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INTERNATIONAL MONETARY FUND

Minutes of Executive Board Meeting 82/144

10:00 a.m., November 8, 1982

J. de Larosière, Chairman
W. B. Dale, Deputy Managing Director

Executive Directors	Alternate Executive Directors
A. Alfidja	
	C. Taylor
J. de Groote	
B. de Maulde	A. Le Lorier
A. Donoso	
	C. Dallara
	T. Alhaimus
	S. R. Abiad, Temporary
A. H. Habib	V. Supinit
T. Hirao	
R. K. Joyce	M. Casey
A. Kafka	J. R. Gabriel-Peña
G. Laske	G. Grosche
	C. P. Caranicas
	A. S. Jayawardena
Y. A. Nimatallah	S. El-Khouri, Temporary
	J. Schuijer, Temporary
A. R. G. Prowse	K. G. Morrell
G. Salehkhou	O. Kabbaj
	E. I. M. Mtei
M. A. Senior	
	J. G. Pedersen, Temporary
	Tai Q.

L. Van Houtven, Secretary
R. S. Franklin, Assistant

Also Present

African Department: J. B. Zulu, Director; R. J. Bhatia, Deputy Director; O. B. Makalou, Deputy Director; N. Abu-zobaa, Buu Hoan, E. A. Calamitsis, F. d'A. Collings, A. G. A. Faria, Y. Fassassi, R. Franco, C. A. François, M. G. Gilman, J. Hicklin, A. Jbili, M. Reichardt, S. L. Rothman, E. Sacerdoti, D. E. Syvrud, A. Tahari. Exchange and Trade Relations Department: W. A. Beveridge, Deputy Director; S. Kanesa-Thasan, P. Thomsen. Fiscal Affairs Department: V. Tanzi, Director; R. R. Schneider, A. Tazi. IMF Institute: S. Bansaid, A. Cherradi, H. Jankee, Participants. Legal Department: J. V. Surr, J. M. Ogoola. Research Department: B. R. H. S. Rajcoomar. Personal Assistant to the Managing Director: N. Carter. Advisors to Executive Directors: J. Delgadillo, A. B. Diao, M. A. Janjua, G. Jauregui, P. Kohnert, H.-S. Lee, P. D. Péroz. Assistants to Executive Directors: H. Alaoui-Abdallaoui, T. A. Connors, R. J. J. Costa, M. K. Diallo, G. Ercel, C. Flamant, G. Gomel, M. Hull, Jiang H., J. M. Jones, M. J. Kooymans, V. K. S. Nair, Y. Okubo, G. W. K. Pickering, E. Portas, J. Reddy, D. I. S. Shaw, H. Suzuki, M. Toro, P. Verly, J. C. Williams, A. Yasseri.

1. EXECUTIVE DIRECTORS

The Chairman welcomed to the Executive Board Mr. Habib as Executive Director and Mr. Morrell as Alternate Executive Director to Mr. Prowse

2. MAURITIUS - STAND-BY ARRANGEMENT - MID-TERM REVIEW

The Executive Directors considered a staff paper on the mid-term review of the stand-by arrangement for Mauritius (EBS/82/182, 10/7/82).

The staff representative from the African Department said that the Mauritian authorities had informed the staff that the Government had issued a white paper and had indicated that, from November 22, 1982, the retail price for rice would be increased from Mau Rs 2 to Mau Rs 2.5 per kilo and that the retail price for wheat flour would be increased from Mau Rs 1.8 to Mau Rs 2.4 per kilo. Those increases would reduce the proportion of subsidies in the unit cost of rice from 45 per cent to 30 per cent and of wheat flour from 53 per cent to 35 per cent. The authorities had also confirmed that, in 1982/83, total subsidies on rice and wheat flour would be held within the budgeted amounts. They had stressed that the Government was going forward with its commitment to contain expenditure in aggregate and was examining specific measures to reduce outlays relating to unemployment and disguised unemployment in the public sector.

Mr. Alfidja made the following statement:

> At the outset, I would like to convey to the Fund management and staff the deep appreciation of my Mauritian authorities for their valuable contribution to the mutual understanding and close collaboration which continue to exist between Mauritius and the Fund. As usual, the staff has prepared a clear and concise report on the mid-term review of the stand-by program, and my authorities and I are thankful for this excellent work.
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> When the present stand-by program was discussed and approved by the Board on December 21, 1981, Executive Directors attached great importance to the mid-term review which was to cover the period through the end of May 1982. Directors were particularly concerned about developments in specific areas, namely, the fiscal deficit, wages and salaries, subsidies, state enterprises, the revenue system, and the exchange rate level. It is comforting to read from the staff report before us that the Mauritian authorities performed remarkably well, as all the program targets were not only met but surpassed in many instances, and that the quantitative performance criteria were fully observed throughout the review period. It is also pleasing to report that in the areas that constituted a source of great concern to many Executive Directors last December, developments are under full control and the authorities continue to make significant progress in their efforts to redress the situation.

In the fiscal area, the determined efforts to bring about a viable budgetary position have been paying off. The overall budgetary deficit was reduced to the level targeted in the program. These efforts are being sustained as witnessed by the 1982/83 budget, which indicates a reduction of the deficit to the equivalent of 10 per cent of GDP. On the revenue side, not only have the authorities taken stronger revenue measures such as increases in the rate and coverage of stamp duties on imports, but they have addressed the question of taking steps to strengthen tax administration and collection with a view to making the revenue system more elastic and more efficient. In this endeavor, Mauritius has benefited from the Fund's technical assistance program. As a result, the authorities have issued a white paper on a sales tax and intend to submit to Parliament a draft legislation for the introduction of such a tax at the beginning of 1983. They also are in the process of implementing the recommendations of the 1980 Fund technical assistance mission regarding the improvement of tax administration and the rationalization of exemptions from import duties. It is in this context that they plan to establish during fiscal year 1982/83 a Unified Revenue Service and a pay-as-you-earn scheme with a view to improving tax collection. On the expenditure side, the policy remains one of tight control. The authorities have kept recurrent expenditure under check and have further reduced the pressure on the budget by a deliberate streamlining of capital expenditure and postponement of low-priority domestically financed projects. Salaries and wages, as well as subsidies, constitute important elements of recurrent expenditure, and my Mauritian authorities share the concern expressed by Executive Directors last December over the potential danger of having unmanageable budgetary imbalances in the event a firm control over these elements was not secured. The 8.5 per cent overall wage increase for government employees in the face of a 13 per cent increase in the consumer price index is a clear indication of the commitment to adhere to a policy of wage restraint. With regard to the question of subsidies, the authorities, while recognizing that great care must be exercised to fully take into account the social realities in the country, especially the needs of the underprivileged segments of the population, stand prepared to take strong and courageous actions so as to have prices reflect market conditions. Accordingly, on the basis of a white paper on that question, which has just been issued, the Government has decided to increase the retail price of rice by 25 per cent from Rs 2 to Rs 2.50 per kilo and the retail price of flour by 33 per cent from Rs 1.80 to Rs 2.40 per kilo as from November 22, 1982. As a result, the proportion of subsidies per kilo in total subsidy outlays will decrease from 45 per cent to 30 per cent in the case of rice and from 53 per cent to 35 per cent in the case of flour. The Government has given assurances that total subsidies on rice and flour for 1982/83 will be held within the budgeted amount as presented at the time of the mid-term review. With regard to the question of parastatal enterprises, the authorities fully share the view that these state enterprises must operate in an efficient and self-sustaining fashion. Accordingly, a study has been undertaken with a view to restructuring the relevant entities. The authorities have also taken incentive measures aimed at enhancing private investment and capital formation.

Regarding exchange policies, the multiple currency practice was only a temporary measure and as such was abolished on August 31, 1982.

Despite the successful implementation of the previous and current stand-by programs with the Fund, my authorities recognize that much still remains to be done in order to put their economy back on the right track. They are particularly concerned about the employment problem, which they are determined to address promptly. Accordingly, they have appointed a committee of officials which has been examining the extent of disguised unemployment and underemployment in the parastatals as well as in certain government departments with a view to recommending redeployment of surplus labor for productive work, especially in agriculture. The authorities are looking forward to the committee's report and recommendations and there is no doubt that the necessary action will be taken in a timely fashion.

Thus, in light of the success so far achieved by Mauritius, very often in extremely difficult circumstances, one can only hope that international institutions, such as the World Bank and the Fund, as well as friendly countries, will continue to lend their full and sustained support to this country.

Mr. de Maulde noted that Mauritius was a small but densely populated island that was highly dependent upon the production and export of sugar. Economic performance in recent years had suffered, in part from the overexpansionary policies that had been implemented during the sugar price boom of the mid-1970s. However, performance had also been severely affected by developments beyond the control of the authorities--cyclones, the second oil shock, and the dramatic decline in sugar prices--which helped to explain why a sustainable internal and external financial situation had not yet been achieved, despite the courageous measures taken by the authorities under three successive Fund-supported programs.

Remarking on performance under the current stand-by arrangement, Mr. de Maulde observed that the slightly higher than forecast overall budget deficit had been due to a decline in imports which, while producing a better than expected current account position, had adversely affected receipts from taxes on imports. He would welcome some elaboration on the decline in imports, particularly with respect to the distribution of the reduction among the different types of imported commodities. He wondered whether too severe a reduction in project-related imports might not have an adverse effect on future economic growth.

The rate of credit expansion had been slightly higher than programmed, but it was significantly lower than the rate witnessed in the previous year, Mr. de Maulde continued. As indicated in the staff paper, changes in the rate of credit expansion reflected a large shortfall in net foreign financing of the fiscal deficit and was thus not a matter for concern. Unfortunately, the budget deficit remained high--not only as a percentage of GDP, but also as a percentage of government revenues--an indication that the adjustment program should focus on the fiscal side. In that regard, the newly elected Government had already demonstrated its willingness to continue the adjustment effort. He welcomed the introduction of several new measures, including an increase in stamp duties and a 5 per cent sales tax, which should produce a 24.2 per cent increase in revenue in 1982/83. Also to be welcomed was the effort to improve the tax administration and to establish a unified revenue service. In passing, he observed that overall government revenues were dependent upon the disbursement of a second structural adjustment loan by the World Bank, and he would appreciate hearing from the staff whether dibursements would be made before the end of the fiscal year, thus allowing the authorities to avoid cutbacks in capital expenditures.

Wage increases in the public sector would apparently be held to no more than 8.5 per cent; and, given the 13 per cent increase in the consumer price index in 1981/82, the standard of living of government employees would therefore be reduced, Mr. de Maulde remarked. The wage limitation was a courageous move by the authorities, as was the recent decision to increase the retail price of rice and wheat flour, especially considering the political sensitivity surrounding subsidies in Mauritius.

