DOCUMENT OF INTERNATIONAL MONETARY FUND
AND NOT FOR PUBLIC USE

FOR AGENDA

EBS/88/154
Correction 1

CONFIDENTIAL

August 29, 1988

To: Members of the Executive Board

From: The Secretary

Subject: Morocco - Request for Stand-By Arrangement

The following corrections have been made in EBS/88/154 (8/2/88):

Page 18, footnote 1: for "EBS/88/175" read "EBS/88/75"

Page 23, para. 1, line 13: for "DH 8,000" read "DH 8,400"

Page 32, Table 9, subheading, column 2: for "June" read "June 1/"

line 2: for "2,800" read "800"

Footnotes: Insert a new footnote 1/: "Estimate." The remaining footnotes should be renumbered as shown as footnote 2 to footnote 5, and should be renumbered as shown in the body of the table.

Corrected pages are attached.

Att: (3)

The implementation of the structural and macroeconomic adjustment program will help to re-establish balance of payments viability and a more manageable debt profile. Medium-term projections of Morocco's balance of payments through 1993 (Table 6) are based mainly on the assumptions shown in Appendix Table I. The external current account is projected to shift from a deficit averaging 0.5 percent of GDP in 1987-88 to a surplus of 0.7 percent in 1989, and to remain in a small surplus at least through 1992. The current account targets are based on an average volume growth of exports of 6.1 percent and of 3.9 percent for imports during 1988-93. As indicated in Appendix Table I, the growth projection for exports exceeds that of projected demand in trade partner countries, owing to the assumption that Morocco's further increases in production capacity, the vigorous promotion of exports, and the prospection of new markets will permit increasing market shares for Moroccan products during the period. On the other hand, Morocco will need to continue to keep abreast of trends in export competitiveness of other North African, Middle Eastern, and European countries, and to be prepared to adopt additional measures to at least maintain its position vis-à-vis its principal competitors.

The strengthening of the overall balance of payments would allow a substantial accumulation of gross reserves, which are targeted to increase from the equivalent of less than one month's imports in 1987 to the equivalent of 2.5 months of imports in 1992, despite significant repurchase obligations to the Fund during this period. Taking into account scheduled amortization, projected borrowing of medium- and long-term credits, and the direct investment from abroad, the need for exceptional financing in the form of debt rescheduling could be eliminated by 1992 at the latest. In the interim years 1988-91, the residual financing gaps drop off sharply, implying that the amount of rescheduling could be limited to progressively smaller proportions of scheduled debt service, or alternatively, the projected financing needs after 1989 could be met without new rescheduling if voluntary lending resumes at an early stage, or if domestic savings can be raised more rapidly than is currently envisaged. At the same time, the debt and debt service ratios are also projected to be reduced significantly over the period. The debt service ratio (before debt relief) is expected to drop rapidly, from 61.6 percent in 1987 to 30.8 percent in 1993. Outstanding external debt, including repurchase obligations to the Fund, would be reduced from 297 percent of exports of goods, nonfactor services, and private transfers in 1987 to 205 percent in 1993.

Outstanding use of Fund resources, which is included in the above numbers, accounted for 8 percent of external public debt in 1985, when Morocco's obligations to the Fund peaked. These obligations have been declining since then, and would fall to 2 percent in 1993 if there are no further Fund arrangements after the one presently requested. By 1997, Morocco would have no further use of Fund resources outstanding.

IV. The 1988-89 Program

In 1988-89, while prospects for overall economic growth are favorable and the outlook for phosphate exports is improving, the external debt service burden remains heavy. Following the sustained adjustment efforts of 1983-87, the 1988-89 program aims at a further improvement in the external account, the total elimination by cash payments of external payments arrears and all other delays in current external payments in 1988, and a significant increase in reserves. In the attached memorandum on economic and financial policy, the Government has outlined the policies it intends to follow in 1988-89. These policies are summarized in Table 8. In both years there will be a further significant reduction in the fiscal deficit, and maintenance of cautious credit policies. The ongoing program of structural reforms, many of which are supported by World Bank lending, will be pressed forward, and a study of the reform of the financial system will be undertaken.

1. Fiscal policies

a. Fiscal objectives

The program's fiscal objectives for 1988 include a reduction of the central government deficit on a payment order basis to 4.5 percent of GDP, down from 6.1 percent in 1987, and a DH 2.5 billion reduction in net government arrears, equivalent to about 50 percent of outstanding arrears at the Treasury at the end of 1987 (Table 4 and Appendix Table II). A further reduction to 3.5 percent of GDP is the 1989 fiscal deficit objective. Current expenditure is expected to reach 22.3 percent of GDP in 1988, as against 21.3 percent envisaged during the third review 1/ and 21.2 percent realized in 1987. This increase in expenditure, however, should be more than offset by an increase in revenue. Government revenue is now expected to reach 24.5 percent of GDP, as against 22.3 percent envisaged during the third review and 21.9 percent realized in 1987. Revenue should be nearly DH 3.7 billion higher than envisaged during the third review.

