings on new external borrowing included in the program, as well as the establishment of the external debt management office in the Central Bank, and the authorities' commitment to eliminate arrears within two years. If the balance of payments position allowed, he hoped that the authorities might consider earlier repayment of the outstanding arrears.

Finally, Mr. Taylor said, there existed a difference of view between Uganda and another Fund member concerning unsettled claims. He hoped that the issue could be settled speedily and fairly and in accordance with the principle of equal treatment of creditors. If the good offices of the staff would help to bring the parties together during the Annual Meeting, he hoped that they would be made available.

Mr. Casey stated that the massive devaluation in 1981 and the freeing of most prices had triggered the rehabilitation of the Ugandan economy and, incidentally, proved the power of market forces. Both courageous actions had had an almost immediate response on the supply side of the economy, and had helped to stabilize the economy and to lower inflation. At present, the economy was more than self-sufficient in food, although there was a long way to go to reach the export and income levels of the early 1970s. The recently concluded stand-by arrangement had been very successful. It had begun well on the basis of the effective price adjustments, including the exchange rate adjustments. The proposed arrangement was also well designed, but it did not have the same dramatic impact as the earlier arrangements.

The overall fiscal deficit had not been large in relation to GDP in fiscal year 1982/83, Mr. Casey noted. Consequently, the ratio could not be expected to improve substantially in 1983/84, but it was encouraging that the overall fiscal deficit was expected to turn into a surplus after 1985. A large part of the growth in revenue in 1983/84 reflected the sharp increase in coffee exports resulting from the depreciation of the first window exchange rate. Other export duties were also growing as the rehabilitation of the economy continued, but the revenue base was rather narrow, being primarily trade related. Income tax, for example, contributed less than 3 percent of total revenues. The authorities would be well advised, therefore, to broaden the revenue base in the period ahead.

Some elements on the expenditure side were worrisome, Mr. Casey commented. Was the growth of 134 percent in development expenditures in one year really necessary? Could it be implemented rationally? Even if such development expenditures were desirable, it should be borne in mind that they would give rise to recurrent expenditures at a later stage. He recognized the reasons for the significant wage increase, but an amount of less than 50 percent might have helped to avoid giving rise to unrealistic expectations in the private sector. The planned study of the parastatal corporations and the flexible pricing policies being pursued by them were welcome; action in that area ought not to be delayed. The overall fiscal deficit in 1983/84 was to be financed largely by external borrowing, a somewhat surprising approach. Greater efforts might have been made to raise funds from the nonbank public sector by making treasury bill rates more attractive.

Commenting on monetary policy, Mr. Casey noted that credit to the Government had exceeded the "adjusted indicative ceiling" at the end of June 1983. Although the Government intended to repay the banking system so as to meet the September ceiling, it was not clear why the excess at the end of June had not needed a waiver or modification. He invited the staff to clarify that point. Monetary policy for 1983/84 was appropriately tight, but it would need to be monitored carefully, not least because money velocity could change erratically in Uganda. Interest rates had been raised recently, and the policy was described as flexible. Nevertheless, rates remained negative in real terms. Negotiable interest rates were significantly higher, suggesting that market equilibrium rates ought also to be higher.

The overall balance of payments was expected to improve in 1983/84, Mr. Casey remarked, but the current balance of payments was expected to deteriorate, owing in part to increased imports under special foreign aid programs. It was unusual for foreign aid to worsen the current external deficit, but in Uganda's case it had to be expected, at least until the process of diversification took firmer hold. Could the staff comment on the degree of diversification under way and indicate whether entrepreneurs who had emigrated in the past were returning to Uganda. As Uganda's standing internationally had improved, the authorities might be able to attract direct foreign investment and the manufacturing expertise that it would entail. The intention to eliminate all remaining external arrears during the coming two years and the establishment of the external debt management office in the Bank of Uganda were welcome steps, and it was encouraging that the debt service ratio would fall to 34 percent in the medium term.

The complex exchange rate system appeared to be working well, Mr. Casey considered. There was increased activity at the second window, and the import-weighted average effective exchange rate was moving in the right direction as the two windows converged. Although the prices of cotton and coffee had been raised by administrative means, it was not clear why those commodities had not also been moved to the second window. It would be a pity if the reason was quota constraints on Ugandan exports of those commodities, because the country could produce much more coffee and cotton. With coffee accounting for 95 percent of total exports, diversification of the productive base was absolutely essential, and it should have the full support of aid donors and the World Bank. The Irish authorities had had a good deal of experience in attracting foreign investment to aid the process of diversification, and they would be ready to offer the Ugandan authorities advice in that area.

It was not clear whether the authorities wished to see a further devaluation of the average exchange rate, Mr. Casey went on. Most attention should be paid to the second window rate, but one of the main reasons for tightening monetary policy was said to be "to contain the depreciation at the second window." The policy had been motivated by a desire to curb inflation, and to improve the balance of payments, although the latter argument was of doubtful validity. The fact that the authorities were increasing the supply of foreign exchange at the second window also suggested that they wished to contain the depreciation of the rate. Indeed, according to the supplementary information provided by the staff, the exchange rate at the second window had appreciated recently, and it was possible that convergence of the two rates might occur at a higher exchange rate than would be warranted. The authorities needed to have a clear sense of direction with regard to the exchange rate; otherwise, they might find the complexities of the system too difficult to manage. Finally, with regard to the amount of the arrangement, he agreed with the comments made by Mr. Taylor and Mr. Williams. He fully supported the proposed decisions.

Mr. Grosche observed that the adjustment measures implemented by the authorities under two consecutive financial programs with the Fund had been bold. Exchange rate measures, in conjunction with a flexible pricing policy and appropriate fiscal and monetary policies, had achieved commendable progress toward reviving the shattered economy. Uganda's case demonstrated that the policies supported by the Fund in close cooperation with the World Bank could be successful. The program was well structured, although its objectives would not be easy to achieve, as the authorities were aware. Further improvement in Uganda's balance of payments was urgently needed, and relaxation of the adjustment efforts would be detrimental, particularly considering Uganda's rapidly increasing repurchases to the Fund.

At the Executive Board's previous discussion of Uganda, Mr. Grosche recalled, Directors had welcomed the authorities' stated commitment to eliminate the dual exchange rate system before the middle of 1984. His chair, among others, had encouraged the authorities to accelerate the pace of unification. In the authorities' memorandum on economic and financial policies for 1983/84, it was simply stated that the intention was to unify the two rates "within a reasonable period of time." He wondered whether the authorities had abandoned the termination date that they had stated at the beginning of 1983. The progress in reducing external payments arrears was welcome, and he encouraged the authorities to continue the reduction with determination and in a nondiscriminatory way. He joined Mr. Taylor in urging the authorities to use the occasion of the Annual Meeting to settle the particular case that had been referred to.

Mr. Polak remarked that he had commented extensively on Uganda's successful recovery program on previous occasions. He fully supported the new stand-by arrangement. While the question of relations between Uganda and creditor countries, consequent upon the Paris Club Meeting of December 1982, was not central to the present discussion, it involved a fundamental principle of the Fund, the principle of nondiscrimination. When the Board had discussed the Ugandan economy in February, Mr. Sangare had provided some assurances in that regard. Specifically, he had stated "that the authorities in Uganda, while seeking to clarify the amounts, even the existence of certain loans, were ready to pay the agreed amounts without discrimination among creditors." The policy memorandum provided as Attachment 1 to EBS/83/180 gave a brief indication of what had been done to date to implement that principle with regard to the claims against Uganda by Israel, a member of his constituency.

The process of verification begun some months earlier had not yet been concluded, Mr. Polak noted, and the bilateral agreement between Uganda and Israel, which, in accordance with an agreed minute of the Paris Club, ought to have been signed by June 30, 1983, had not been signed. Consequently, no payments had been made to Israel, while payments had been made to other countries. The time that the process was taking was a matter of concern; his concern had increased as a result of an indication by the Ugandan authorities in the previous few weeks that they were considering potentially very large counterclaims of an as yet unspecified magnitude.

In February, he had hoped that every effort would be made to resolve promptly the outstanding issues so as to avoid risk of a later impasse that might complicate the Fund's assistance to Uganda, Mr. Polak recalled. Considering the slow progress that had been made since February, additional efforts were necessary, including a direct meeting between representatives of the two countries, who had been dealing through intermediaries to date. The Annual Meeting would constitute an excellent occasion for such a further step. The Fund's management could lend its good offices by inviting representatives of the two countries to meet under its chairmanship.