According to the staff, the effort to reduce disguised unemployment and to cut expenditure on welfare programs was insufficient, Mr. de Maulde observed. He wondered whether it was sensible to further reduce the number of employees in the public sector without at the same time affording individuals the opportunity to take on new jobs. There was an obvious need to develop employment in the private sector, which would require new investment, particularly in industry; in that respect, the introduction of an investment allowance and the increase in the rate of depreciation for fixed assets--both of which were designed to promote private investment--seemed commendable. In passing, he wondered whether there was any scope for further development of tourism; Table 3 in the staff paper did not clearly indicate how much revenue tourism produced. Finally, while he could support the proposed decision on the mid-term review of the stand-by arrangement, he noted that the path toward a sustainable internal and external financial position for Mauritius would require further painful adjustment efforts and continued close cooperation with the Fund.

Mr. Dallara, noting that he was in broad agreement with the staff appraisal, said that he also could support the proposed decision. The authorities should be commended for the resourcefulness and thoroughness with which they had implemented the adjustment policies under the current stand-by arrangement; all performance criteria had been observed and, on balance, most of the near-term adjustment targets of the program had been attained. While he could generally accept the emphasis in the program on reducing the overall government deficit, he urged the authorities to reconsider the mix of policies being adopted. In particular, he questioned whether concentrating on reductions in capital expenditure--as had been done in 1981/82--might not have an adverse effect on other long-term structural goals. In the 1982/83 program, projections for capital expenditure and net lending as a percentage of GDP represented only a marginal improvement over the outcome for 1981/82 and were in fact almost 2 percentage points below the original 1981/82 targets. Greater emphasis should perhaps be placed on reductions in current expenditure, and he would appreciate comment from the staff or Mr. Alfidja on that matter.

Remarking on the balance of payments prospects for 1982/83, Mr. Dallara observed that the authorities intended to finance the overall deficit in part by drawing down reserves to a level equivalent to only slightly more than three weeks' imports. It was unclear whether any short-term financing alternatives were available; however, he found the drawdown of reserves to be a worrisome development, and he would appreciate some comment from the staff on the adequacy of projected reserves. He had also noted the goal of a net amortization of SDR 8 million in Eurodollar credits, and he wondered whether additional information could be provided on the composition of Mauritian debt with some indication of the authorities' goals regarding the future debt mix. Finally, he considered the modification of the phasing of purchases under the stand-by arrangement to be appropriate in present circumstances.

Mr. Taylor stated that, like others, he was in broad agreement with the staff analysis and recommendations. Performance under the stand-by arrangement had been encouraging: real GDP had grown by 5 per cent at the same time that inflation had been halved, and the current account deficit had been substantially reduced. Such progress owed much to the courage and skill with which the authorities had pursued prudent and flexible policies in the face of adverse circumstances. In that regard, it was reassuring to note that the new Government firmly intended to continue the adjustment path initiated by its predecessor.

He welcomed the constructive efforts being made--with Fund technical assistance--to improve the revenue base as receipts from import taxes declined, Mr. Taylor continued. However, further efforts would be needed to reduce the growth in current expenditure, and he could support Mr. Dallara's concern that too much emphasis had perhaps been given to reductions in capital expenditure. He recognized that a shift in emphasis along the lines recommended by Mr. Dallara would be difficult, but he noted that the recent announcements regarding price increases for rice and wheat flour were steps in the right direction. Even if the authorities were fully successful in reducing current expenditure, the budget deficit would remain high and a large proportion of it would need to be domestically financed. In that regard, there was the danger that the authorities' success in reducing inflation might be jeopardized by excessive monetization of the public debt, and the situation would therefore bear careful watching.

With respect to external policies, Mr. Taylor said that he could endorse the suggestion that strict control should be maintained over the contracting of further commercial foreign debt. The rising debt service ratio could threaten to become a heavy burden on the balance of payments after 1983, particularly given the likely constraints on the sugar industry that would be brought about because of the need to replant a major proportion of the crop.

The erosion of competitiveness since the 1981 devaluation also bore careful watching, Mr. Taylor remarked. He wondered whether the staff or the authorities had considered a possible modification in exchange rate policy in light of the fact that so much of the Mauritian sugar crop was exported to the European Community. Perhaps thought should be given to pegging the rupee to the ECU (European Currency Unit). Finally, he hoped that any negotiations on a possible follow-on program would prove successful.

The staff representative from the African Department remarked that, like Mr. de Maulde, the staff was unhappy that the adjustment in the budget had taken place mainly through a reduction in investment expenditure. The authorities had intended to increase investment expenditure beyond the level attained in 1981/82, but the inflow of long-term capital for projects had declined, which showed up as a reduction in investment expenditure in the budget.

Regarding prospects for disbursements under the structural adjustment loan from the World Bank, the staff representative noted that a World Bank mission was in Mauritius at present, and the authorities were hopeful that disbursements could be made during the current fiscal year. The World Bank staff had been unable to indicate the precise timing for the disbursements, although it had been suggested that if any were to be made in the current fiscal year they would be quite late. Hence, the Fund staff had not accounted for the structural adjustment loan, either in the budget or in the balance of payments. It should be noted that capital expenditure was not expected to be reduced if the structural adjustment loan were not forthcoming, because it had not been incorporated in the budget. Rather, if disbursements under the loan were received during the fiscal year, reliance on domestic bank financing would be lower and foreign financing would be higher than budgeted.

With respect to questions on the distribution of declines in imports, the staff representative observed that, although investment goods had declined, reductions had also taken place in consumption goods, partly because of destocking on the part of traders and because of reaction to the increase in interest rates. Those reductions also reflected the effects of the September 1981 depreciation of the rupee and prudent demand management policies.

On prospects for tourism in Mauritius, the staff representative noted that the country was a desirable place to visit, that the appropriate infrastructure was available, and that the price level was moderate by comparison with that in other countries. In fact, the net receipts from tourism had been increasing, although the rate of increase was perhaps not as rapid as might otherwise be expected, because Mauritius was geographically quite far from both Europe and the United States.

The authorities considered the level of projected reserves to be inadequate, particularly given the vulnerability of Mauritian exports, the staff representative from the African Department noted. However, they had been forced to choose between a reduction in reserves in 1982/83 and increasing Eurodollar borrowing; the choice had been to avoid net recourse to Eurodollar borrowing in 1982/83 even if the decision entailed some reduction in reserves. Finally, with respect to Mr. Taylor's question on exchange rate policy, he observed that the authorities had asked the Fund to study the appropriate pegging of the Mauritian rupee. Such a study was currently under way and, once completed, would be discussed with the authorities, probably sometime before the end of the fiscal year.

Mr. Alfidja said that he wished to assure Executive Directors that the Mauritian authorities would take account of their comments and would continue, in a pragmatic way, to discuss the various measures necessary for adjustment of the economy.

The Executive Board then turned to the proposed decision, which it adopted.

The decision was:

1. Mauritius has consulted the Fund in accordance with paragraph 4(c) of the stand-by arrangement for Mauritius (EBS/81/236, Supplement 1 and Supplement 2 of December 23, 1981 and February 24, 1982, respectively) in order to reach understandings subject to which further purchases may be made by Mauritius under the stand-by arrangement.

2. The letter from the Minister of Finance and the Governor of the Bank of Mauritius, of September 30, 1982, shall be annexed to the stand-by arrangement for Mauritius, and the letter of December 5, 1981, attached to the stand-by arrangement, shall be read as supplemented by the annexed letter.

3. Accordingly, paragraph 4(a) of the stand-by arrangement shall be amended to read:

"(a) during any period in which the data at the end of the preceding period indicate that

(i) the limit on total domestic credit described in paragraph 6 of the statement attached to the letter of intent dated December 5, 1981, and in paragraph 7 of the annexed letter of September 30, 1982, or

(ii) the limit on net credit by the banking system to Government as described in paragraph 6 of the statement attached to the letter of intent dated December 5, 1981, and in paragraph 7 of the annexed letter of September 30, 1982

are not observed, or."

4. Paragraph 2 of the stand-by arrangement for Mauritius is amended to read:

"2. Purchases under this arrangement shall not, without the consent of the Fund, exceed the equivalent of SDR 7.5 million until March 10, 1982, SDR 15 million until June 10, 1982, and SDR 22.5 million until December 1, 1982 but none of these limits shall apply to a purchase under the stand-by arrangement that would not increase the Fund's holdings of Mauritius' currency in the credit tranches beyond 25 per cent of quota or increase the Fund's holdings of that currency resulting from purchases of borrowed resources beyond 12.5 per cent of quota."

Decision No. 7242-(82/144), adopted
November 8, 1982

3. MOROCCO - 1982 ARTICLE IV CONSULTATION AND REVIEW UNDER STAND-BY ARRANGEMENT

The Executive Directors considered the staff report for the 1982 Article IV consultation with Morocco, together with a review under the stand-by arrangement for Morocco (EBS/82/168, 10/1/82; Cor. 1, 10/7/82; and Cor. 2, 10/13/82). They also had before them a report on recent economic developments in Morocco (SM/82/205, 10/14/82).

The Deputy Director of the African Department observed that the staff had recently received data indicating that the performance criteria as of end-September had been met. The staff had also been informed that the Government of Morocco had decided to increase prices of petroleum products--a move that would balance the petroleum accounts for 1982--by an average of 6 per cent, effective November 9, 1982. Furthermore, in line with their intention to reform public enterprises, the authorities had signed a development contract with Royal Air Maroc that would govern the airline company's future investment and other operations as well as its financial relationship with the Government.

With respect to the budget for 1983, the Deputy Director noted that a staff mission had visited Rabat during October to discuss the authorities' preliminary estimates of revenue and expenditure. The authorities were currently expecting to receive a substantial amount of external concessional assistance, and they were revising their initial budget proposals in light of that expectation while remaining in close contact with the staff on the matter.

Mr. Kabbaj made the following statement:

My Moroccan authorities welcome the opportunity to discuss the Article IV consultation with the Fund, as well as the mid-term review under the stand-by arrangement. They are thankful to the staff for the useful set of papers prepared for Board consideration and are in broad agreement with their content.

The year 1981 was a very difficult one for Morocco and--as was noted during the previous Board discussion--a host of exogenous and adverse factors made it almost impossible for the country to keep the program under the extended arrangement on track. These factors--well known to the Board--were, notably:

(1) the international environment of the world economy and international trade, with the inevitable negative impact on Moroccan exports of phosphates;

(2) the most severe drought of the century, with far-reaching effects on imports and, given the weight of the agricultural sector, on the whole economy; and

(3) the sharp increase in interest rates and the sizable appreciation of the U.S. dollar.

Despite these difficulties, the Moroccan authorities continued to demonstrate their willingness to pursue steadfastly a strong adjustment policy, and requested the support of the Fund in 1982. This support took the form of a stand-by arrangement and a purchase under the compensatory financing facility with a cereal component.

As the Board noted, the program presented by the authorities was sufficiently strong to justify the use of the facilities approved by the Board on April 26, 1982. This program not only addressed the pressing problems of stabilization and containment of the balance of payments deficit, but also maintained all of the medium-term strategy contained in the extended Fund facility program.

To this end, the program aimed at reducing the overall budget deficit by one third and comprised a further depreciation of the dirham and an upward revision of the interest rate structure. It also emphasized the pursuit of a restrained credit and monetary policy. On the structural front, it resolved to continue the implementation of the tax reform, the reform of state enterprises, and the reform of the education policy.