The large increase in government revenue results from various favorable factors and from two important measures already taken in the context of the original 1988 budget. These measures, which are expected to contribute to a durable enhancement of tax revenue in 1988-89 and beyond, were: (i) the replacement of the flat 5 percent import surcharge and a 10 percent import stamp duty by a single 12.5 percent flat surcharge, yielding about DH 0.9 billion in net additional revenue; and (ii) the taxation, under the value-added tax regime, of some products formerly exonerated, as well as the shift to higher tax rates of some products formerly taxed at low rates, in particular transportation, rice, coffee, and cattle feeds, for an additional revenue of DH 0.3 billion. Recent favorable developments include, on the other hand, a

---

1/ See EBS/88/75, pp. 11-14 for a detailed description of the authorities' original 1988 budgetary projections.

b. Structural measures

A major program of fiscal reform in Morocco has been carried out in recent years with the assistance of the Fund and the World Bank. Some important additional measures to improve the efficiency and equity of the tax system, as well as to reduce excess tax burdens have already been introduced in 1988. A general reform of investment codes was approved by Parliament at the beginning of the year. The aim of the reform was mainly to eliminate excessive and open-ended exemptions. It limited to five years the duration of the exemption, except for the export sector for which a 50 percent exemption for the corporate income tax was maintained after the five-year period, and it increased from 4.5 percent to 8 percent the minimum tax rate on profits paid by exempt firms. In the 1988 budget, the zero-bracket threshold for the personal income tax was raised from DH 6,000 to DH 8,400, in order to simplify tax administration and to improve equity, by eliminating from the tax records a large number of low-income taxpayers. The tax rate applicable under the new corporate income tax was also lowered from 48 percent to 45 percent on 1987 profits, payable in 1988; it will be reduced further to 40 percent next year. Although some immediate revenue losses are expected as a result in 1989, the incentives benefit of the rate reduction and the raising of the threshold for personal income should in time outweigh its cost, provided in particular that sufficient improvements in tax administration are also made in the near future. In fact, the buoyancy evident in tax revenue performance during the first months of 1988 indicates that some of these losses have been largely offset by the impact of improvements in collection and other aspects of administration. Measures to improve the quality and frequency of tax audits and to simplify and reinforce the structure of penalties applicable to late payments and tax evasion are being introduced. In particular, the authorities will improve the training and sharply increase the number of tax inspectors and will reorganize the function of the Tax Department so as to benefit systematically from the pooling of information provided by the corporate income tax and the value-added tax. Finally, the authorities reasserted their intention to submit the draft law for the new general income tax on individuals to the fall session of Parliament.

On the expenditure side, improvements in the investment budgeting process are being implemented, including a new nomenclature and improved computerization of the accounts. The lack of consistency of budgetary appropriations for investment expenditure with available financing has been in the past a source of substantial difficulties, and has led to a large accumulation of arrears and to a stop-go pattern of spending, as all departments have been required in recent years to resubmit each year all remaining appropriations granted but unused in the previous year, as well as all amounts that are already committed but have not yet given rise to payment orders. The Moroccan authorities are currently considering the possibility of returning to a system in which only authorizations not committed by the end of the year are subject to cancellation. This would, however, require substantial improvements in

budgetary programming and a sharp reduction of yearly budgetary appropriations submitted to Parliament. This issue will be further discussed at the time of the first review of the program.

2. Monetary policies

a. Credit policies

A moderately tight credit policy will be maintained in 1988 and 1989 to validate the fiscal, external, and inflation objectives of the program. The expansion in domestic bank credit will be limited to 7.4 percent in 1988 which, in view of the 5.6 percent increase targeted for net credit to Government, will permit an increase in credit to the private sector of 9.8 percent (Table 5 and Appendix Table IV). The proportionately higher increase in credit to the private sector reflects the expectation that there will be larger statutory cereal crop financing in 1988 owing to the record cereal harvest that is projected. It is expected that total financing for cereal crops will grow from DH 1.5 billion at the end of 1987 to a peak of DH 2.7 billion in September, dropping to DH 2.6 billion at the end of 1988, and dropping further thereafter. Taking into account the rapid expansion of crop credit, the growth of other credit to the private sector will be about 7 percent, or less than that granted in 1987. Under the 1988-89 program, however, some of the financing needs of the private sector will be met by the substantial further repayment by the Government of its domestic payments arrears. Moreover, on the assumption of a return to more normal harvest levels in 1989, other credit to the private sector would increase more rapidly in 1989, helping to accommodate the expansion in productive investment by the private sector that is foreseen under the program.