Mr. Ainley said that the Ugandan authorities had made considerable progress in reconstructing the economy. Production had increased, the budget deficit had been reduced, and the external position had improved. Perhaps most important, confidence was returning. Those were real achievements that could be traced to the firm pursuit of appropriate policies under the two stand-by arrangements with the Fund. However, there remained some way to go in correcting the imbalances, a point that the authorities recognized. The arrangement proposed for 1983/84 seemed well designed to consolidate previous gains and to continue the process of recovery.

He welcomed the emphasis on export growth and diversification, which was essential if the balance of payments targets were to be met, Mr. Ainley continued. As Mr. Sangare had pointed out, the recent increases in producer prices should stimulate a further rise in agricultural exports. He agreed with Mr. Taylor that it would be important to speed up viable agricultural projects and to put aid commitments to effective use. The growing involvement of the World Bank in the recovery program was an encouraging sign. Exchange rate policy had a key role in the export-oriented strategy, and the moves to simplify the dual system and to improve the allocation of scarce foreign exchange resources were, therefore, welcome. On balance, the dual system had worked well, but he joined other Directors in encouraging the authorities to unify the rate within a reasonable period.

The flexible stance on domestic prices and on the exchange rate would have to be supported by firm financial policies, Mr. Ainley commented. The revenue-raising measures in the 1983 budget went very much in the right direction. On the expenditure side, the 50 percent wage increase for the civil service appeared justified, but savings would have to be found elsewhere to limit the growth in current spending. He welcomed the proposals to strengthen expenditure control and to limit off-budget outlays and hoped that the authorities would press ahead with plans to review government administration and restructure the public enterprises. The new credit ceilings were fully in line with the objective of containing inflation, and he supported the authorities' request for further technical assistance from the Fund to improve monetary data and speed up the collection of monetary statistics. The progress made in reducing arrears and in codifying outstanding debt had helped to restore foreign confidence, although the high debt service ratio underlined the need for cautious borrowing policies and for continued efforts to streamline debt management procedures. In sum, the program represented a further important step on the road to recovery.

As for the amount of Fund assistance, Mr. Ainley said that he had read the staff's comments, and listened to those made by Mr. Sangare and other speakers. Two sets of considerations had to be borne in mind. First, adjustment in Uganda would be required for several years, further Fund assistance might be necessary, and Uganda's repurchase obligations would rise sharply after 1984. Second, Uganda had cooperated well with the Fund, and its performance under the two recent stand-by arrangements had been good. Furthermore, the country would be faced with a cash-flow problem in early 1984, a difficulty that was being dealt with through short-term commercial borrowing by the Central Bank, in the amount of $20 million to date. That amount was about the same as the additional SDR 17.5 million requested by the authorities, which could reduce the need for further expensive commercial borrowing. The additional amount requested by the authorities might, therefore, make a real difference at present, perhaps more so than in the future. The issue came down to weighing the balance of payments need, both at present and in the future, and what was required for the success of the program. He invited the staff to comment further on the issue.

Mr. Prowse agreed with other speakers that a great deal of progress had been achieved in the period of the Fund's involvement with Uganda. There was a basis for guarded optimism, but not for relaxation of the adjustment effort. Uganda was making the transition from a period of crisis management to a period in which a more medium-term perspective could be taken, and in that context, the program was well constructed.

The projected elimination of the balance of payments deficit, the progress in arrears reduction, and the measures being taken to improve the external position, in particular the transfer of non-oil cash imports to the second window in June, a policy urged by Directors in February, were all welcome, Mr. Prowse continued. The authorities should be encouraged to pursue such policies further. On the production side, was the relatively small increase in the projected output for coffee the result of quota constraints rather than supply factors? The use of the IDA credit for imports through the first window did not appear appropriate, because it involved a subsidy to the enterprises that were importing more, and thereby ran counter to the objective of allocative efficiency. The proposed reduction in the fiscal deficit and the reductions achieved to date were encouraging; progress in that area needed to be continued.

Commenting on the amount of the arrangement, Mr. Prowse suggested that Mr. Ainley had clearly described the relevant considerations. The balance of the points made by Mr. Ainley were in favor of meeting the request of the authorities. He hoped that, since the amount involved was very small, any disagreement on the issue would not adversely affect relations between the Fund and Uganda. For the reasons put forward by Mr. Ainley, including the cash-flow question, his chair would be willing to support the larger amount requested by the authorities if other Directors agreed.

The Deputy Director of the African Department remarked that the authorities were convinced that they had to unify the exchange rates progressively and that the exchange rate at the first window would have to depreciate. The Ugandan shilling had declined quite rapidly at the first window during the previous three months, and the same policy would be pursued in the period ahead. The staff considered that the second window had been functioning satisfactorily and that the existence of the second window was a reason for the progressive elimination of the parallel market. The marked decline in parallel market activity was an important achievement in light of the fact that two years earlier the dollar rate in that market had been 30 times the dollar rate in the official market. The second window had also improved the allocation of foreign exchange. The level of the exchange rate at the second window was sensitive to the domestic money supply, as could be seen in the last quarter of fiscal year 1982/83, when the relaxation of fiscal discipline had contributed to a substantial increase in the dollar rate. At present, monetary policy had been tightened considerably, and the price of the shilling at the second window had risen to U Sh 270 to the dollar. Thus, the level at which unification of the rates would take place would depend greatly on the success of fiscal and monetary policy during the course of the program. The proposed decision on the exchange system permitted the dual system to exist until February 15, 1984. However, it was unlikely that unification would take place by that time.

The authorities hoped to diversify the revenue base, the Deputy Director continued, but such a policy could only be implemented gradually, given the administrative weaknesses in the country. On the expenditure side, it had to be accepted that public sector wages had militated against administrative efficiency. The 50 percent wage increase had been an attempt to overcome that problem.

One Director had suggested that more use might have been made of nonbank domestic financing through the sale of treasury bills, the Deputy Director noted. In that regard, efforts had been relatively successful in the previous two months. The staff had been a little overoptimistic with regard to the speed of foreign aid disbursement in the previous two years, thereby overestimating the amount of imports and, consequently, the current account deficit. A precise assessment of the speed with which foreign aid would be disbursed was always difficult, and it was affected by the absorptive capacity of the public administration and of the economy. Progress had been made in that area through the establishment of a special unit to deal with aid disbursement in the Bank of Uganda.

From a medium-term perspective, the Deputy Director remarked, the diversification of exports was particularly important. The increase in producer prices, especially the increase in the price of coffee, appeared likely to mobilize further coffee production, and there would probably be no difficulty in meeting the coffee export quota. However, when production exceeded quota, it had to be sold in difficult conditions and at a substantial discount. Thus, coffee had not been shifted from the first window to the second window because the producer price for coffee appeared to be sufficiently high to ensure that the quota would be met. Indeed, the stock of coffee held by the Coffee Marketing Board had increased substantially following the rise in the producer price of coffee in July. The shift of other exports, such as tea, tobacco, and cocoa, to the second window would stimulate production, but there remained a long way to go in the process of diversification. However, in light of the World Bank's assessment of the medium-term prospects for Uganda, the staff considered that, if domestic conditions improved, exports would increase significantly through the expansion of the resource base.

It was true that the importation of spare parts associated with the IDA II credit at the first window involved a subsidy, the Deputy Director went on, but the practical problem had been to find a means of financing the local currency counterpart of import costs without commitment by the Treasury. Instead of having most of the funds onlent by the Treasury as in IDA I, the compromise solution for IDA II had been to have most of the local cost of imports financed by the private sector--either through the importer's own resources or through the use of domestic credit--but to ease the financial burden on importers by valuing imports at the Window I rate. However, as the Window I rate had depreciated rapidly, the subsidy was less than it had been a few months earlier.

The staff agreed with Directors that the Ugandan authorities would not be able to relax their adjustment efforts for several years, the Deputy Director of the African Department said, and that continued cooperation between the Fund and Uganda would be desirable in that regard. The staff and management had, therefore, believed that it would be prudent not to commit too many resources under the present program so as to leave room for further arrangements with the Fund in later years. He noted that one Director had suggested that the review in February 1984 might provide an occasion for consideration of the possibility of an extended arrangement at an appropriate time. Finally, with regard to the settlement of claims between Uganda and Israel, a meeting of the Paris Club had been tentatively scheduled for the second week of November. It would be desirable if the two parties could discuss the question before then.