Before reviewing the program's implementation, I would like to comment on the general evolution of the economy in 1982. This year has been characterized so far by the return to more normal weather conditions and, at the same time, by a deterioration in the exports of phosphates. Despite this last adverse outcome, the rate of growth of GDP is estimated at 5.5 per cent in real terms against the 4 per cent forecast in the program. The rate of inflation has fallen and is now expected to be much lower than expected (in fact, the latest figures released are in the vicinity of 8 per cent to 9 per cent for the last 12 months).

The deterioration of the phosphate markets as well as the high level of interest rates and the appreciation of the U.S. dollar will increase the budget and the balance of payments current account deficits even further than expected. But, the authorities--as stated in the letter from the Minister of Finance attached to EBS/82/168--did not request a revision of the ceilings indicated under the program for the remainder of 1982.

As far as the program itself is concerned, the Moroccan authorities have so far demonstrated their strong commitment to its implementation. All performance criteria for June and September 1982 have been observed. Moreover, Table 1 of EBS/82/168 shows that all the measures that were to be taken have been implemented. I will discuss the measures in the order of their presentation in Table 1, and will try to update them wherever possible.

On the fiscal front, new tax measures yielding DH 1 billion, or 1 per cent of GDP, were introduced in the 1982 budget, no salary increase was granted in the public sector, and a reduction of DH 900 million in current expenditure from the approved budget was planned, but actual savings will not exceed DH 600 million. Petroleum prices were increased at the end of last week. A new education policy was initiated and, beginning September 1982, scholarships will be granted on a selective basis, which will result in increased savings over the years. The tax reform was presented to Parliament and its approval is anticipated. Preparation for the implementation of the tax reform was initiated with Fund assistance.

On monetary policy, interest rates were actually increased by up to 1.5 percentage points, while limits on credit expansion were set. So far, these limits have been observed. Concerning interest rates, the authorities have again expressed their concern about the effects of this policy on investment, and would like to review this policy with the next mission, particularly in view of the general fall in interest rates worldwide and the greater than expected abatement of inflation in Morocco.

On public enterprises, the first development contract between the Government and Morocco's national airline was signed last month, and discussions with two other public enterprises are being actively pursued.

On external sector measures, the depreciation of 3.5 per cent in the value of the dirham has been implemented, and the review with the staff conducted under the stand-by arrangement concluded that the level of the exchange rate was appropriate. Of course, the authorities wish to renew their commitment to a flexible exchange rate policy, and they continue to monitor it carefully. The planned phasing out of the import deposit scheme has been achieved.

These developments show that the 1982 program has been well devised and is working satisfactorily so far, thanks to the authorities' commitment and also to the full cooperation of the Fund staff. The consultations have also shown that, as far as 1982 is concerned, the issue of financing will not pose a major problem.

However, the situation remains difficult given the international environment and the uncertain prospects for phosphates in 1983. Thus, long discussions between the Fund and the Government have been conducted on these prospects. The authorities are well aware of the necessity for further reductions in the deficit and are actively discussing the various options offered to them. It is hoped that the final draft of the budget--due to be completed this month--will be consistent with the continuation of Fund assistance, for which the support of the Board is most welcome. In this regard, my Moroccan authorities have asked me to convey to the Board and to the management their gratitude for the continuous support that the Fund gives to their adjustment policies.

Mr. de Maulde observed from the staff report that the financial program adopted in April 1982 seemed to be generally on course and that the real economy had performed better than initially envisaged, largely because of a recovery in agriculture. That was not to say that all was well in Morocco; indeed, it was clear that serious imbalances--both domestic and external--persisted. In that context, the intention of the authorities to request a new stand-by arrangement at the expiration of the program in force seemed appropriate.

The staff report showed that the external balance was far from being sustainable and that further progress would have to be made in a number of key areas, Mr. de Maulde continued. While the budget had improved somewhat during the course of the year, there was substantial scope for further improvement; indeed, it appeared that the outcome of the deficit for 1982 would be higher than expected, in spite of the implementation of a number of tax measures and a continued improvement in tax administration.

Apart from the lower than expected contribution of the Office Chérifien des Phosphates (OCP) to fiscal revenues, most of the 1982 budget shortfall had been due to difficulties in expenditure control. The Ministry of Finance and other ministries had experienced overruns on expenditures for material in 1982, and the implementation of the policy on subsidy reductions remained to be more firmly established. In that regard, it did not appear that the DH 210 million reduction in subsidies on some items--such as wheat and sugar--reflected a decision to allow consumer prices gradually to reflect market prices; rather the reduction seemed to reflect an unexpected decrease in import prices of subsidized items. In the circumstances, it was not clear whether a reversal of the present evolution of import costs might not once again entail a rise in subsidies. Of course, he welcomed the recent decision to increase petroleum prices and hoped that the decision represented a firm approach on the part of the authorities to avoiding the payment of substantial subsidies in the petroleum area. Generally speaking, the adoption of a comprehensive policy with respect to the structure and volume of expenditures--together with the means to keep actual expenditures within decided limits--should be viewed as more meaningful than the determination of a precise limit on budget deficits set each year during the preparation of the budget.

In the monetary field, limits on domestic bank credit had been fully observed, Mr. de Maulde commented. Unfortunately, one result of that observance was a weakness in private demand for credit, which reflected unfavorably on the strength of activity in the productive sector. On the other hand, the authorities had gained some margin of maneuver for the remainder of the year; moreover, the financing of the large 1982 cereal harvest would apparently not fuel any excessive inflationary pressures, as overall credit expansion was expected to remain within the original limits. For the longer term, however, a continued weakness in private investment could affect the performance of the economy. One reason given by the authorities for the weakness of private investment was the level of interest rates, which seemed to be discouraging investors. The shift toward quasi-money during the first half of 1982 was an indication that the upward move of interest rates might have had a greater effect than expected on financial variables, and lent some support to the view that an adjustment in the interest rate structure should be considered at some point.

On the external side, the most important factor likely to improve the balance of payments appeared to be an increase in demand for phosphates, Morocco's main export item, Mr. de Maulde remarked. Prospects for an improvement in phosphate exports, however, seemed to be mixed; Morocco's large share of the market implied that exports would increase at best no faster than world demand; and the 21.5 per cent decline in phosphate exports during the first half of 1982 thus stood in sharp contrast to the 17 per cent increase targeted in the program for the year as a whole. There were, of course, some encouraging signs for the remainder of 1982 and for 1983, but they were mainly technical in nature. The precise timing of the expected pickup in demand for phosphates was not easy to determine, and a prudent assessment of the balance of payments prospects for 1983 should perhaps take account of the possibility of a somewhat slower increase in demand than previously expected.

Remarking on investment policy, Mr. de Maulde expressed interest in hearing whether the development plan recommendations recently sent to the authorities by the World Bank would have any impact on the implementation of the plan. The World Bank had suggested that project selection and implementation, as well as the improvement of productivity of existing capital stock, could contribute to a great extent to making the investment process more efficient than in the past.

Finally, with respect to exchange rate policy, Mr. de Maulde agreed with the staff that the flexible policy adopted by the authorities since late 1980 had undoubtedly helped to maintain or improve the competitiveness of Moroccan products on the export markets. Hence, there seemed to be no basis for recommending a change in that policy. In that regard, he was uncertain whether the staff was recommending a further depreciation of the dirham in real terms on the scale observed in 1981 and the first half of 1982 or simply a stabilization of the real effective exchange rate at its present level. In his own view, the case for a further depreciation was not overwhelming; given the adjustment brought about by the policy adopted in 1980, and the fact that Morocco's price performance was currently as good as or better than that of its main trading partners, a stabilization of the exchange rate should not be considered a departure from the authorities' objectives.

Mr. de Groote observed that the Moroccan authorities had consistently acted in a positive, confident, and responsive manner in their relations with the Fund. That had been especially true during the implementation of the extended arrangement approved in October 1980 and during the discussion of the current stand-by arrangement that had replaced it on April 26, 1982 when the extended arrangement had had to be canceled because of unforeseen exogenous developments, mainly the weak world demand for phosphates. During the period, the authorities had undertaken properly directed efforts to diversify their exports and thus to attack the problems brought about by excessive dependence on a single commodity. Besides its tertiary sector, which accounted for 39 per cent of GDP, Morocco had an expanding agricultural sector that required financing for its continued modernization, and a mining sector that would no longer be based solely on the exploitation of phosphate deposits. Moreover, with the aid of World Bank financing, the authorities had more recently embarked on a program to exploit oil and gas reserves recently discovered in the Essaouira Basin.

Commenting on the stand-by arrangement under review, Mr. de Groote noted that the authorities had consistently demonstrated a willingness to observe the performance criteria included in the agreement. Unfortunately, strict observance of those criteria had not, in and of itself, led to the attainment of the objectives of the program: a significant reduction in the balance of payments deficit and an improvement in the performance of the economy as a whole. In fact, the Government's budget deficit was expected to reach 9.3 per cent of GDP--which was greater than the 8.2 per cent deficit anticipated in the program--while the current account deficit and the overall balance of payments deficit would also exceed expectations. In attempting to understand the reasons behind the relatively weak performance under the stand-by arrangement thus far, it was important to note that external factors had eroded Morocco's economic position since the beginning of 1982, and that the performance criteria themselves had not been allowed to reflect any deterioration in the economic situation. In the circumstances, he wondered why the criteria had not been linked more closely to the realization of the objectives of the stand-by arrangement. An arrangement might have been designed--as it had been in other cases--to permit the criteria to be adjusted automatically whenever the assumptions underlying them were overtaken by events. If such an approach had been taken, the drop in phosphate earnings would have required the authorities to follow a stricter path of adjustment and might have led, in a "semiautomatic" fashion, to the achievement of the arrangement's main objectives.

The issue he had raised led him to question the general methodology underlying the performance criteria in the Moroccan program, Mr. de Groote stated. With respect to the phosphate industry, it appeared that the staff projections--which had anticipated rapid increases in both value and volume of phosphate products--had been optimistic. While accurate predictions were of course difficult to make, he wondered whether the staff's analysis had taken sufficient account of the oligopolistic position of Morocco in the world phosphate market. It would be interesting to know whether, if Morocco had in fact reduced its phosphate production, it might have received a better price and netted greater export proceeds. Since Morocco owned 75 per cent of the world's phosphate reserves and since phosphate products accounted for 45 per cent of the country's total exports, the point seemed relevant. Indeed, it was all the more pertinent when one considered the staff prediction for a rebound in phosphate demand in 1983. Such a rebound would enable the country to dispose of its excess production from 1982 smoothly over the entire period, thus minimizing the price fluctuations and leading to a greater stability in fiscal revenues.