The level of counterpart deposits under the system for the dirham provisioning of requests for foreign exchange not immediately met by Bank Al-Maghrib 1/ will fall progressively in 1988 as external arrears are eliminated and the net foreign assets of the banking system improved (Appendix Table V). Since the end of March 1988, the average waiting period between the time a request for foreign exchange was registered with Bank Al-Maghrib and the receipt of the foreign exchange has been reduced to 25-27 days, compared with an average waiting period of 90 days in 1987.

Reflecting the impact of the expected improvement in the net foreign assets of the banking system, together with the authorities' domestic credit objectives, money and quasi-money is projected to

---

1/ The provisioning system currently entails counterpart deposits against commercial arrears. It has absorbed domestic private liquidity by requiring that 50 percent of the domestic currency counterpart be transferred by the banks to the Treasury as an interest-free loan, which is, however, included under the ceiling on credit to Government.

authorities are taking steps to implement the remaining conditions, and it is expected that ASAL II will become effective in the near future. Other elements and objectives of the program are described in Appendix II, Attachment I, paragraph 25.

5. Performance criteria, indicative targets, and reviews

The program contains the following quantitative performance criteria: (i) quarterly ceilings on the cumulative overall budgetary deficit on a cash basis; (ii) quarterly ceilings on the reduction of the Government's domestic payments arrears; (iii) quarterly ceilings on net bank credit to Government; (iv) quarterly ceilings on total bank credit; (v) quarterly ceilings on outstanding external public-sector short-term debt; (vi) quarterly ceilings on new nonconcessional external borrowing with a maturity of between 1 and 12 years contracted or guaranteed by the Government, with a subceiling on loans with a maturity of 1 year to less than 3 years; and (vii) quarterly ceilings on the level of external payments pending. The ceilings are defined in paragraphs 2 through 8 of the Technical Memorandum of Understanding (Appendix II, Attachment II) and shown in Table 9. Ceilings shown for December 1989 constitute indicative targets and will be reviewed during program reviews. Performance criteria for end-March, end-June 1989, and end-September 1989 will be established during the first program review scheduled for completion by February 28, 1989.

In addition, the program contains the following indicative targets: (i) quarterly ceilings on cumulative government revenue; (ii) quarterly ceilings on public investment expenditure commitments; and (iii) quarterly ceilings on the net foreign assets of Bank Al-Maghrib. As with the quarterly performance criteria, the quarterly indicative targets for end-March, end-June, and end-September 1989 will be set during the first review. Failure to observe any indicative target will entail consultation with the Managing Director as to whether additional measures may be required to ensure adherence to the program.

Two reviews are scheduled with the Fund to be completed by end-February 1989 and end-September 1989. The first review, which will be combined with the 1988 Article IV consultation, will focus on the 1989 budget to be approved by Parliament at the end of 1988, on the accompanying financial measures, and their effect on the economic and financial program for 1989. The first review will also examine the mobilization of external resources, including debt rescheduling, to cover remaining financing gaps, the further liberalization of imports, the privatization program, and exchange rate policy, including the Treasury's new system of exchange risk coverage. It will examine possible changes to be made in the end-December 1989 indicative targets, and, as noted above, performance criteria and indicative targets for end-March, end-June, and end-September 1989 will be set during this review. The second review will examine the execution of the economic and financial program during the first half of 1989, and assess progress in the preparation of the studies regarding the reform of the financial system and the behavior of private investment. During both reviews,

Table 9. Morocco: Performance Criteria and Indicative Targets, 1988-89

	1987	1988			1989
	Dec.	June 1/	Sept.	Dec.	Dec.
	Actual	Program			
A. Performance criteria		(In millions of dirhams)			
1. Budgetary deficit (cumulative)	9,794	3,600	5,600	10,000	
2. Reduction in government payments arrears	623	800	500	2,500	
3. Net bank credit to the Government	41,235	45,200	44,200	43,700	
4. Total bank credit	73,753	77,400	78,700	79,400	
		(In millions of U.S. dollars)			
5. External borrowing by the Government					
a. Outstanding short-term debt 2/	225	300	300	300	300 3/
		(In millions of SDRs)			
b. New nonconcessional borrowing 1-12 years 4/	...	350	350	350	700 3/
Of which: 1-3 years 4/	...	50	50	50	100 3/
6. Outstanding external payments arrears 5/	378	220	160	—	—
B. Indicative targets		(In millions of dirhams)			
1. Total government revenue	32,972	20,100	30,400	41,000	
2. Investment expenditure commitments	8,274	4,000	7,000	11,000	
		(In millions of SDRs)			
3. Net foreign assets of Bank Al-Maghrib	253	190	260	355	590

Source: Technical Memorandum of Understanding of July 28, 1988.

1/ Estimate.
2/ Excluding Kuwaiti deposit.
3/ Indicative targets.
4/ Cumulative amounts of new commitments since January 1, 1988.
5/ Measured as valid payments requests pending settlement by Bank Al-Maghrib plus external payments arrears of the Treasury.