The Acting Chairman, noting that some Directors had suggested that the Fund staff or management might play a role in the claims question, said that with the approval of the Managing Director he would be prepared to try to convene a meeting between the Ugandan and Israeli representatives during the Annual Meeting. Given the sensitivity of the matter, he would do so on three understandings. First, the meeting could only be held provided that both parties agreed. Second, such a meeting would have to be technical and as low-key as possible. Third, the issues involved between the two parties would not be such that the Fund as an institution could usefully take a view on the merits; rather, he would attempt to facilitate communication between the two sides with a view to eventually reaching a solution.

He would attempt to encourage the Paris Club to take a positive role in the case in question and similar cases, the Acting Chairman added, and to lend good offices in the observation of the principle of nondiscrimination in relation to matters of debt, a matter of importance both to the Paris Club and to the Fund. He hoped to play a role in facilitating the Paris Club Meeting to which the Deputy Director of the African Department had referred. In that context, it would be helpful to assure, if possible, that the two parties had a bilateral discussion prior to the November meeting of the Paris Club.

Mr. Sangare remarked that concern had been expressed about the narrow revenue base in Uganda. The authorities also regarded it as an important problem, but it had to be approached gradually, given the continuing administrative weaknesses. For the time being, the authorities would have to rely on trade-related revenues. They also intended to be flexible with regard to interest rate policy, but they did not believe that interest rate policy was always an effective means of mobilizing savings, particularly in a country like Uganda, which had suffered a good deal of disruption and in which there was no banking system in the rural sector. An increase in interest rates could hinder the adjustment effort and it could also jeopardize the prospects for investment. The authorities, therefore, preferred to take a cautious approach to interest rate policy.

The pricing of petroleum products also had to be approached cautiously, Mr. Sangare commented, because petroleum constituted an important input for development. In addition, as there were speculative elements in the economy, raising input prices too much could carry grave risks. The problem of the absorption of foreign aid was complicated by the lack of local funds that were often needed as a counterpart to the foreign assistance. With regard to the unification of the dual exchange rate system, he welcomed the comments of most Directors that unification should be achieved within a reasonable period. The Ugandan authorities believed that, because the dual system had been operating for only about one year and because the gap between the two rates continued to be large, though narrowing, an abrupt speed-up of the process of unification could create inflationary pressures and intensify the speculation from which the economy continued to suffer. The authorities would, therefore, approach the unification issue with great care.

His remarks at the Executive Board discussion of the Ugandan economy in February had been correctly recalled by Mr. Polak, Mr. Sangare stated. He was grateful to Mr. Polak for having raised the question with him before the Board discussion, and he understood his concern and his request. He had contacted his Ugandan authorities, who had sent him a telegram that read, in part:

> This serves to confirm that the Ugandan delegation to the World Bank/IMF Meeting would be able to discuss the indebtedness of Uganda to Israel with representatives of Israel under the Fund's chairmanship.

He could confirm that his authorities were open to undertaking such a discussion with Israel under the chairmanship of the Acting Chairman during the Annual Meeting. As the Acting Chairman had indicated, the participation of the Fund management could not go beyond the technical aspects of the problem. As Mr. Polak was aware, the Ugandan authorities had expressed reservations about the extent of their indebtedness to Israel, and they also had claims to make against some Israeli firms. His authorities' agreement to attend the proposed meeting in Washington had demonstrated their willingness to deal with the problem. Morgan Grenfell, a financial consulting firm in London, had already been employed to look into the matter. The only problems remaining were the specification of some data about Uganda's debt vis-à-vis Israel and the extent of the claim that Uganda had on Israel. He would convey the comments and suggestions made by Directors during the discussion to his authorities.

Mr. Erb said that he welcomed Mr. Sangare's confirmation that his authorities were willing to discuss the claims issue with the other member involved. He agreed with the Acting Chairman's suggestion that the Fund could attempt to facilitate such discussion and to provide appropriate technical analysis.

Mr. Polak stated that he was grateful to Mr. Sangare and to the Acting Chairman for their prompt responses to the suggestion that he had made.

The Executive Board then took the following decisions:

Stand-By Arrangement

1. The Government of Uganda has requested a stand-by arrangement for the period from September 16, 1983, to September 15, 1984.

2. The Fund approves the stand-by arrangement attached to EBS/83/180, Supplement 1, for an amount equivalent to SDR 95 million.

3. The Fund waives the limitation in Article V, Section 3(b)(iii).

Decision No. 7527-(83/141), adopted
September 16, 1983

Exchange Measures

1. The Fund welcomes the intention of Uganda to eliminate external payments arrears and to unify the dual exchange arrangements.

2. The Fund grants approval until February 15, 1984 or the next Article IV consultation with Uganda, whichever is the earlier, for the retention and modification by Uganda of the multiple currency practice involved in the dual exchange market arrangement as described in EBS/83/180, and for the retention of exchange restrictions including external payments arrears as described in EBS/83/5 and EBS/83/180.

Decision No. 7529-(83/141), adopted
September 16, 1983

3. MOROCCO - REQUEST FOR STAND-BY ARRANGEMENT

The Executive Directors considered a staff paper on a request by Morocco for a stand-by arrangement equivalent to SDR 300 million (EBS/83/178, 8/19/83).

The staff representative from the African Department made the following statement:

> The Executive Directors will have noted the statement made on pages 29-30 of EBS/83/178 that the authorities continue to regard the flexible exchange rate policy, initiated in late 1979, as an effective element in the overall adjustment effort. Consistent with this assessment, the Moroccan authorities have

further allowed the dirham to depreciate by 10 percent since last July, in line with the understandings reached with the staff during the negotiation of the program. This depreciation, which the staff considers appropriate, was assumed in fixing the program target as set out in EBS/83/178.

The staff has also just received some additional information relating to the external debt of Morocco that revises the figures of outstanding debt stated in Table 8, page 15 of EBS/83/178, and the balance of payments deficit shown in Table 5, page 9. The main difference arises from the inclusion of military debt and its servicing, though other minor revisions in respect of valuation, etc., have also been made. The revised figure of total outstanding debt--excluding short-term debt of $750 million--at the end of 1982 is now estimated at SDR 11.2 billion, instead of SDR 9.9 billion as indicated in EBS/83/178.

Making allowance for the revisions in the debt servicing figures, and for other minor revisions in various items of the balance of payments, the staff now estimates that the overall balance of payments deficit would amount to SDR 881 million in 1983 and SDR 1,339 million in 1984, instead of SDR 612 million and SDR 1,225 million shown in Table 5; the current account balance remains about unchanged.

The Moroccan Government has formally submitted requests to the Paris Club, to other official creditors, and to its commercial bank creditors to reschedule all official medium- and long-term debts, including military debt and arrears outstanding on such debt. In addition, the commercial banks have been asked to maintain their current exposure in short-term credit and credit lines. The staff understands that the Moroccan authorities are requesting that the rescheduling cover amounts due through 1987--principal and interest for the Paris Club and official creditors, and only the principal for the commercial banks--in the light of the medium-term scenario presented in Table 10, page 19, of EBS/83/178.

In their request to the creditors, the Moroccan authorities are seeking that for each of the years through 1987 the Paris Club reschedule 90 percent of the principal and interest due, as well as arrears, and that the commercial banks reschedule 100 percent of the principal due in the remaining period 1983, 90 percent of the principal due in 1984, 80 percent in 1985, 70 percent in 1986, and 60 percent in 1987. Preliminary discussions on Morocco's external situation were held by the Paris Club on September 14 and 15 and the Club has scheduled a further meeting in this regard on October 24-28. A first meeting between banks and Morocco was held last week in Rabat, and the banks' Steering Committee met in London this morning to consider the Moroccan request. The Chairman of the Committee has just informed the staff that the Committee saw no reason why a satisfactory solution could not be found, and there was a general consensus to accommodate Morocco. They accepted the principle that short-term exposure of banks would be maintained and, pending formal global agreement, individual banks were prepared to reinstate short-term facilities as they fell due and were paid. The Committee also indicated that at this time it would only consider rescheduling through 1984.

Assuming, therefore, that Morocco obtains the requested debt relief for 1983 and for 1984--the period covered by the proposed stand-by arrangement--the staff estimates that the debt service after making allowance for additional interest payments on deferred debt, would be reduced by approximately SDR 560 million and SDR 1,000 million. Taking into account the proposed purchases from the Fund, a gap of about SDR 175 million and SDR 220 million would still remain to be filled during these two years, respectively. In addition, in view of the virtual depletion of Morocco's reserves, the authorities are hoping to reconstitute their external reserves by about SDR 250 million--the equivalent of one month's imports--during 1984. On this basis, and on the basis of existing aid commitments, the gap still to be covered amounts to SDR 178 million in 1983 and SDR 474 million in 1984, which the authorities are seeking to meet through additional balance of payments assistance.