As he had noted earlier, the budget deficit was currently expected to exceed the original target because of reduced receipts from phosphate sales, Mr. de Groote continued. The increase in the deficit would apparently be financed by higher than anticipated disbursements of external concessional resources under some existing agreements; however, as useful as those resources might be for financing the deficit, they were only a stopgap solution and did not remove the need for producing additional revenues, especially if phosphate revenues remained low. Other means of financing the deficit--such as increases in the tax on petroleum products and the introduction of a comprehensive value-added tax system--were already in use and, together with limitations on government borrowing from the banking system, should be continued. However, further adjustments in the fiscal area would be needed if the objective of reducing the overall budget deficit to 7 per cent of GDP by 1983 was to be attained without too much reliance on external assistance.

The usefulness of the flexible exchange rate policy adopted in September 1980 should be stressed, Mr. de Groote remarked. The 11 per cent depreciation of the dirham in real terms that had taken place between 1980 and February 1982 had enabled Morocco to achieve a good price performance. The continued devaluation of the dirham in real terms--which was required for a better allocation of resources--would obviously make imports more costly and might favor the substitution of domestically produced goods for imported ones, thereby permitting a policy of gradually liberalized import restrictions. The result would be the stimulation of new initiatives in business and the fostering of redistribution of demand. Clearly, an appropriate exchange rate policy could have positive effects on longer-term development perspectives.

The administrative aspects of the process of adjusting an economy must not be forgotten, Mr. de Groote said, and he fully supported in that connection the intention of the Moroccan authorities to continue efforts under the terms of the current stand-by arrangement to improve the performance of the public sector enterprises. Finally, he could support the staff's view that further adjustments must be made in the fiscal area and that dependence on medium-term external financing must be carefully monitored.

Mr. Taylor remarked that, despite Morocco's record harvest and a commendable adherence to the main targets of the program, the economy's external position had, if anything, worsened. When the Executive Board had approved the stand-by arrangement with Morocco in April 1982, the debt service ratio had been projected to remain at around its 33 per cent level, and it had seemed reasonable to hope at the time that Morocco's balance of payments might reach a sustainable position within three or four years. However, because exports in 1982 had been considerably lower than anticipated, the debt service ratio was likely to rise to 40 per cent in 1983 and might even exceed 50 per cent at some point. Moreover, the ratio was calculated on the assumption of an export value growth of approximately 15 per cent a year, which seemed somewhat optimistic.

It was currently expected that the deficit on services and transfers would be eliminated in 1984 and might even turn into a surplus of nearly SDR 1 billion by 1987, Mr. Taylor observed. However, that forecast relied heavily on projections of strong growth in tourism and remittances, and prospects for both those items remained uncertain. Hence, there seemed to be little margin for slippage in the external position. He would appreciate hearing whether the staff remained confident about its projections. Given the worsening of the external position, it seemed that more corrective measures might be needed, although the criteria for the remainder of the stand-by arrangement could remain unchanged, since adherence to the existing program would present a severer test for the authorities in the second half of the year and might in itself call for more determined action by the authorities.

With respect to external policy, the staff had given pertinent advice in suggesting that "the authorities should continue to use the exchange rate policy as an effective element in a comprehensive adjustment effort and to avoid any real effective appreciation of the currency," Mr. Taylor remarked. On a matter of detail relevant to the balance of payments position, he wondered whether the staff could provide any information on when the recently discovered oil and gas reserves would be brought on stream.

Regarding fiscal policy, Mr. Taylor noted that current expenditure was rising strongly, and he would welcome staff views on the adequacy of control procedures. In the first half of the program year, the fiscal criteria had been met, although that had largely been due to lower import prices of subsidized wheat and sugar. Other government spending had been significantly higher than anticipated, in spite of the implementation of the wage freeze and steps to contain public sector employment. It seemed that a sharp reduction in spending in the second half of the year would be needed if the fiscal objectives were to be met, and he would appreciate hearing from the staff whether the required adjustment was feasible. For 1983, even further fiscal tightening would be necessary if the economy was to move toward a sustainable external position. The staff had mentioned the figure of 7 per cent of GDP as an objective for the overall budget deficit for 1983; and he wondered whether that figure had been assessed in light of recent developments in the economy's productive and financial capacity. At first glance, there would appear to be a case for rather more ambitious adjustment than proposed.

The Moroccan program showed that a stand-by arrangement could be an effective vehicle for structural change, Mr. Taylor commented, even when the fragility of the economy meant that the emphasis must remain on stabilization. Since there seemed to be some consideration being given to a follow-on arrangement with the Fund, he was inclined to suggest that a further stand-by arrangement would be appropriate, given the acuteness of the fiscal and balance of payments problems. Reductions in subsidies, the elimination of advanced import deposits, and other key structural adjustments might even be brought in as early requirements or conditions for a new program. Moreover, consideration should be given to looking at progress on tax reform in any mid-term review of a new program.

Mr. Joyce agreed with others that the Moroccan authorities should be congratulated for the steps already taken to bring about adjustments envisaged under the current stand-by arrangement with the Fund. However, a great deal remained to be done. In 1982, the economy had been performing well in terms of growth and inflation, although it had to be admitted that, in a subsidized environment, it was difficult to know the true rate of inflation. Despite some slippage, the fiscal position had also improved, but the balance of payments situation continued to be a cause for concern. Although external assistance would presumably help somewhat, and world demand for phosphates would likely improve in due course, the Moroccan economy would still face a number of structural problems.

The stand-by arrangement for Morocco had replaced an extended Fund facility program that had failed for various reasons, Mr. Joyce noted. The stand-by arrangement appeared to be working well, and he wondered what sort of arrangement was being considered as a follow-on program. In April 1982--when the issue had most recently been discussed--there had been some suggestion that the stand-by arrangement might be succeeded by an extended Fund facility program. As he understood it, the thinking had shifted since that time, and the staff currently appeared to be looking toward a further one-year stand-by arrangement. He wondered whether that change reflected any concern about the pace of structural adjustment in Morocco.

On the fiscal side, it was disappointing to note that data on the public sector as a whole were not readily available, Mr. Joyce continued. Based on what information was available, it was expected that the overall fiscal deficit of the Government would be reduced to 9.3 per cent of GDP in 1982 through certain tax increases, a freeze on wages, and a curbing of some questionable educational expenditures. However, there remained serious structural problems in the fiscal area; for example, phosphate revenues and import duties together would account for almost 40 per cent of total current revenue, which suggested a real need to overhaul and diversify the tax base. In that regard, it was not clear when the Loi Cadre would be implemented or what its effects on the revenue side were likely to be. While the revenue produced from indirect taxes was substantial, a large proportion of it was returned to the consumer in the form of subsidies, representing a sort of "circular transfer." The question of consumer subsidies was a particularly sensitive one, but he wondered whether progress in reducing subsidies had perhaps been too cautious, bearing in mind that minimum wages in the private sector had risen by 15 per cent in 1982.

Capital expenditures had actually fallen steadily in absolute terms since 1977, Mr. Joyce observed, in part because of inadequate utilization of capacity. In the circumstances, he would have expected a fairly simple restoration of equilibrium in the public finances; however, recurrent expenditures had escalated, and the overall fiscal deficit thus remained in excess of 9 per cent of GDP.

A large number of public enterprises in Morocco received subsidies from the Government, Mr. Joyce noted; while some subsidies had recently been reduced, much more needed to be done. The staff had indicated that the authorities could no longer delay decisive action on consumer subsidies, the growth of public employment, and the restructuring of public enterprises; further discussions on such changes would be held in advance of the 1983 budget. He would appreciate information on the timing of those discussions and on whether it was considered that a further reduction in the fiscal deficit--to the 7 per cent targeted level--was realistic in the circumstances.

On monetary policy, Mr. Joyce observed that growth in domestic credit expansion would probably be held to 13 per cent for 1982 as a whole, despite some likely acceleration in the second half of the year. The restraint on domestic credit expansion seemed appropriate in light of the growth in nominal GDP of 16 per cent. The recent increases in interest rates had clearly been beneficial because they had caused a shift to quasi-money and had helped to curb effective demand. He also noted that the Bank of Morocco had recently been given the authority to vary the commercial banks' required reserve ratio from zero to 4 per cent; while that was a step in the right direction, the range of variation needed to be somewhat wider.

On the external side, Mr. Joyce considered that the most worrying elements were the current external deficit, the level of reserves, and the debt service ratio. The current external deficit was 12 per cent of GDP, and reserves were equivalent to only two weeks' imports. The debt service ratio--at 36 per cent--was expected to peak at 50 per cent in 1986 and then to decline slightly thereafter; however, those figures might go even higher if recovery in phosphate exports was not sufficiently strong. He would appreciate elaboration by the staff concerning its assumptions for phosphate exports in future. Specifically, he wondered whether any effort had been made to diversify exports into nontraditional markets, for example, Eastern Bloc countries.

The exchange rate seemed to be appropriate, following the recent devaluation, Mr. Joyce remarked; however, the situation in Morocco led to some interesting questions on the rate. Imports were being discouraged, both by the licensing system and by high import duties; at the same time, nonphosphate exports were being encouraged by subsidized inputs to agriculture. Despite the working of incentives, the balance of payments remained seriously in deficit, which led him to wonder whether the current exchange rate was truly an equilibrium rate. The calculation of the real effective exchange rate in Morocco was of course a difficult exercise. Using the recorded rate of inflation was not necessarily appropriate, since the foreign purchaser did not receive the benefit of Moroccan consumer subsidies; at the same time, it was uncertain whether the "third country effect" had been taken into account in assessing information on the competitiveness of the Moroccan economy. Whatever the answers to his questions, it was clear that the authorities would need to be even more flexible in future with respect to the exchange rate. He welcomed the decision to reduce the scope of the advance import deposit scheme, which would be phased out in 1983. On another point, he wondered why the bilateral payments arrangements were being retained; as he understood it, they had in fact been inoperative for some time.

With respect to the investment program for 1981-85, Mr. Joyce joined others in asking whether the authorities planned to modify their investment intentions in light of the advice provided by the World Bank. He would also be interested in hearing whether there was any intention to build investment review procedures into the planning mechanism. It went without saying that an economy with high external indebtedness needed to have the highest possible return on investment, and that was particularly true in Morocco where the very young labor force was growing rapidly and the saturation point for employment in public service had long ago been reached.

For the remainder of the current stand-by arrangement, he agreed with the staff that the existing performance criteria could be left unchanged, Mr. Joyce said. However, he noted the additional recommendation by the staff that the authorities should forgo a significant use of any new external assistance during the remainder of 1982. Presumably, "significant use" meant more than 50 per cent, but he wondered what figure the staff actually had in mind. It should probably be a fairly high figure, given the slippages in the recent past and the fact that the 50 per cent requirement--as set out in footnote 3 on page 25 (EBS/82/168)--could be circumvented by speeding up disbursements of an existing loan instead of arranging new concessional loans. Finally, it appeared that the policies under the stand-by arrangement were headed in the right direction, although the pace of adjustment had been somewhat slow, especially in respect of structural problems. Hence, structural adjustment needed to be accelerated somewhat, especially if a further stand-by arrangement was to be considered.