The Moroccan Minister of Finance has approached friendly creditors to obtain such assistance and has requested the Fund staff to coordinate it. Accordingly, management and the staff have been in bilateral contact with representatives of these countries and, in consultation with all parties, are planning to hold, in close cooperation with the World Bank, an informal meeting with Morocco and donor countries during the period of the Annual Meetings to discuss the necessary assistance. On the basis of the indications received by the staff from the Paris Club, the commercial banks, and the responses provided by donor countries, the staff believes at this stage that the 1983 gap should be financeable, but that uncertainties remain regarding the 1984 gap. However, it may be noted that these estimates are based on disbursements from existing aid commitments only. It is hoped that a more definitive conclusion for the financeability of the total gap should be available by the time of the scheduled review of the program at the end of November, when the terms of debt rescheduling should be known and the planned donors' meeting would have been held.

Mr. Kabbaj made the following statement:

During the previous discussion on Morocco in November 1982, Executive Directors expressed satisfaction that the Moroccan economy had experienced a recovery in 1982 and that the authorities had implemented most of the measures contained in the stabilization program, which was supported by a one-year stand-by arrangement and by a substantial drawing under the compensatory financing facility.

The staff makes it clear that despite some shortcomings, the Moroccan authorities were, broadly speaking, successful in implementing the 1982 program and met all the quarterly performance criteria set in the stand-by arrangement. My authorities feel that a careful reading of the report does reveal that as far as structural adjustment is concerned they have, indeed, embarked on major reforms, the outcome of which is not immediately apparent. It should also be noted in this regard that there is generally resistance, as well as political sensitivity, to such reforms, which have to be carried out in an orderly and careful manner.

I would also emphasize that the implementation of the program took place in an adverse environment, characterized by a recessionary climate in the world economy, a stagnation in world trade, a soaring dollar, high interest rates, and, last but not least, rising protectionism in the industrial countries. More specifically, in Morocco itself, while the agricultural crop was average, the slump in the phosphate market continued to exercise its negative effects on the balance of payments, as well as on the budget. The magnitude of this problem can be illustrated by the fact that nominal prices of phosphates declined by about 50 percent in the period 1974-83. Finally, the Saharan problem has also affected the economy for almost seven years.

Following our meeting in November 1982, the Moroccan authorities presented a budget for parliamentary approval; the budget was somewhat expansionary partly because a number of assumptions did not materialize. Such assumptions included, in particular, the recovery of the world market for phosphates, which was forecast by some international institutions but which did not actually take place; the projection of a normal crop, which in fact turned out to be less than average; and lower than expected external flows.

The staff report indicates that the adjustment process was halted for six months. I can agree with the staff that the measures under the requested stand-by arrangement could have been implemented in February or March. I would like to stress, however, that the Moroccan authorities never lost contact with the Fund, but needed some time to prepare public opinion, various political parties, and Parliament for the set of drastic measures that were later adopted. As a precautionary measure, however, the authorities imposed restrictions on imports in March, and then instituted an import deposit scheme in order to avoid any disruption. They continued to promptly service the external debt until last week, when they held a meeting with the banks and made official contacts with the Paris Club regarding debt rescheduling.

Another reason for the delay is that Morocco has been pursuing an adjustment process since 1978; for five years the authorities have had to impose austerity measures that proved in every instance to be insufficient in the face of the adverse external environment. The magnitude of the measures taken over these five years was significant, as can be assessed from previous staff papers on Morocco.

It is also noteworthy that the prospects for the next two to five years--as the staff paper clearly shows--will not be easy either.

It is in this environment that the Moroccan authorities have requested Fund assistance in support of an adjustment program comprising bold measures and aimed at a sharp reduction in the current account deficit of the balance of payments. This program is based on rather reasonable assumptions, particularly with respect to growth, exports, and changes in the terms of trade.

The new measures include price increases ranging from 4 percent to 67 percent on consumer goods, fertilizers, and petroleum products, and also a depreciation of the dirham by 10 percent. These measures were implemented as prior actions. The budget was sharply revised downward and submitted to Parliament and will now result in a deficit of 8.7 percent of GDP instead of 20 percent of GDP as initially projected. New recruitment was almost halved and vacancies caused by retirement will not be filled.

The program also comprises a trade liberalization by steps, including the phasing out of the import deposit scheme by July 1984, which would mark the return to the situation prevailing in 1982. It also includes the usual performance criteria ceilings and three reviews on which I would like to say a few words.

As will certainly be noted by Executive Directors, the program is heavily back-loaded and extends to the beginning of 1985 as far as the purchases are concerned. Although it is an 18-month program, it deals with three annual budgets. The understandings to be reached on two of them are considered as performance criteria. By accepting this approach, the Moroccan authorities wish to show their resolve to tackle their problems in a medium-term context.

Furthermore, while the program addresses mainly the period covering the last six months of 1983, it also includes firm understandings on major components for 1984, inter alia, on the size of the budget deficit, a ceiling on recruitment, and external policies and subsidies.

In addition, this program will hopefully engage Morocco in a more active phase of structural adjustment.

The pricing policies have been well defined and a new policy on subsidies has been implemented. As the staff points out, a liberalization of prices for petroleum products is under study. The prices for agricultural crops will also be revised, if necessary.

The monetary policy will be more flexible and further increases in some interest rates will take place. The education policy, which traditionally placed heavy pressure on the budget, has been studied comprehensively by the World Bank, and the Moroccan authorities are discussing the report with the Bank, while some of its recommendations are being implemented. The same can be said of the investment strategy for which a World Bank report was one of the bases for the revision of the Investment Plan and the 1983 budget. The tax reform, the loi-cadre, which was adopted last year, will be implemented with technical assistance from the Fund.

I would now like to address one important point that will certainly attract the attention of Executive Directors, namely the financial gap to be filled in order to make the program work. First, I wish to point out that following a small purchase--10 percent of the total amount of the arrangement--there will be an early review of the program, which includes as a performance criterion, the assessment of Morocco's efforts to obtain financing of the 1983-84 balance of payments deficit. Second, I will try to give the Board the latest information available on this matter. As mentioned above, the authorities have officially requested the Paris Club and the commercial banks, as well as other friendly countries, to reschedule the Moroccan debt. The Paris Club meeting will take place at the end of October, while the chefs de file of the Bank meet in Rabat to discuss the matter with the authorities. Since mid-August, the Minister of Finance has been visiting several capital cities in order to inform his counterparts of the situation and to request the rescheduling of part of the existing debt, as well as possible new concessional assistance. The Fund management and staff are taking an active part in this process and my authorities wish to thank them for the efforts they are making in favor of Morocco. They are also thankful to the Executive Directors who have lent their assistance in this process.

Finally, I would like to inform the Board that Morocco is negotiating a substantial loan with the World Bank to finance the promotion of its exports and these negotiations entered into an active phase at the beginning of this week. This loan will entail major structural changes in order to eliminate the existing bias against exports.

Mr. Nimatallah said that he warmly supported Morocco's request for a stand-by arrangement. The program adopted by the authorities was strong and comprehensive. It contained several prior actions that had been implemented before the program had been brought to the Executive Board, including, inter alia, the approval by Parliament of the revised austerity budget for 1983, a significant reduction in subsidies, easing of import restrictions, and a depreciation of the dirham by 10 percent. Furthermore, the program contained three reviews that covered the formulation of a satisfactory budget not only for 1984, but also for 1985. Thus, the program covered the budget policies for the three fiscal years from 1983 to 1985. The three reviews also ensured that the program would be monitored carefully and constantly. In addition, the adjustment envisaged in the program was substantial. For example, the ratio of the budget deficit to GDP was expected to decline by 6.5 percentage points between 1982 and 1984, and performance criteria additional to the customary criteria were being included to avoid the pitfalls in the implementation of the previous program.