Mr. Nimatallah remarked that Morocco was a country that had adjusted successfully in spite of difficult external circumstances. The credit ceilings for end-June and end-September had been met, petroleum product prices had been raised, and the authorities had indicated that they would maintain the program's initial performance criteria, despite adverse developments in the phosphate export markets and the impact of those developments on the budget. It appeared that the authorities were clearly determined to adjust, and they should be commended for that determination. It was noteworthy that they were proceeding with structural adjustment along the lines envisaged in the canceled extended Fund facility program.

Two specific aspects of the adjustment program--the extent of fiscal adjustment and the pursuit of a flexible exchange rate policy--were impressive, Mr. Nimatallah considered. In Fund programs, fiscal adjustment was generally spoken of in terms of a decline in the ratio of the budget deficit to GDP. In the case of Morocco, there had been a decline not only in that ratio but also in the absolute level of the deficit from DH 11.3 billion in 1981 to an estimated DH 9.7 billion in 1982. Also, since September 1980, the value of the dirham had been determined daily on the basis of a revised currency basket that was more reflective of currencies of settlement and trading patterns. The dirham had been depreciating, both on a trade-weighted basis and on a currency settlement basis, in nominal and real terms, and the authorities were to be commended for the courage they had exercised in allowing that depreciation to occur.

Regarding the design of the program, Mr. Nimatallah noted the statement by the staff that the 1983 budget deficit needed to be reduced by approximately 2.5 percentage points in relation to GDP if progress was to be achieved toward a sustainable balance of payments position. In his view, it was not prudent to indicate at the present stage the precise magnitude of the required fiscal adjustment in 1983, especially since balance of payments projections for 1983 and beyond were still quite tentative. On the occasion of the next mission to Morocco, the staff would be better able to evaluate the situation and to recommend fiscal adjustment with precision. Finally, assuming that Morocco's balance of payments difficulties would continue for some time, he hoped that some sort of follow-up arrangement--either a stand-by or extended arrangement--could be worked out at the conclusion of the current stand-by arrangement.

Mr. Grosche remarked that the authorities should be commended for meeting all quantitative performance criteria under the stand-by arrangement and for observing all provisions relating to trade and payments. The favorable trend in consumer prices should also be noted, although he realized that subsidies might have played a role in that improvement. Similarly, while the rate of growth was well above the program's forecast, the good performance in that area may have resulted partly from the large increase in stocks, as shown in Appendix III on page 31 of the paper. In addition, the authorities should be commended for their flexible use of exchange rate policy--which was an effective element in the adjustment effort--despite some slippages in implementation.

Regarding developments in the budget, Mr. Grosche welcomed the efforts to increase revenues by raising taxes and public utility rates. On the expenditure side, the authorities had lowered consumer subsidies to compensate for higher than expected expenditures for goods and services and, in so doing, should be able to limit the overshooting of the targeted deficit to about 1-1.5 per cent of GNP. However, despite their efforts, fiscal policy could not be judged completely successful. Additional steps were needed to strengthen the budgetary stance and to restrain further the increase in expenditures for goods and services. He welcomed the fact that there had been no general wage increase for government employees but questioned to what extent the 15 per cent minimum wage increase in the private sector in 1982 would create pressures on the Government to raise public wages in future. He also wondered whether the problem of increasing the number of government employees was not more serious than the problem of wage increases. It had been noted in the April 1982 discussion that the Government had postponed recruiting some 40,000 people until 1983 in order not to create too much pressure on the 1982 budget. While the staff had recommended that the Government should "keep new recruitment within the budgetary allocations," it was not clear how that advice would in fact be followed, especially in future.

On the matter of public sector enterprises, Mr. Grosche observed that only small progress in restructuring had been recorded. Hence, like others, he considered that the issue of the public enterprises' contribution to the budget remained a matter for concern. He had been impressed by the favorable outlook for the exploitation of Morocco's natural resources, but he wondered whether it might not be more beneficial for Morocco's economic development if investment were directed toward scarce skills and resources in order to restructure the public enterprises rather than toward a further growth in phosphate facilities, especially given the uncertainty of world demand for phosphates. In any event, all large investment projects needed constantly to be monitored to avoid unforeseen pressures on the budget.

The budget deficit for 1982 was expected to be larger than previously envisaged, Mr. Grosche noted; unfortunately, the deficit in the past had mainly been financed through foreign borrowing rather than through internal savings, which highlighted his concern with the present level and expected development of Morocco's foreign indebtedness. According to the staff's forecasts, the debt service ratio would increase from 33 per cent in 1982 to 50 per cent in 1986, a projection that was even more disturbing when one recognized that it had been based on optimistic assumptions about future export receipts. Actual exports had fallen short of program targets for the third year in a row, and he wondered--like Mr. Taylor--whether the staff was not once again being overly optimistic in assuming a 14-16 per cent value increase in phosphate exports in coming years. Finally, he would appreciate comment from the staff on the positive projection for transfers and services. If the staff forecasts for export growth and transfers did not materialize, the need for foreign financing--and the consequent further deterioration in the debt service ratio--would create greater problems for Morocco in future.

Mr. Dallara said that he was broadly in agreement with the staff appraisal and could support both decisions. The Moroccan authorities had been able successfully to implement most of the measures called for in the current program and were to be commended for their determination, as well as for their ability, to meet all performance criteria. Unfortunately, earlier expectations regarding the phosphate market had not materialized, and the implementation of certain adjustment measures had fallen short of targets; consequently, the progress achieved to date had not been as great as had been hoped, and prospects for 1983 and beyond were somewhat worrisome. In particular, he was not as optimistic as the authorities with respect to near-term prospects for a rebound in demand for phosphates and derivatives, and he was thus inclined to be somewhat more pessimistic in his assessment of the medium-term prospects for the economy and for the balance of payments.

Morocco was yet another case in which the weak world economy had, in combination with other factors, rendered the original policies of the program insufficient, Mr. Dallara continued. Metaphorically speaking, it could be said that, while the Moroccan authorities had been pursuing an uphill journey at a steady pace, the hill had in the meantime become somewhat steeper, and a greater effort would be needed if the journey was to be completed within a reasonable time frame. The projected decline in net foreign assets in 1982 of SDR 445 million--excluding possible additional external assistance--was a key indicator of the need for an enhanced adjustment effort.

On specific aspects of the program, Mr. Dallara considered that the authorities should be commended for reducing the budget deficit substantially from 14.7 per cent of GDP in 1981 to a projected 9.3 per cent of GDP in 1982. The major factors preventing an achievement of the original target of 8.2 per cent of GDP had been the DH 600 million shortfall in revenues from the state-owned phosphate company (OCP) and the DH 300 million shortfall in anticipated expenditure cuts. Those developments had diminished the benefits of a very impressive increase in discretionary revenues of DH 1 billion, resulting from tax measures adopted in the first half of 1982.

He was concerned that current expenditures for goods and services had grown by 19 per cent in the first half of 1982, Mr. Dallara remarked. That growth was not, in his view, sustainable and would require vigorous action if the overall budget deficit was to be brought under control. It was not entirely clear from the staff papers how the authorities proposed to control current expenditures, and he would appreciate clarification by the staff or Mr. Kabbaj on the specific steps that the authorities intended to take.

Despite the progress that had been made in the fiscal policy area during 1982, more was clearly required, Mr. Dallara considered. Further adjustment along the lines set forth in the staff appraisal would be appropriate and consistent with the need to continue to move toward a viable payments position in the medium term. An item that appeared to deserve prompt attention in that regard was the matter of subsidies. The decision taken by the authorities to eliminate subsidies on petroleum products was courageous, and he hoped that it could serve as an example for action in other areas. Given international price trends, the time seemed right to move toward a more market-related pricing structure.

With respect to the capital budget, Mr. Dallara welcomed the close collaboration with the World Bank in the evaluation of the 1981-85 Economic Development Plan. It was important that the principal conclusions and recommendations of that evaluation should be considered and, where appropriate, acted upon by the authorities. It was only through such an approach that momentum toward the desired structural adjustment could be maintained.

Regarding balance of payments prospects for the medium term, Mr. Dallara referred to the helpful table on page 21 of the staff paper, which showed that the current account deficit might fall to 2.1 per cent of GDP by 1987. Like other Directors, he had some questions regarding the assumptions underlying that projection. He had noted that exports were expected to increase on average by 15 per cent a year, that private inward transfers would increase by 10 per cent a year, and that imports would increase by only 8 per cent on average. While recognizing the difficulty of making any projections as far ahead as five years, he would appreciate staff comment on the assumptions underlying those projections, which seemed to him to be somewhat optimistic. In sum, while the authorities should be commended for the progress that they had achieved to date, they should be encouraged to reinforce their adjustment effort in order that agreed objectives could be achieved.

Mr. Abiad stated that he also was in agreement with the thrust of the staff appraisal. The Moroccan economy had performed reasonably well thus far in 1982, moving broadly in line with the course that had been charted when the stand-by arrangement had been approved in April, in spite of a difficult external environment. As pointed out in the paper, a higher than anticipated growth rate in real GDP would apparently be achieved, inflationary pressures had been held in check, and the country's price performance seemed to be better than that in Morocco's trading partners. Moreover, the growth in monetary aggregates had been moderate. All the quantitative performance criteria for end-June and end-September had been observed, which seemed to suggest that the stance of macroeconomic policies adopted by the authorities and the introduction of several corrective measures had been appropriate. Also, some progress in the implementation of supply-oriented structural reforms had been achieved.

Those achievements, however, had been accompanied by unexpected difficulties, Mr. Abiad continued. Because of declining prices and a slackening of demand for phosphates, Morocco's major export item, total export revenues had fallen, despite a significantly better than anticipated performance of nonphosphate exports. While resulting in a deterioration in Morocco's terms of trade and a widening of the current account deficit--which had offset in part the flexibility of the country's exchange rate policy--the export shortfall, which was clearly due to factors largely beyond the authorities' control, had led to a temporary slippage in the attainment of the fiscal target. The persistence of the shortfall might in fact put the authorities' entire adjustment effort in jeopardy through its adverse impact on budget revenues.

In present circumstances, the overall tight monetary stance taken by the authorities seemed broadly appropriate, particularly in view of the weakening external position, Mr. Abiad commented. A continuation of the current demand management stance might help in keeping inflationary pressures within reasonable limits, although the authorities' financial adjustment task had been compounded by the combined effects of the strong dollar and relatively high levels of international interest rates on external debt servicing and payments. Still, it was remarkable that the unexpected weakening of the external position and its consequent impact on the budget had not prevented the authorities from implementing most of the measures envisaged in the program or from observing all performance criteria during the period under review. In fact, despite those adverse developments, the authorities had reasserted their determination to carry on their adjustment effort for the remainder of the program period in the framework of the current arrangement and initial performance criteria. The intention was a commendable one, particularly given that the external economic environment was expected to remain uncertain.