Commenting on fiscal policy, Mr. Nimatallah noted that the program aimed at a substantial reduction in the overall budget deficit in 1983, not only in relation to GDP but also in absolute terms. The reduction would be achieved through both revenue-raising and expenditure-cutting measures. New taxes had been approved in the revised budget for 1983, and they ought to raise revenues equivalent to about 1 percent of GDP on an annual basis. The revised budget for 1983 also encompassed sharp reductions in expenditures compared with the original budget. Furthermore, nominal expenditures in 1983 were being reduced below their actual 1982 levels in two areas, subsidies and capital expenditures. He commended the authoritites for their courage in adopting such budget decisions. It was also encouraging that the lower level of public investment assumed in the program was compatible with satisfactory economic growth and that it was in conformity with the recommendations of the World Bank. In order to ensure that the fiscal objective of an improvement in the overall budget position would be achieved, three ceilings on budget performance had been introduced: on net domestic credit to the Treasury, on total borrowing by the Treasury, and on domestic arrears. There was merit in introducing such additional performance criteria.

With regard to monetary policy, Mr. Nimatallah continued, the program aimed at a deceleration in the rate of monetary expansion from 21 percent in 1982 to about 15 percent in 1983. The objective was to be achieved by limiting domestic bank borrowing by the Treasury and continuing the present policy of quantitative credit controls. It was also encouraging that the authorities had started to implement the process of monetary reform whereby the traditional tools of reserve requirements, liquidity ratios, and open market operations would be used to regulate the money supply. However, such a process was necessarily gradual because the financial markets in many developing countries, including Morocco, were not yet well developed.

The balance of payments had recently come under intense pressure, Mr. Nimatallah observed, and reserves had fallen to a level equivalent to only one week's imports. The first reaction of the authorities had been to tighten import restrictions so as to prevent the loss of foreign exchange. That tightening was being reversed at present. For such a liberalization policy to succeed, however, the first drawing under the proposed program should be released immediately. The authorities were continuing to pursue a flexible exchange rate policy and, with the help of the World Bank, they were adopting various policies aimed at promoting exports. The success of those policies would depend to a large extent on the recovery in the world economy and on the removal of barriers to international trade.

It was encouraging that the authorities' efforts to seek a rescheduling of debts to both official and private creditors had met a favorable response, Mr. Nimatallah went on. However, even with a successful rescheduling, a financing gap remained in the balance of payments. Saudi Arabia was already contributing, and it would be happy to contribute more to close that gap. His authorities were certain that the other friends of Morocco would do the same. Therefore, he urged the Board to approve the request for a stand-by arrangement, so that the authorities would not have to waste time before proceeding with adjustment. Morocco faced a difficult period ahead, and adjustment would have to be pursued vigorously. The present stabilization program represented strong efforts in that direction, and he wished the authorities every success in their endeavors.

Mr. de Maulde said that he believed that the program had a reasonable chance of success on the basis of the various assumptions made and in light of the anticipated adjustment. That conclusion was not self-evident, given the difficulties experienced since 1978 in the authorities' repeated efforts to deal with severe imbalances affecting the economy. However, there were two grounds for a degree of optimism. First, in spite of the drawbacks and shortcomings of the previous arrangements, the new program appeared likely to benefit from the adjustment already undertaken with regard to the structure and management of the economy. Important measures had been taken in the areas of fiscal and trade policy, and there had been the less quantifiable, but not necessarily less significant, achievement of the acceptance by all social groups of realistic prices for a wide range of basic commodities. Important progress had been made with regard to the cuts in subsidies since 1982. The program would, therefore, benefit from an unusual amount of prior action. A second reason for confidence was that the strategy and the objectives of the program were well tailored to Morocco's economic circumstances. The degree of adjustment of domestic consumption required under the program appeared consistent with a return to a manageable external situation within a medium-term framework, i.e., by 1988.

Although the anticipated adjustment was severe, Mr. de Maulde continued, it was both economically and socially realistic. There was a major emphasis on the reduction of the overall budget deficit to 4 percent of GDP for 1983 as a whole, implying the realization of a surplus in the second half of the year. Significant new measures would be taken on both the revenue and expenditure sides, the implementation of which would require skill, determination, and political courage. Progress in the fiscal area should be closely monitored throughout the life of the program, beginning with the review later in the year.

A second major aspect of the program was the question of balance of payments financing, Mr. de Maulde added. The success of the program depended heavily on the provision of a level of external assistance commensurate with the seriousness of the external imbalance. In that regard, the forthcoming Paris Club Meeting would play an important role; the French authorities would be willing to play an active part in those negotiations and in the provision of other forms of assistance that might be required. Finally, the example of Morocco would provide a good test of the effectiveness of the cooperation between the Fund and the World Bank; he invited the staff or Mr. Kabbaj to provide additional information on that question, particularly with regard to the negotiation of the World Bank loan to finance the program of export promotion and diversification.

Mr. Joyce stated that he agreed with the proposed adjustment measures and with the ceilings set under the program. The Moroccan authorities had already taken a number of important steps in advance of the Executive Board's discussion of the program. The opportunities provided under the arrangement to review the program's progress at frequent intervals were welcome. Although there had been some encouraging signs recently, particularly the strong rebound in agricultural output following the 1981 drought, it was clear that the overall economic situation in Morocco had deteriorated significantly since the last quarter of 1982. Official reserves in June 1983 had been equivalent to less than one week of imports, phosphate markets in 1983 and 1984 were expected to remain relatively weak, and Morocco's debt service obligations over the coming few years were heavy.

The proposed strategy for reducing consumption was appropriate, Mr. Joyce continued, especially as consumption had grown significantly as a proportion of GDP since stabilization efforts had been initiated in 1978. High consumption levels had also been encouraged in part by price subsidies, particularly on imported commodities. The authorities should be commended, therefore, for their recent efforts to reduce or eliminate subsidies. Further progress in that direction was essential; the Government could not afford to falter in its efforts. The revised investment program worked out with the help of the World Bank should reduce and reallocate investments away from capital-intensive projects and direct new investment toward directly productive and export-oriented sectors, an appropriate approach, particularly if Morocco was to achieve balanced growth and if it was to meet its short-term and medium-term economic and financial objectives. In 1982, the volume of capital goods imports had increased by more than 30 percent, largely due to high levels of public sector investment; thus tighter supervision of public sector investment was essential if domestic and external imbalances were to be eased. The authorities should be commended for the revised 1983 budget, particularly for the measures to increase tax revenues, limit public sector employment, and reduce transfers to public corporations. The revenue projections envisaged a 34 percent increase in revenues from the state-owned phosphate company, which could be optimistic, given the serious difficulties currently facing the industry. Perhaps the staff could provide information on that question.

Commenting on external policy, Mr. Joyce welcomed the Government's commitment to continue pursuing a flexible exchange rate policy. An appropriate exchange rate would be essential, both to limit imports as import restrictions were eased, and to promote nontraditional exports, a policy crucial to the success of the adjustment program in the medium term. The discussions between the Government and the World Bank aimed at finding ways to achieve import substitution and to reduce the subsidies against nontraditional export industries were also welcome.

It was clear that Morocco faced difficult times, and that the program alone would not be sufficient to bring the adjustment process to a point at which Morocco's balance of payments was placed on a sustainable basis, Mr. Joyce considered. Those conclusions gave rise to two major concerns, namely, whether the program in its present form was financeable, and whether the degree of adjustment envisaged was appropriate. The information provided by Mr. Kabbaj and by the staff on the proposals being considered both for the rescheduling of official debt in the Paris Club and for the rescheduling of commercial debt was welcome and somewhat reassuring. Nevertheless, by the time of the review, it would be necessary to have clear conclusions with regard to the rescheduling of both public and private debts, as well as assurances that the financing gap in both 1983 and 1984 could be met as a result of new undertakings by donors.

The question of what would happen after 1984 remained open, Mr. Joyce observed. He agreed with the authorities that Morocco's rescheduling should be considered in a medium-term context, and that attempts should be made to reach preliminary understandings with respect to the period from 1985 to 1987. The question of what financing might be sought from the Fund following the successful completion of the program remained a matter of concern, given that Morocco had already drawn a high proportion of the financing available to it under the present rules. As a result, Morocco might have to depend much more on non-Fund resources in the future.

Turning to the adjustment measures, Mr. Joyce acknowledged that the full adjustment required could not be carried out during the period of the proposed arrangement. However, the authorities had already taken a number of useful actions and the program envisaged further progress along the same lines. As Mr. Kabbaj had stated, the program contained firm understandings on major policy measures for 1984. It was also true that the Moroccan authorities had had to cope with difficult circumstances in recent years, both on the domestic and on the external fronts. However, for whatever reason, they had not always been fully successful in implementing the measures called for under Fund programs. The authorities should therefore be aware of the seriousness that many Directors attached to the successful implementation of the arrangement and to the introduction of all the measures set out in the letter of intent and in the agreements with the Fund.

Precisely because the road ahead was difficult, it was essential that Morocco should pursue the objectives of the program vigorously and take the required measures promptly, Mr. Joyce stated. In that regard, the review process would be crucial. He invited the staff to comment on the standards by which it would judge the progress made, particularly in the areas of tax reform, the parastatal sector, and education. The authorities would have to be willing to take additional measures if they proved to be necessary, either because external developments were less favorable than anticipated or because there had been slippages in implementation, or simply because the results of the measures already taken had not been as good as expected. He agreed wholly with the staff's statement that "the authorities cannot allow a repetition of substantial slippages in policy implementation or abandon flexibility in favor of rigidity in policy formulations."

Mr. Lovato remarked that Morocco's request involved an extensive use of Fund resources, closely approaching enlarged access limits. As the Executive Board had recently reviewed the principles governing access, it was appropriate that the relevant criteria should be borne in mind. The size of the payments imbalance and the need for financing from the Fund appeared to be largely satisfied in the present case, and the quality of the adjustment program was also broadly appropriate. However, the recovery of the balance of payments and the past record of the member with regard to the use of the Fund's resources over a protracted period were areas of less certainty. He invited the staff to comment on those issues.

It had been disconcerting to read that Morocco's record of policy implementation had not been satisfactory under previous arrangements with the Fund, Mr. Lovato continued. He understood that in 1981 unforeseen external events had caused the failure of the program under the extended arrangement, and that in 1982, the momentum of adjustment had faltered following the initial adoption of corrective measures. The staff had said that slippages had occurred mainly because of forecasting errors made by the authorities, who had anticipated large inflows of concessional aid and who had undertaken sizable capital outlays in excess of the program targets. That explanation for the failure of the program was not satisfactory. The linkages between compliance with the Fund's criteria and failure to attain the targets for the budget and balance of payments deficits had been inadequately analyzed by the staff. Perhaps the performance criteria had not been properly designed; for example, the omission of ceilings on total treasury borrowing and on short-term external debt, which were included in the new program, could have contributed to the slippages. Even if the criteria in the early programs had been appropriate, the link between them and the final targets was more complicated and less certain than the staff appeared to believe at times.

The proposed program appeared sensible, Mr. Lovato considered, and it could be expected to help Morocco to redress its severe imbalances more quickly than would otherwise have been the case. The growth rates for exports and imports assumed in the medium-term projections were 6.6 percent and 1 percent, respectively, in volume terms through 1987. Such projections were necessarily somewhat arbitrary, but it would be useful if the staff could comment on their realism. With regard to the ceiling on short-term debt, could reliable statistics be collected and could short-term foreign borrowing be properly monitored? Similarly, would the fonds réservés be monitored carefully so as to close that large loophole in the budget deficit? Morocco's need for Fund support and for increased debt relief from official creditors and commercial banks to cover the financing gap of SDR 1.6 billion was clear. His authorities stood ready to play their part in providing such assistance.

Mr. Grosche commented that it was disappointing that, despite three Fund-supported programs, Morocco had not reached a viable balance of payments position. The situation had arisen partly as the result of external factors beyond the control of the authorities, such as the sharp decline in the export price of phosphate, deteriorating terms of trade, and bad weather, but it had also been brought on by the failure of the authorities to persist in the implementing the agreed policies, and by their lack of readiness to adjust policies to deteriorating circumstances. In view of that discouraging record, he was not yet fully convinced that the authorities would adhere closely to the new program and that they would implement the agreed measures with determination.

It was encouraging, however, that the prior actions already taken could be regarded as significant steps in the right direction, Mr. Grosche continued. In view of the large disequilibria and the unsustainable volume of external debt, it was particularly important that Morocco should reach a sustainable balance of payments position within a short period. In the meantime, it was becoming more difficult to close the large and growing financing gap. The overall deficit for 1986 was projected to increase to a level three times that of 1983. Even if the repayment of external debt was delayed through rescheduling, the question of how the remaining large gap could be closed would remain. Adding to the already heavy debt burden was not an appropriate response.

The efforts undertaken in an attempt to close the gap for the program period demonstrated the difficulties that the authorities were facing, Mr. Grosche stated. It was most regrettable that, contrary to the staff's expectations, no firm understandings on the closing of the financing gap could be reached before the Board's consideration of the program. Under those circumstances, it would have been preferable to postpone the present discussion or to decide at the present meeting only on the principle of the arrangement, and to make the actuation of the arrangement dependent on the closing of the financing gap. But in light of the information provided by the staff about the encouraging reaction of creditors and in view of Mr. Nimatallah's statement, it would be acceptable to reach a decision at the present meeting. Such a decision was easier to reach because only 10 percent of the amount of the arrangement would be available following Executive Board approval: the second purchase would be subject to the availability of adequate financing for the estimated gap for the whole program period. However, proceeding in that way ought to be a rare exception; it should not become common place.

Commenting on the proposed program, Mr. Grosche welcomed the strong emphasis placed on the reduction in the budget deficit. Continuing budget deficits had been the main cause of imbalances between consumption and domestic resources. In particular, the planned reform of the education sector, the curtailment of subsidies and transfers to public enterprises, higher taxes, and the streamlining of the investment program were all steps in the right direction. It was questionable, however, whether even those steps would be large enough, in light of the forecast that the position would remain in disequilibrium over the coming years.

The authorities should aim at a fundemental restructuring of foreign debt, and they ought to consider a further reduction of the current account deficit in order to reduce the remaining gap, Mr. Grosche considered. The continuation of a flexible exchange rate policy would help the promotion of exports and the reduction of arrears. Efforts to broaden the export base and to attract foreign investment would also be useful in that regard.

He hoped that the quantitative performance criteria for total bank credit and for net bank credit to the Treasury would be met, Mr. Grosche remarked. The limits set for the remainder of 1983 appeared tight, but achievable, as the expansionary surge of credit policy in the first half of the year had left an overhang of liquidity. The program also envisaged a streamlining of monetary policy by scaling down the quantitative control of credit. While the intention to make monetary policies more effective through market instruments was welcome, the authorities should be urged to proceed carefully so as not to endanger the program targets. In sum, the authorities would have to implement the adjustment policies with far more determination than they had followed previously. As the prior actions were encouraging, he could give the authorities the benefit of the doubt and support the proposed decision. However, further strong adjustment efforts would be needed beyond the program period.

Mr. Polak observed that Directors were considering the proposed program for Morocco against a background, stretching back to about 1978, of earlier arrangements with Morocco, the results of which had not been wholly satisfactory. External factors had played an important role. Morocco had been hit by a number of adverse factors, including a severe drought, a dramatic increase in the price of phosphates, and a rise in international interest rates. Directors should also recognize that the lack of success in the past had been due in part to incomplete performance by the authorities. In particular, a number of promised measures had not been introduced at the time that they were supposed to have been introduced, such as matters relating to education policy, the reform of public enterprises, and tax reform, although it had to be admitted that all those issues were matters creating great domestic difficulties. The authorities had allowed the budget and the balance of payments to deteriorate, so that the initial estimate of the 1983 budget deficit had been for an amount more than 20 percent of GDP. They had also been influenced by expectations with regard to foreign aid that had proved to be unduly optimistic. Those past disappointments were no reason for the Fund not to engage in a new arrangement with Morocco, but such an arrangement had to be structured in a way that would not allow past experience to be repeated.

The new program met that test, Mr. Polak considered. It was based on prior actions in a number of important areas, such as the 1983 budget, including steps to reduce subsidies, and to reverse import restrictions. In addition, reviews had been built into the program to ensure that good performance would continue and that the program was not again constructed on unrealistically optimistic assumptions with regard to foreign assistance and bank loans. He welcomed the statement by the staff at the beginning of the meeting and the statements of a number of previous speakers on what might be expected for 1983 and 1984 in that regard.

It was also particularly appropriate, given the remaining degree of uncertainty, that the review later in the year would cover the subject of the financing gap, and that additional adjustments would be made if the expectations with regard to financing were not fulfilled, Mr. Polak continued. He welcomed the measures taken to move in the direction of a more open economy. It was unsatisfactory that it still remained necessary to reduce taxation discouraging exports, but, in the circumstances, it was welcome that such steps were being taken in connection with arrangements with the World Bank. The measures being taken to encourage exports were also welcome, including those affecting the exchange rate. On the same grounds, the reversal of the import restrictions introduced as an emergency measure in 1982 was commendable. The actions already taken and those announced indicated the likelihood that the program would be successful, and the phasing and reviews built into the program provided strong additional incentives in that direction. With those points in mind, he could support the proposed decision.