Commenting on the period beyond the one-year stand-by arrangement, Mr. Abiad noted from the staff paper that a number of domestic and external disequilibria needed to be addressed. The authorities' awareness of the serious problems involved and their resolve to tackle them with vigor had been reflected in their insistence that the structural aspects of the canceled extended Fund facility program should be included in the current stand-by arrangement. Given the structural nature of many of the difficulties experienced by Morocco, the success of the authorities' adjustment policies required both a realistic time perspective and appropriate financing. In that regard, it was important for the Fund to continue to provide the financial assistance that would enable the authorities to build upon the achievements realized thus far and to pursue their adjustment policies while endeavoring to steer the economy toward a path of recovery and sustained growth with some measure of financial stability. In sum, it seemed that the Moroccan authorities had implemented important adjustment measures and shown considerable flexibility in various policy areas, notwithstanding exogenous factors that had hindered progress in the fiscal and external areas. Further achievements in those areas would be greatly facilitated through continued adjustment efforts, as well as an easing of external constraints, and a greater availability of financial resources on adequate terms.

Mr. Caranicas observed that, following almost two years of Fund support for the authorities' adjustment efforts, the one-year stand-by arrangement granted to Morocco in April 1982 had given the Government some breathing space, and it appeared to be working well. The rate of growth in real GDP in 1982 should exceed the rate of 4 per cent anticipated earlier in the stand-by program; indeed, according to Mr. Kabbaj, the rate was currently expected to reach 5.5 per cent, a remarkable achievement by comparison with growth rates in many Western European and Mediterranean countries. At the same time, the inflation rate was declining, and consumer prices had remained more or less stable during the previous two months. Nonetheless, the general economic picture in Morocco was not encouraging, and there appeared to be no easy way out of the difficult external position of the country. Gross official reserves at end-August had fallen to the equivalent of three weeks' imports. Exports of phosphates continued to be sluggish and, while other exports were showing vigorous growth, it was estimated that the current account deficit in 1982 would be substantially higher than that witnessed in 1981.

In anticipation of the deficit, the one-year stand-by arrangement had contained elements of structural adjustment and had been designed as a precursor to a future extended arrangement, Mr. Caranicas observed. Indeed, the authorities had made special reference in their letter of intent in April 1982 to the fact that they had been interested in an extended arrangement at the end of the current stand-by arrangement. He wondered whether any significance could be attached to the fact that there had been no reference to such a follow-on program in the latest letter to the Fund. Even Mr. Kabbaj had been unclear about the matter, barely touching upon the continuation of Fund assistance in his statement. Obviously, when the authorities presented their budget, a further review would be conducted by the staff in the context of some sort of program for 1983 but--as had been agreed by the staff and the authorities--there would be no changes for the remainder of the 1982 program period.

In general, the authorities in Rabat deserved credit for their consistent approach to adjustment, Mr. Caranicas considered. The measures that they had implemented during the program period had been far from popular. There had been no salary increases in the public sector, public utility rates had been raised, budgetary measures had been taken to raise revenues, interest rates had been increased, and a further depreciation in the value of the dirham had taken place. At the same time, there had been reductions in the scope of the import deposit scheme and some further liberalization of imports had taken place. Consequently, all performance criteria and understandings concerning interest rates and exchange rate policies had been respected. However, particularly in the area of structural policies, further determination would be needed if the authorities were to consolidate the progress made thus far, especially as far as state enterprises, subsidies, and education were concerned.

During the Executive Board's discussion of the one-year stand-by arrangement in April, many Executive Directors had observed that the Government's performance in implementing policy decisions in some parts of the program--such as reform in the public enterprises and reorientation of investment outlays--had been less than satisfactory, Mr. Caranicas recalled. On the other hand, the authorities had demonstrated during the 1982 stand-by arrangement their strong commitment to the program's implementation. In passing, he wished to commend the summary presentation by the staff of the current status of the implementation of policy measures. Such an approach should perhaps be repeated in similar reviews.

In recent years, Executive Directors had commented often on the problems of state enterprises, Mr. Caranicas noted, and it would be repetitious for him to exhort the authorities to improve efficiency in the state enterprises and to look toward the advantages of reforms and adequate control. It was sufficient to suggest that they should look closely at what efforts might be needed in that area. Previous speakers had already commented on the importance of focusing on the development plan in the context of recommendations by the World Bank on investment. For his part, he would merely take note of the rather limited progress being made in the formulation and implementation of comprehensive development contracts and of the fact that subsidies for the current operations of major enterprises for 1982 were likely to be stabilized.

Another important problem to be faced was the level of external debt, Mr. Caranicas considered, and he supported the staff view that a further increase in medium-term commercial indebtedness was undesirable. The figures on outstanding external debt and on debt servicing seemed high by international standards and were therefore disquieting. Moreover, the debt ratios were projected to rise further through 1983/84, and it was questionable whether Morocco could or should continue to rely on further external financing, concessional or otherwise. At least the ceilings on nonconcessional borrowing--set out as performance criteria under the stand-by arrangement--should be maintained beyond April 1983. The staff and the authorities were apparently well aware of the debt problem; indeed, the staff had recommended that the authorities forgo significant use of any new external assistance during the remainder of FY 1982. He endorsed that recommendation and welcomed the fact that, because of parliamentary requirements and the short period remaining in 1982, no such aid would be possible except in the context of the 1983 budget.

Private investment was another matter worth examining, Mr. Caranicas remarked. He wondered why the latest investment code approved by the authorities apparently would not remove the obstacles for investment, and he asked whether there were any legal or bureaucratic impediments remaining to private investment in Morocco, which badly needed capital inflows. No doubt interest rate policy and investments were intertwined, and he wondered whether savings and investment were interest elastic. Specifically, would a rise in interest rates bring about a better allocation of resources? During the most recent Executive Board discussion on Morocco, the staff had felt that the 1.5 per cent increase in interest rates had been inadequate, but Mr. Kabbaj had expressed fears that higher rates "would give the wrong signal to entrepreneurs," particularly at a time when the Government was attempting to revive the private sector. The authorities had said that measures contemplated for adoption by the legislature should exert a favorable effect on private capital flows, and he hoped that was true because, in present circumstances of stagflation, high unemployment, and gloomy prospects generally worldwide, it was difficult to encourage investment. Mr. Kabbaj had indicated that the Government was concerned about the effects of interest rate policy on investment and wanted to review that policy with the staff mission. He presumed that the authorities felt that the sudden fall in interest rates during recent months in the United States, similar trends in some other industrial countries, and the reversal of the inflationary trend in Morocco necessitated a reappraisal of the problem.

He would be listening with interest to comments by the staff on subsidies, investment, and interest rate policy, as well as on other crucial aspects of any future cooperation between the Fund and Morocco, Mr. Caranicas said. With an overall treasury deficit of more than DH 8 billion in 1982, a balance of payments deficit on current account of more than SDR 200 million above the program objective, and doubts about sustainability in the external accounts, the Moroccan economy currently stood at a crucial juncture. Harsh choices had to be made in the area of subsidies, public employment, tax reform, and public enterprises. Consumer subsidies needed to be reduced, the rate of growth of public employment limited, tax reform vigorously implemented, and public enterprises restructured. The authorities could not rely for adjustment merely on "a combination of internal measures and external financing."

Mr. Mtei considered that the performance of the Moroccan economy in 1981 had on the whole been satisfactory. Agricultural production had recovered from the impact of the drought and, except for mining, a moderate expansion was expected in other major sectors as well. Real GDP growth was projected to be 5.4 per cent in 1982, following a decline of 1.3 per cent in 1981. In the meantime, inflationary pressures appeared to be easing. The stabilization program that was supported by the stand-by arrangement approved in April 1982 seemed to be on track, and the performance criteria had thus far been met. However, it was clear that the adjustment process had been made difficult by the continuing worldwide recession, which had led to a sharp contraction in world demand for phosphates, Morocco's main export item. Similar difficulties were being experienced in many developing countries attempting to pursue adjustment policies.

An important complement to the stabilization program was the effort to promote developments in the rural sector, Mr. Mtei noted. In agriculture, for example, producer prices were being maintained at remunerative levels, while activities had been stepped up to expand irrigation, advisory services, and fertilizer use and to improve marketing procedures. Moreover, a major effort was under way to promote agricultural exports to the European Community; if successful, that move should help to diversify the sources of foreign exchange. The fishing industry was another area in which the authorities seemed to be expanding vocational training and modernizing equipment, with a view to increasing production.

With respect to the manufacturing sector, steps being taken by the authorities appeared to go in the right direction and should place the country in a good position to benefit from food processing activities and the production of chemicals, Mr. Mtei continued. It was a welcome sign that manufacturing activities were geared not only to import substitution but to export markets as well. However, he wondered whether the policy of allowing export firms to obtain credit at preferential rates might not have some impact on capital flows, since foreign firms might be inclined to borrow locally rather than bringing in capital from abroad.

In the fiscal area, measures to increase revenue had been successful, and the revenue targets established for the program period would have been achieved had it not been for the fact that the contribution from the state-owned phosphate company (OCP) was expected to fall short of projections because of weak demand for phosphates abroad, Mr. Mtei remarked. Arrangements had been made for OCP to contribute at least DH 700 million to the budget during the remainder of the year, although it was unclear how that would be possible. He wondered what the effect of the weakness in the demand for phosphates would be on the medium-term investment program of the company, which had intended to increase capacity by 5 million tons by 1985. On the expenditure side, interest payments on the public debt remained a major problem, which had been compounded by slippages in the implementation of measures aimed at containing the growth of the other components of recurrent expenditure. In that regard, he welcomed the indication by Mr. Kabbaj that the authorities had recently increased prices on petroleum products, which had been subsidized heavily during the first half of 1982.

In the monetary field, total domestic credit would apparently increase in line with the program's objectives, and net claims on the Government were expected to rise by less than the rate provided for in the program, Mr. Mtei observed. Also, interest rates had been increased, with the maximum for short-term credit currently at 12 per cent. The increase in the interest rate structure had taken place against the background of a fall in the rate of inflation, which was currently running at 8-9 per cent for the previous 12-month period. In that regard, his authorities had long been interested in the negative impact that high interest rates might have on investment, and he looked forward to the staff paper on the role of interest rates in less developed countries, which was scheduled for discussion in December.

In the external sector, pressures on the balance of payments reflected Morocco's dependence on the phosphate industry as a source of foreign exchange, Mr. Mtei noted. While imports were expected to remain within the program target, the increase in the exports of consumer goods had not been sufficient to offset the decline in earnings from the export of phosphates. With respect to the overall deficit, the staff had indicated that additional external assistance might be forthcoming in the latter part of 1982, which would lead to some improvement in the situation. However, it was not clear how that assistance fit in with the statement on page 12 of the staff report that the Government intended to make only limited use of additional aid expected in the final quarter of 1982. Morocco's external debt had risen rapidly in recent years, and the debt service ratio--currently at 36 per cent--was quite high. The situation should be monitored closely, because such a high level of debt service could limit development options in future. One positive factor was that the flexible exchange rate policy adopted by the authorities had helped the competitiveness of Morocco's exports, in spite of weaknesses in the international markets.

The authorities had shown their awareness of the seriousness of the problems faced by the economy, and they seemed to be willing to work with the Fund to find appropriate solutions, Mr. Mtei said. The development plan should provide a useful framework for mapping out a longer-term strategy to bring about the necessary structural adjustment and, in that regard, he noted that the authorities had already begun to take steps to improve the efficiency of public corporations, reform the tax system, and develop a comprehensive energy policy. They should also be encouraged to strengthen the planning process so as to be in a position to more clearly define their priorities and improve the investment program.