Mr. Erb commented that he could support the proposed stand-by arrangement, but with two serious reservations regarding, first, the strength of the adjustment effort, and, second, the balance of payments projections, particularly the size of the financing gap and the uncertainties about whether that gap could be filled. His authorities would support the organization of an appropriate financing package, but they would have to have a comprehensive set of facts upon which to make their decisions on the nature and extent of the financial support that they could provide. While his authorities welcomed the information that the gap for 1983 was closed, they had a number of questions concerning the magnitude of the financing gap projected for 1984. The balance of payments tables in EBS/83/178 provided information only on concessional assistance already committed and, as a result, no disbursements were shown for 1984. It seemed likely that several governments planned to continue assistance to Morocco in 1984, but they had not yet made formal commitments. In view of the magnitude of the need for new aid, it would have been useful to have had greater detail on the aid components so that the amounts for 1983 and 1984 could have been more closely compared.

There had not been sufficient time to examine the information that the staff had provided at the beginning of the meeting with regard to the revised balance of payments position for Morocco, Mr. Erb added. In light of the remaining uncertainties about the size of the gap and the prospects for closing it, he would have strongly preferred that the program should have been considered for the Board's approval at a later date. Such an approach would have been consistent with the approach followed in a number of previous cases in which there had been large financing gaps.

He shared the concerns of other Directors on the financing question, Mr. Erb continued, but he could support the proposed program since the initial drawing would be relatively small and subsequent drawings would be contingent upon total financing for the program being in place. At the time of the November review, he would wish to see evidence that firm commitments by creditors and donors existed to eliminate the gap. He was also concerned about the rigor of the proposed adjustment effort, and the review in November would be an occasion to strengthen the overall effort, particularly if the level of external financial assistance was insufficient to close the gap. The willingness of governments not only to provide additional assistance in 1984 but to indicate possible assistance in the years beyond 1984 would depend importantly on their judgments about the adequacy of the adjustment effort contemplated in 1984 and beyond.

Under the previous stand-by arrangement, Morocco had met all the performance criteria, Mr. Erb noted. However, several of the targets in the program had been missed by a wide margin. The budget deficit had reached 8.2 percent of GDP. External debt, which ought not to have exceeded 61 percent of GDP, had in fact been more than 72 percent. The reasons behind the failure to meet those targets were particularly disturbing. In the fall of 1982, the authorities had rapidly expanded capital expenditures in anticipation of large amounts of concessional external assistance. Those expenditures had been financed by a buildup of arrears and a drawing down of short-term lines of credit. It was a dangerous and financially imprudent practice for countries to spend on the basis of anticipated financial flows, including concessional flows, before reasonably firm commitments were in hand. The same problem had arisen in other countries. In such cases, the aid level ended up being lower than expected, but expenditure plans were based on the original anticipation, and, as a result, the budget problem intensified. The targets had also been missed because structural adjustment measures included in the program, such as changes in education policy, reform of the public enterprises, and tax reform, had not been implemented. He invited the staff to say why the performance criteria had been inadequate to the task of giving the Executive Board a signal that the adjustments were not taking place. Why should Executive Directors have any confidence in the proposed performance criteria and their linkage to the new targets?

The situation had continued to deteriorate in 1983, Mr. Erb went on, and the budget deficit had originally been projected to reach 20 percent of GDP. The current account had widened dramatically, and the anticipated foreign assistance had failed to materialize. Foreign exchange reserves had been depleted, causing the authorities to reverse earlier trade liberalization moves by restricting all imports in order to conserve foreign exchange. The proposed arrangement raised several questions that needed to be addressed in judging the adequacy of the planned adjustment effort. They included the stringency of the adjustment measures, the authorities' ability to adhere to the needed policy changes, the prospects of financing the payments gap, and the prospects of achieving a sustainable balance of payments position within an appropriate period.

The staff's approach of placing the program in a medium-term context was welcome, Mr. Erb remarked. The proposed program was the fourth in a series of stabilization programs since 1978 for which the authorities had sought Fund support; nevertheless, Directors were being told that the program for 1983 and 1984 aimed at reaching a sustainable position only by 1988, ten years after intensive Fund involvement with Morocco had begun. As a consequence, Morocco's use of Fund resources under the financial arrangements was approaching high levels in relation to its quota. Those points suggested that the authorities ought to consider carefully whether the chosen pace of adjustment was appropriate to the circumstances. The scale of any future access to the Fund ought also to take into account those factors.

The policy changes recommended by the staff ought to have the effect of reducing consumer demand by reducing or eliminating the subsidies on consumer goods and by depreciating the currency, thereby raising import prices, Mr. Erb considered. While the authorities should be commended for having taken a number of prior actions in that regard, stronger measures would be needed to reduce further the growth of consumption expenditures. The planned reduction of the fiscal deficit by 4 percentage points went in the right direction, and some measures to achieve that goal had been adopted. No new capital projects were planned. However, under the circumstances, existing public investment projects ought to be evaluated carefully to determine whether some of them could be temporarily suspended until financing became available. Additional cuts ought to be sought in current government expenditure. The first review would focus primarily on the budget for 1984. He expected that a further tightening of fiscal policy would be proposed in order to ensure that adequate adjustment took place. The tax reforms planned in 1984 included a value-added tax, and he hoped that those measures would be implemented as soon as possible, and that they would create additional revenues, thus reducing further the fiscal deficit.

Commenting on monetary policy, Mr. Erb observed that real interest rates remained slightly negative, acting as a disincentive to savings. He urged the authorities to adjust interest rates promptly. In the past, relatively little progress had been made in implementing agreed structural measures. He was pleased that the World Bank was negotiating a structural adjustment loan; he agreed with the thrust of the policies being discussed and hoped to see the relevant policy measures implemented soon. Other structural adjustment efforts in education and in government employment should help to improve the efficiency of those sectors of the economy. With regard to external policies, he strongly encouraged the authorities to adhere to the timetable for reversing the significant tightening of import restrictions and to continue pursuing a flexible exchange rate policy. It was especially disturbing that, in the context of extensive Fund involvement with the country, it had been necessary to impose additional direct import restrictions. That approach again reflected the performance problems and the lack of adjustment that had taken place. Finally, he stressed that, while he could support the proposed program at present, he attached great importance to the review that was to take place in November.

Mr. Wicks remarked that, although he shared the doubts expressed by a number of speakers, he could commend some actions taken by the authorities, including the austerity measures recently approved by the Moroccan Parliament, particularly the reduction of subsidies. He also commended the authorities' resolution to take cost increases into account when reviewing producer prices, and he endorsed their objective of enhancing the role of the money market in allocating resources. The introduction of an interest rate on workers' remittances was welcome, and there were also some encouraging signs of longer-term diversification of the export base, particularly through the authorities' promotion of Morocco's oil and gas potential.

While all those measures were welcome, Mr. Wicks continued, there were reasons why the proposed program created concerns. There was the inescapable fact of recent history. Despite substantial use of the Fund's resources since 1978 in three stabilization programs, Morocco had failed to solve its underlying structural problems. While those problems had been compounded by low world demand for phosphates, a factor outside the control of the authorities, it was impossible to escape the conclusion that the abandonment of stabilization policies in late 1982 had also contributed. The staff had been right, therefore, to stress the need for continued firm policies. The adoption of prior actions was welcome, but additional actions, for example, with regard to interest rates and exchange rates, might have been timely.

Another area of concern involved the projections for exports, which appeared to be optimistic, Mr. Wicks commented. The medium-term scenario assumed a small increase in world trade and an increase in world demand, but industrial countries outside North America were, unfortunately, not generally showing signs of sustained strong recovery so far. There was, therefore, a real risk that the demand for and the price of phosphates would not increase by the margins expected. An increase of 16 percent was projected for the value of exports other than phosphates, again somewhat optimistically. He invited the staff to say whether the projected increase depended on new markets or whether it was based on a continuation of the strong growth seen in consumer goods in 1982. If events in 1983 and 1984 repeated those of 1982, Morocco might meet the financial targets, but the program as a whole could fail to halt the deterioration of the external position, thus creating an even larger financial gap.

The financing gap was expected to double in 1984, Mr. Wicks noted, and the staff had expected that resources would have been made available to close the gap before the present discussion by Executive Directors. Although the position was clearer with regard to 1983 in the staff's assessment, no understandings had been reached with regard to 1984, a situation that left the Executive Board in an awkward position. It was not appropriate for the Board to consider papers when the resolution of the financing gap was so unclear; he hoped that that position could be avoided in the future. As other Directors had observed, the initial drawing was relatively small. He could, therefore, support the proposed decision on the basis that firm understandings on the financing gap would be reached by the time of the November review. If such a gap remained in November, he agreed with Mr. Polak that measures would need to be taken to eliminate it.