The Deputy Director of the African Department noted that, generally speaking, Executive Directors seemed satisfied with developments under the 1982 stand-by program, although they had expressed some concern or even pessimism with respect to medium-term prospects. On the 1982 program itself, Mr. de Groote had observed that the Moroccan case was one in which the performance criteria had been satisfied but the results did not seem to conform to the objectives specified in the program. He had moved from that observation to question the methodology employed in setting performance criteria. While it was true that some of the expectations of the program had not been met, the difference between the outcome and the objectives was not particularly great and could in any event be attributed to a single factor--the decline in the export of phosphates. Except for that decline, most of the program targets would have been achieved. It should not be forgotten that there had been a substantial adjustment, including a 5 percentage point reduction in the overall budget deficit. Emphasis should perhaps be given to that reduction rather than to the fact that the deficit had turned out to be 1 percentage point higher than originally expected.

With respect to the staff's overall projections for exports, the Deputy Director observed that nonphosphate exports had performed quite close to expectations; they had been rising in volume terms about

15-20 per cent from one year to the next. For its estimates on phosphate exports, the staff had relied heavily on projections made by the World Bank and by the Commodities Division of the Fund's Research Department. The staff had felt confident that the assumed increase would be realized; unfortunately, the outcome had been disappointing.

With regard to the budget, a number of Executive Directors had questioned the adequacy of control procedures, given that expenditure on materials in the first six months of the program period had been higher than expected, the Deputy Director recalled. As mentioned in the report, there was some "lumpiness" in the way in which orders were placed by various departments, and the staff had been assured by the Minister of Finance that the pace of expenditure in the first six months of the year had been due to a preference by departments to use appropriations in the first half. Indications thus far were that the rate of expenditure had been reduced substantially in the third quarter and that overall expenditure would be within the limits suggested by the staff. In any event, it was not so much that expenditure had been higher than appropriations; rather, appropriations had been higher than projected in the program because of the assumption that the authorities would be unable to realize some of the economies on outlays for which credits had already been opened in the budget. As it happened, the estimates of the savings from the budgetary credits had turned out to be more optimistic and had thus led to a shortfall on the expenditure side. The problem was not so much with the control procedures within the Ministry of Finance as with the difficulty of actually implementing resources once certain credits had been opened and voted by Parliament.

Regarding questions on the indication by the staff that the authorities should forgo significant use of any additional external assistance during the program period, the Deputy Director noted that it had been assumed in the program that only 50 per cent of any additional assistance could be used for additional development expenditures on projects already included in the 1982 budget. The staff had felt that, because it was late in the current fiscal year, it was unlikely that the limitation would be exceeded because there was not sufficient time to reactivate some of the projects that had earlier been dropped from the budget. In the circumstances, the staff had advised the authorities--and they had agreed--that there would be no need to work out specific limits but that the net impact of any additional assistance would be viewed in terms of the performance criteria on the government deposit side. The entire amount of any additional assistance received would be shown as deposits and netted as credit to the Government. To the extent that it was not used up to the 50 per cent limit, net credit to the Government would remain below the performance criteria agreed upon and would not be subject to change under the mid-term review. The limitation could of course be circumvented by accelerating the use of present loans, although such circumvention was unlikely in Morocco's case, where there was little in the present loans that could be accelerated. If countries wished to do so, they could always find means of circumventing performance criteria; however, the staff was satisfied that the Moroccan authorities were serious in their intentions and were not looking toward ways of escaping their responsibilities.

With respect to Mr. Mtei's questions about the contribution to the budget of the state-owned phosphate company (OCP) and the impact of the shortfall in that contribution on investment policy, the Deputy Director observed that the Government had agreed that the company would have to pay only DH 600 million rather than the DH 1.3 billion originally targeted. It had to be recognized that companies like the OCP would always have substantial investment requirements; however, a company that produced or contributed as much to GDP and exported such a large share of the country's mineral wealth could not be totally absolved from paying any contribution to the budget, particularly since its investment had been financed initially by the Government and was guaranteed by it. The authorities were anxious to see some return from the company, and wished it to be subjected to a sort of market mechanism in which tax liabilities were a part of expenditures. From that point of view, a close look had been taken at the investment policies of OCP. Some of the investment had been deferred, although the cutback was hardly draconian because the company had a fairly large excess capacity and already had two or three projects under way.

With regard to medium-term prospects for the Moroccan economy, Directors had concentrated their remarks in three or four areas, the Deputy Director recalled. One concern was with the staff projection for exports to increase by 15 per cent, which seemed optimistic in light of recent performance. However, the rate of growth projected for nonphosphate exports was somewhat lower than had actually been achieved in the past; and, with any recovery in European or world markets, Morocco should be able to match its past performance. It was for that reason that the staff did not feel that its estimates were particularly optimistic. As for phosphate exports, it should be remembered that the starting base was somewhat lower than might otherwise have been, because of the recession. In relation to what the noncyclical exports should have been, the rate of growth would be far smaller in future. Also, the World Bank had only recently completed a study on the phosphate sector and had seemed reasonably optimistic, noting that phosphates were a good investment in Morocco at present. The World Bank had encouraged the authorities to continue with the investment program by the state-owned phosphate company, noting that Morocco enjoyed a unique competitive position in the world that should be taken advantage of as the demand for exports increased. For 1983, it was assumed that the volume of exports would rise by about 7 per cent and that prices would increase by a similar amount, providing an overall increase of approximately 14-15 per cent. However, the staff would take another look at the situation in negotiating the 1983 program.

On the services account, the staff had shown a shift from a negative to a substantial positive position, the Deputy Director noted. It was not that a substantial increase in the services item was being assumed; rather, the staff was showing interest payments on existing debt and, to the extent that existing debt was paid off between 1983 and 1987, the interest payments would be reduced. As Directors would observe from the debt servicing item, the interest on debt was projected to decline substantially by 1987, and that improvement was reflected in the "services and transfers (net)" item shown in the current account. Interest payments on new debt were also shown under the debt servicing item, and by making appropriate adjustments it would be possible to see that actual improvement on the services account was not as dramatic as it might appear if one looked only at service payments on debt contracted through December 1982.

Medium-term prospects for Morocco had become inevitably intertwined with short-term policies, the Deputy Director considered. While it might have been possible in 1982 to employ ad hoc measures belatedly to bring about large declines in the budget deficit, those actions would not necessarily have been formulated in a medium-term or comprehensive perspective. It was time to look toward more medium-term structural policies that would serve well in the shorter and longer run. With that idea in mind, the staff had suggested that the authorities could no longer avoid taking painful decisions in areas like subsidies. Following price changes effected in July 1981, the authorities had felt unable to attack the subsidy issue comprehensively until the dust had settled, although they had indicated that the question would be reviewed in the context of the 1983 program. In the meantime, the Moroccan authorities had requested Fund technical assistance to study the matter. That study had been completed, and the results showed that the decline in subsidies in 1982 had not been the result of any policy decisions on the part of the authorities but had been due mainly to changes in international prices that had been favorable and had reduced subsidies as a proportion of cost. The staff was therefore indicating that the time was ripe for hard decisions on subsidies, and it was to be hoped that such decisions would be taken and reflected in the 1983 budget, which would otherwise be subject to international prices and would generate uncertainty in the conduct of fiscal policy.

Regarding Mr. de Maulde's question of whether the staff was recommending a further depreciation in the exchange rate or only a stabilization of the existing rate, the Deputy Director remarked that the staff's reference to flexibility allowed either approach to be used, depending upon the situation. Generally speaking, the exchange rate question should be viewed not merely in terms of the competitiveness of a particular country vis-à-vis the existing exports but also in the context of the overall policy package, of which exchange rate policy was only one element. It was equally important to look at prospects for the balance of payments to see whether an exchange rate adjustment might be helpful in bringing to the fore some of the marginal products that, at the existing rate, might have no chance of competing in the international markets either as import substitutes or as export products. On a related question, Mr. Joyce had wondered whether one should view competitiveness only in terms of a country's trading partners or whether a closer look should be taken at the competing products themselves, even when those products did not come from trading partners. The staff had looked at competitiveness from both angles; indeed, its original study on the exchange rate had taken into account not only the overall competitiveness--and, hence the calculations of effective nominal and real rates--but also the related competitiveness of Morocco vis-à-vis four or five designated competitors in the export markets. It was necessary to look at exchange rate policy in terms of competitiveness as well as in terms of overall balance of payments prospects. Given the prospects for Morocco for the next four or five years, it was clear that some use of exchange rate policy as an essential element in the adjustment process could not be avoided.

It had to be wondered whether the authorities were sufficiently flexible in other areas of policy as well, the Deputy Director said. When Morocco had previously been discussed in the Executive Board, some Executive Directors had inquired about the rationale behind the very small 3 per cent appreciation of the currency, and they had assumed that one of the reasons had been to compensate for the inflexibility that the authorities had faced at that time in budgetary policy. It was to be hoped that, with the passage of time, the authorities would be able to take decisions relating to subsidies, tax reforms, and public enterprises so that it would be possible to look at exchange rate policy more in terms of export competitiveness and balance of payments prospects than simply as an instrument to offset shortfalls in some other policy areas.

The staff tended to feel that employment policy, which had been touched upon by Mr. Grosche, was a more severe problem than wage policy, the Deputy Director remarked. As constituted at present, employment policy could not serve as a sustainable base for any kind of workable budget policy and the problem of employment would have to be viewed critically to see whether the public sector in fact had the resources to continue to be a significant employer of labor in the near future.

Several Executive Directors had inquired about whether the World Bank study on investment had been taken into consideration by the Moroccan authorities, the Deputy Director recalled. The staff had been informed that the final draft of the report by the World Bank had been received by the authorities during the previous week, and the Minister had indicated that the report was being considered seriously in discussions. It was to be hoped that it would be a useful guide in the effort to work out the investment or development budget for 1983 and subsequent years. As to the sort of follow-up arrangement that the staff was considering, he noted that the hoped-for progress during the course of the existing stand-by arrangement toward identifying and working out structural policies had not taken place. Structural policies would form a part of the short-term program through 1983 but, at present, the staff was not on sufficiently firm ground to negotiate an extended arrangement with the Moroccan authorities at the end of 1982. In the circumstances, any follow-on program would likely take the form of a one-year stand-by arrangement.

The staff did not feel that the 15 per cent increase in the minimum wage in the private sector would create further pressures on government wages, the Deputy Director commented. However, the problem of government wages was important by itself because, in the previous year, no increase had been provided.

With respect to Mr. Mtei's question of why, despite the investment situation, there had not been an increase in capital inflows to Morocco, the Deputy Director observed that, without the provision of a subsidized interest rate for export finance, the impact on capital inflows would be adverse. Also, capital had tended to move with some lag once the rules regarding capital inflows had been relaxed; Directors would recall that, until recently, there had been substantial controls and restrictions on private capital in Morocco. The situation had been changed, and foreigners at present could own 100 per cent of equity, but it took time for the change to be understood and to affect the behavior of foreign investors. Moreover, the recent increase in petroleum prices might have acted to counter the liberalization of the investment code because increased prices made it more costly to invest.

As to when the Loi Cadre would be implemented and what its impact would be on revenues, the Deputy Director of the African Department noted that the Loi Cadre had already been introduced in Parliament and was expected to be passed during the current session, but enabling legislation would be required. The authorities had taken the view that the enabling legislation could be introduced only following the 1983 elections; hence, the impact of the Loi Cadre on revenues would take some time. In the meantime, the authorities were moving on the matter of individual items of taxation, which would affect revenues somewhat earlier. It should be remembered that, when the staff had produced its study on tax reform, the purpose of the reform had not been to raise revenue per se but merely to improve the efficiency of the tax administration and machinery. That objective continued to be valid; it was therefore unlikely that the tax reform would have a substantial impact on revenues, although an increase in the efficiency of tax administration should make the tax system more elastic and more responsive to changes in the economy so that, over a longer period, it should yield a higher rate of growth in revenue.

The staff representative from the Exchange and Trade Relations Department, responding to Mr. de Groote's question whether the program should perhaps have contained a more automatic feature that would have adjusted performance criteria in a way that would have allowed main objectives of the program to be realized, said that there were two aspects to the matter. The first was whether the program provided for additional adjustment in the event that the export performance of the country were to worsen; the second was whether or not the additional adjustment required could be of such magnitude that the balance of payments and other objectives could be realized within the same one-year time span. As far as the Moroccan program was concerned, the fact that the performance criteria had been maintained despite a worsening of the export situation implied that additional adjustment would have to take place. Further, the program already provided a limit on the extent to which a country could avoid adjustment by using borrowed funds, in the event the export situation worsened. Morocco's export performance in 1982 had indeed proved worse than anticipated in the program, and it was likely that export receipts would remain depressed in 1983. In such a situation, while additional adjustment would be called for under the program, given the lagged effects involved, it would not be possible for the extra adjustment to ensure the attainment of the balance of payments target for 1982. On a separate question, he had no information on why Morocco continued to maintain two inoperative bilateral arrangements with Fund members.

Mr. de Groote stated that he continued to feel that the "automatic" approach to stand-by arrangements would be useful because it would indicate clearly to a country from the outset what adjustment would be necessary if external circumstances were to turn out to be not as favorable as had been envisaged when the arrangement had been agreed. It might be advantageous for the authorities to know in advance that changes would be taking place and to know what sorts of additional measures would have to be introduced if the objectives were to be achieved.

The Chairman said that, like Mr. de Groote, he had been struck by the fact that adherence to performance criteria under Fund arrangements did not always lead to the attainment of targets. Since it was the targets that were the raison d'être of Fund programs, rather than the quantitative criteria, the point by Mr. de Groote was well taken, and he himself wondered whether it would not be possible to revise performance criteria in the course of a program if the basic assumptions underlying the attainment of targets were to change fundamentally.

The staff representative from the Exchange and Trade Relations Department remarked that, generally, the most volatile components of the balance of payments were export developments and capital flows. One or both of those elements could deviate substantially from the assumptions in the program, so that the balance of payments targets might not be met, even though the performance criteria were observed. A rather extreme way of avoiding such a situation would be to specify a balance of payments target as a performance criterion. The staff had discarded the idea of a generalized balance of payments test for that purpose.

The Chairman observed that the Fund had negotiated a number of programs in the past with balance of payments tests.

The staff representative from the Exchange and Trade Relations Department noted that those tests had been used to ensure the proper implementation of a flexible exchange rate system only when it had been considered important to limit the capacity of a country to intervene to maintain an unrealistic exchange rate. If the approach were to be applied in all situations--rather than only in those cases in which the rate was floating--the Fund would be departing from its practice of linking performance criteria to policy instruments.

The Chairman remarked that Mr. de Groote had only been asking the staff to review performance criteria and agree with the relevant government that they might be changed if the fundamental assumptions underlying the targets were to change. In such circumstances, the government would have been asked to agree in advance to the idea that policy tools and performance criteria might have to be adjusted in the course of the program under certain circumstances.

Mr. de Groote said that he could envision the adjustment taking place in a semiautomatic way, with the additional required measures already having been identified at the time the agreement was negotiated.

Mr. Dallara considered that Mr. de Groote's point deserved further thought. He could imagine that it might be difficult for a country to face a situation in which the actual quantitative level of performance criteria might have to be adjusted during the course of the program since, for example, budgets were generally formulated on an annual basis. The implication was that an automatic approach would have to be taken only with caution and on a very selective basis. Still, it seemed that such an approach might provide for greater continuity in the adjustment process and might eliminate the ratcheting effect that often occurred when programs had to be adjusted on an ad hoc basis because progress was not taking place as expected.

Mr. El-Khouri observed that, for Mr. de Groote's approach--automatically adjusting the credit ceilings to achieve the program's objectives--to work, a tightening of credit would have to have an immediate effect on imports. However, that process usually worked with a lag. Since Fund missions visited countries often during the year in connection with Fund programs, it might be better to adjust the credit ceilings during a mission's visit rather than working it automatically in the program.

Mr. Caranicas, recalling the recent explanation of the shift since 1980/81 from extended arrangements to one-year stand-by arrangements, noted that longer-term arrangements seemed to offer greater flexibility during the course of the program period.

The Chairman replied that the sort of automatic changes referred to by Mr. de Groote were already accomplished in the course of three-year arrangements, as performance criteria were adjusted annually in the light of developments over the course of each year. The question was whether or not, in the framework of a one-year set of performance criteria, greater flexibility could be introduced in the utilization of policy instruments in order to avoid too sharp a slippage from the main targets of the program. Mr. El-Khouri had been correct in noting that fine-tuning of performance criteria would not necessarily produce an attainment of targets, because time lags were involved; however, the results would certainly be better than they would be if no changes were made. Mr. Dallara had correctly observed that there were certain instruments that did not lend themselves to change during the course of a year. While budgets, for example, could be corrected or amended in certain circumstances, the process was not an easy one. Perhaps during the Executive Board's next review of stand-by and extended arrangements, Directors could more systematically reflect upon the relationship between performance criteria and targets in light of Mr. de Groote's suggestion.

Mr. Kabbaj said that he had been surprised by the reaction of Executive Directors to the fact that the Moroccan authorities had taken no action on subsidies in 1982 except in the area of petroleum prices. There was nothing in the program that called for an increase in the prices of products other than petroleum products. He had also been surprised by the reaction of Directors to the performance of phosphate exports. Since 1976/77, it had always been felt that there would be a pickup in phosphate exports, although the Moroccan authorities had indicated that care should be taken in the forecasts. That was why the estimates were relatively modest, despite the fact that Morocco had maintained its share of the phosphate market even during the difficult years since 1977. Moreover, as noted by the staff, the World Bank had recently conducted a study concluding that the investment program in phosphates was appropriate, given the comparative advantage of Morocco, and should be implemented as soon as possible.

On investment policy generally, the authorities had during the previous week received the recently completed study by the World Bank, Mr. Kabbaj continued. The authorities had asked the World Bank to produce the report, which showed their concern for the situation, and they would make as much use of the study as possible. Unfortunately, the study might have arrived somewhat late; many investment projects had already been launched, and the plan was at the end of its second year.

Regarding Mr. Taylor's question on the recently discovered oil and gas reserves, Mr. Kabbaj said that it was too early to tell when those reserves might be fully exploited. A second drilling had been initiated in order to evaluate the reserves more precisely; if all went well, the reserves might be exploited by 1985/86. On the other hand, three contracts with major oil companies had been signed for drilling offshore, and it was possible that better results in that area might occur, thus improving the energy picture in Morocco.

With respect to observance of the performance criteria for December, Mr. Kabbaj said that the authorities would have preferred a certain relaxation of performance criteria; in that regard, he had been pleased by Mr. de Groote's proposal, although studies would have to be undertaken before any such proposal could be implemented. In the case of Morocco, ceilings had been fixed in January/February, with no possibility for revision. Usually there were two sets of ceilings at the inception of a program, one of which could be changed on the occasion of the midyear review. However, the Moroccan authorities had been convinced by the staff to have fixed ceilings, and they would apparently do their best to observe the performance criteria despite adverse developments, particularly in the phosphate sector. One element that should help them in their efforts was the sharp decrease in interest rates in the world financial markets, which should provide the authorities with some room for maneuver. The recent increase in retail oil prices should also help the authorities to observe performance criteria.

Regarding Mr. Joyce's suggestion that some effort should perhaps be made to diversify export markets into Eastern Bloc countries, Mr. Kabbaj noted that the state-owned phosphate company already sold phosphates almost everywhere in the world, with a large share of exports going to eastern countries.

It had been rightly observed by the staff that the present exchange rate in Morocco was appropriate, Mr. Kabbaj remarked. Aside from the problem of phosphate exports, nonphosphates had behaved far better than expected, and that was one of the indicators that had been used to judge the level of the exchange rate.

On the matter of interest rates, Mr. Kabbaj said that he had not in his statement been asking for a decrease in interest rates in Morocco for the time being. The Moroccan authorities and the staff had already discussed the matter during the review and would discuss it once again in January or February 1983. He had linked the interest rate question to private investment because, as mentioned by the staff, the authorities would like to avoid giving wrong signals to investors, especially those who were not aware of the latest developments in the Moroccan economy. However, the central bank and the Minister of Finance of Morocco had long been studying the exchange rate and interest rate questions in consultation with the staff. If warranted, there would be a decrease.

As noted by one speaker, he had played down the potential for an extended arrangement in 1983, Mr. Kabbaj commented. The Moroccan authorities had not discarded the possibility entirely; however, given the uncertainty surrounding medium-term prospects, they were aware of the difficulties involved in committing themselves to a medium-term program, especially since they wanted to be certain that every performance clause of a stand-by or extended arrangement would be observed. If prospects for phosphate exports did not improve in the near future, the authorities would probably request a one-year stand-by arrangement and await better times before requesting an extended arrangement. Finally, if budget discussions for 1983 had to be delayed somewhat beyond the expected timetable, it was only because the authorities were aware of the medium-term problems that had been pointed out by the staff. Intensive discussions were under way with the staff on ways of addressing those problems, and it was to be hoped that success in overcoming them would be sufficient to enable the Fund to continue its assistance to Morocco in future.

The Executive Directors agreed to continue 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/82/143 (11/5/82) and EBM/82/144 (11/8/82).

4. EXECUTIVE BOARD TRAVEL

Travel by an Executive Director as set forth in EBAP/82/387 (11/5/82) and by an Advisor to Executive Director as set forth in EBAP/82/385 (11/4/82) is approved.

5. STAFF TRAVEL

Travel by the Managing Director as set forth in EBAP/82/386 (11/5/82) is approved.

APPROVED: April 13, 1983

LEO VAN HOUTVEN
Secretary