Mr. Wang stated that he supported Morocco's request for a stand-by arrangement equivalent to SDR 300 million in support of the authorities' Fourth Stabilization Program. The strategy of the proposed program seemed appropriate to ensure improvement in the balance of payments. It was also appropriate to make external debt management one of the key elements of the program. He wished the Moroccan authorities success in achieving financial assistance and debt relief under their financial plan for the balance of payments deficits in 1983 and 1984.

Mr. Camara commented that the 1983/84 program addressed the issues crucial to the recovery of the Moroccan economy. The staff had clearly analyzed the problems that the Moroccan authorities faced in their adjustment efforts. Since 1978, there had been an attempt to correct a series structural imbalances in the economy. Initially, the current account of the balance of payments had been in a comfortable position because of the favorable demand for Moroccan phosphates in the international market. As a result, the authorities had been encouraged to expand expenditures and public investment. Unfortunately, world market conditions had turned out to be less favorable than anticipated by the authorities, and they had deteriorated to the point at which the current account deficit had widened significantly. The Moroccan authorities, aware of the problem, had attempted to redress the financial imbalances through drastic cuts in government investment outlays and other measures. However, their efforts had not brought about a substantial correction, although they had taken place in the context of three Fund-supported programs; while the performance criteria for the programs had generally been met, they had not resulted in a tangible improvement in the economy. He agreed with Mr. Lovato that that outcome suggested that the performance criteria had not been set appropriately and that the achievement of the criteria had been misleading in terms of the major developments in the economy. He invited the staff to comment on that question.

Deteriorating world economic conditions had had a great deal to do with the setbacks experienced by Morocco, Mr. Camara continued, including the high level of interest rates in international capital markets and the deterioration of the country's terms of trade. A series of droughts had compounded the problems, which were mainly exogenous. The program for 1983 and 1984 appropriately aimed at reducing the current account deficit of the balance of payments from 12.9 percent of GDP in 1982 to 9 percent in 1983. An annual growth rate of 3 percent was assumed for the program period, and it was expected that inflation would be maintained at below 11 percent. A considerable effort would be needed to control consumption.

The distribution of the amount to be purchased could have been made more carefully, Mr. Camara considered. The proposed distribution was likely to result in relatively high charges to Morocco. The information provided by the staff at the beginning of the meeting was welcome. It was unfortunate that the figures for debt and for the balance of payments deficit had to be revised upward, but he was confident that a satisfactory solution could be found to Morocco's financing problems. He welcomed Mr. de Maulde's remarks with regard to the actions that the French authorities stood ready to take, and he supported the efforts of the Moroccan authorities to obtain essential assistance from friendly countries.

Mr. Jayawardena stated that Morocco's problems were the result of exogenous factors and that Fund support was warranted. The adjustment effort in Morocco was substantial, and the monetary policy reforms were appropriate. He was confident that the Moroccan authorities would soon discover the beneficial results of the liberalization of the financial markets in terms of mobilizing the necessary domestic savings. The proposed adjustment on the external side was also strong, and he welcomed the authorities' intention to take further measures if necessary.

Placing the proposed program in a medium-term context was particularly welcome, Mr. Jayawardena continued, because it helped to focus on the adjustment task in a more realistic way. In addition, by focusing on the longer-term outlook, the Moroccan authorities would be able to prevent the recurrence of stop-go adjustments. It appeared that the focus on the longer term was a result of the concerns that had arisen in the past year with regard to the debt crisis. If such an approach was adopted for most countries, the Fund's programs would be improved, and the countries would be helped in planning their efforts over a longer period.

Mr. Finaish noted that the Moroccan authorities had been attempting to deal with the country's domestic and external financial imbalances and structural difficulties for a number of years. Several corrective steps had been taken in the 1982 program supported by the stand-by arrangement with the Fund, including increases in interest rates and tariffs for major utilities, and a freeze on wages. Furthermore, all performance criteria in that program had been met. The overall fiscal deficit as a percentage of GDP had declined. Budget revenue had increased as anticipated under the program. The actual rate of expansion of credit in the economy was in line with the Government's target, and there had been progress in containing inflationary pressures. Furthermore, the growth rate of real

GDP was estimated to have exceeded the program target, partly reflecting a strong rebound in agricultural output. The authorities had also taken a number of important structural measures, which could not be expected to have an immediate impact, as Mr. Kabbaj and Mr. de Maulde had emphasized.

Notwithstanding those achievements, Mr. Finaish continued, policy slippages and unfavorable exogenous developments had adversely affected overall financial performance. A number of external factors, including high interest rates, sluggish world demand for phosphates, and a strong dollar, had contributed to the widening of the current account deficit beyond the program target. Weaker external demand for phosphates, through its impact on the fiscal contribution of the state-owned phosphate company, had already negatively affected the budget. The fiscal deficit had been further aggravated by the large increase in capital spending. In evaluating the performance of the authorities, reasonable weight had to be given to all those external factors.

In the face of the weakening financial situation in early 1983, Mr. Finaish remarked, the authorities had decided, albeit with some delay, to tighten their policies and reaffirm their determination to accelerate their adjustment efforts. That determination had been reflected in a number of corrective policy actions that the authorities had recently introduced in the context of the proposed program. The program, aimed at achieving major adjustment in a relatively short period, was a comprehensive one with fairly stringent quantitative performance criteria. In addition to the considerable tightening of fiscal and monetary policies envisaged, the program involved structurally oriented policy actions in various areas, including education, investment, and pricing policies. Prior actions had been taken and the authorities had also agreed to cooperate with the staff in formulating the budget for 1985, i.e., after the expiration of the proposed arrangement. The scope and design of the program, as well as the continuity of policy actions before, during, and after the program period, had convinced him that the authorities' action was fairly strong, and he could support them. He noted the remarks made by Mr. Kabbaj, the staff, and some other Executive Directors on the question of the financing gap. In the past, some of the countries in his constituency had been helpful to Morocco and he believed that they would continue to play a constructive role in the future.

Mr. Orleans-Lindsay said that the adjustment efforts that the Moroccan authorities had taken previously had turned out to be unsuccessful. The deterioration of the economy in the late 1970s and early 1980s had been the result, among other things, of unfavorable weather conditions, declines in the export price and demand for phosphate, the appreciation of the U.S. dollar, the increase in international interest rates, and the high level of consumption in the economy. GDP had not grown appreciably, although it appeared that agricultural output, accounting for about 15 percent of GDP, had rebounded following the severe drought. There had been a sharp decline in real value added in the mining sector, reflecting the persistent depressed levels of export prices for phosphate. It was estimated that the manufacturing sector had picked up slightly in 1982, having stagnated in 1981.

The authorities had fought inflation vigorously, Mr. Orleans-Lindsay continued, and they had held the increase in prices to 6 percent in 1982 compared to 12.5 percent in 1981. There continued to be room for improvement in that area. They had also taken a number of fiscal actions recently, including a decrease in capital outlays, a reduction in subsidies, a cutback in public sector employment, and the imposition of new tax measures. All those steps went in the right direction. The situation in the external sector was worrisome; the current account deficit was about 13 percent and the debt service ratio had been about 34 percent of GDP in 1982. He welcomed the information provided by Mr. Kabbaj and the staff about the proposals being made to reschedule official and commercial debt. He hoped that the authorities would be able to make progress under the aegis of the Paris Club and that the worrisome financing gap could be reduced to an acceptable size in the medium term. The authorities would also need to take steps to reduce the excessive levels of domestic consumption, to increase agricultural output, and to diversify the economy. He supported the proposed decision.

The Executive Directors agreed to resume their discussion in the afternoon.

DECISIONS TAKEN SINCE PREVIOUS BOARD MEETING

The following decisions were adopted by the Executive Board without meeting in the period between EBM/83/140 (9/14/83) and EBM/83/141 (9/16/83).

4. EXECUTIVE BOARD TRAVEL

Travel by Executive Directors as set forth in EBAP/83/231 (9/14/83) is approved.

5. STAFF TRAVEL

Travel by the Managing Director and the Deputy Managing Director as set forth in EBAP/83/232 (9/14/83) is approved.

APPROVED: March 14, 1984

LEO VAN HOUTVEN
Secretary