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AGENDA

EBS/86/262

CONFIDENTIAL

November 24, 1986

To: Members of the Executive Board  
From: The Secretary  
Subject: Morocco - Request for Stand-By Arrangement - Letter of Intent

Attached for consideration by the Executive Directors is a copy of the letter of intent from the Moroccan authorities requesting a stand-by arrangement equivalent to SDR 230 million for the period ending March 31, 1988, together with a memorandum on economic and financial policies and a technical memorandum of understanding. The staff paper describing and analyzing the financial program of Morocco will be circulated in due course.

This subject will be brought to the agenda for discussion on a date to be announced.

Mr. François (ext. 8510) or Mr. Franks (ext. 8512) is available to answer technical or factual questions relating to this paper prior to the Board discussion.

Att: (1)

Kingdom of Morocco  
Ministry of Finance  
The Minister

November 12, 1986

Dear Mr. de Larosière:

1. I am sending you herewith a memorandum describing the economic and financial policies that the Government of the Kingdom of Morocco will be implementing in the last quarter of 1986 and in 1987. This comprehensive and coherent program is an important supplementary stage in re-establishing the fundamental equilibria of our economy and achieving sustained growth commensurate with the country's potential.

2. Despite the undeniable progress made since 1983, often under difficult circumstances, in the restructuring of the economy and in improving its financial soundness, and despite the factors that favor us at the present time, the success of our reform and development efforts requires support from the international financial community. For this reason, the Government wishes to avail itself of a stand-by arrangement in an amount equivalent to SDR 230 million for the period until March 31, 1988. It is counting on financial assistance from the World Bank in 1987 in order to pursue its policy of restructuring certain key sectors of the economy, in particular the public enterprises and agriculture. The Government is also counting on the support of the International Monetary Fund and of the World Bank to enable it to mobilize financial assistance from the commercial banks as well as the exceptional public aid needed to maintain the minimum level of investment essential to economic growth and to the improvement of the external debt profile. At the meeting of the Consultative Group for Morocco scheduled for early 1987, the Government will present its medium-term strategy for adjustment and growth.

3. The Government of Morocco will monitor closely, in close cooperation with the Fund, progress made in achieving the program's targets and in implementing the policies and measures defined. It is proposing an initial review of the program before end-February 1987, with a second review before end-September 1987, and a final review before end-February 1988.

4. The Government believes that the policies and measures set forth in the attached memorandum should make it possible to achieve the program's targets, but will take any additional measures that may be appropriate for this purpose. It will consult the Fund throughout the period of the stand-by arrangement on the adoption of any measures that may be appropriate in accordance with the policies of the Fund on such consultation.

Sincerely yours,

/s/

Mohamed Berrada  
Minister of Finance

Mr. J. de Larosière  
Managing Director  
International Monetary Fund  
Washington, D.C. 20431



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

Rabat, November 12, 1986

I. Introduction

1. From the time an adjustment program was introduced early in the 1980s, the Moroccan economy, under difficult circumstances, has made undeniable progress in the reduction of domestic and external disequilibria, in financial reorganization, and in a resumption of an economic growth rate consistent with the country's potential. Following a prolonged period of drought, of deterioration in the terms of trade, of recession abroad, and of high foreign interest rates, the economy regained in 1985, mainly owing to a return to more normal agricultural production, a growth rate which had not been seen for a number of years. Moreover, the inflation rate eased, despite a considerable depreciation of the exchange rate and a relatively rapid monetary expansion. Finally, reflecting a sizable increase in national saving, the external current account deficit decreased sharply despite the reduction in exports receipts from phosphates and phosphate derivatives. The economic prospects for 1986 are also highly favorable. Abundant and regular rainfall produced unprecedented harvests which, combined with an expansion of most other economic activities, should lead to an increase in GDP of almost 5.5 percent. In the external sector, lower cereal imports, the strong growth in exports of manufactured products, earnings from tourism and transfers by Moroccans working abroad, falling interest rates on the international market, the drop in the dollar rate, and above all the fall in oil prices, will make possible a considerable decrease in the external current account deficit and, to a lesser extent, in the fiscal deficit. During the last two years, significant progress has also been made in implementing in-depth structural reforms, particularly in the areas of foreign trade, industry, agriculture, and the financial system.

2. The very positive economic results achieved in 1985 and 1986 have not yet been reflected in domestic financial performance. Indeed, progress in reducing the fiscal deficit has been slower than expected. As this coincided with lower than expected external assistance, the targets set for 1985 as regards bank credit to the Government, total bank credit, the elimination of external arrears, and the reconstitution of foreign assets could not be achieved. These financial difficulties continued during the first months of 1986. The improvement in the external current account was not accompanied by a reduction in the fiscal deficit. Despite the Treasury levy on the price differential for petroleum products, overall government revenue increased only slightly in 1986, and it proved necessary to limit new investment expenditure commitments in order to avoid increasing payments arrears. The overall Treasury deficit as well as monetary financing remained very high during

the first six months of the year, but declined significantly during the third quarter. As the favorable factors have not yet had their full effect on the balance of payments and foreign transfers of resources remained negative during the first nine months, the foreign asset position of the banking system has remained very weak and additional external payments arrears have accumulated, mainly in the form of commercial arrears. Part of these arrears reflect the contraction in foreign lines of credit granted to Moroccan banks and importers.

## II. The adjustment program

3. The adjustment difficulties encountered both domestically and externally underline the need for a vigorous pursuit of the structural reforms which have been under way for several years. The present coincidence of a number of favorable factors which may well prove only temporary does not warrant any relaxation of effort. To ensure the continuity of these reforms while remedying the difficulties which arose in the past, the Government of the Kingdom of Morocco has just adopted a new comprehensive and consistent adjustment program which includes both short-term and medium-term actions aimed at: (a) ensuring a reasonable and lasting rate of economic growth that will permit a balanced development of all sectors and regions of the country while stimulating employment; and (b) quickly restoring basic financial equilibria in government finance and the external accounts in order to reduce both the vulnerability of the Moroccan economy to changes in external economic conditions and the burden of the external debt. To achieve these aims, the program stresses the reform of public finance, the rationalization of domestic expenditure, and structural measures designed to improve productive efficiency so as to enhance the growth of exports and the expansion of import substitution activities. These aims will be pursued in the framework of a gradual liberalization of the economy, particularly as regards foreign trade, prices, interest rates, and investment. The Government also intends to reduce its intervention in the country's economic activities and to revitalize the role of the private sector and of local government.

### Targets for 1986 and 1987

4. Within the framework of this medium-term strategy, the specific program adopted for 1986-87 is aimed at reaching a GDP growth rate of at least 3 percent in 1987, after the rapid 5.5 percent increase expected in 1986. The rate of inflation as measured by the cost of living index should not exceed 7 percent in 1986 and 1987. In the external sector, the program aims at reducing the external current account deficit (before debt relief) from DH 9.9 billion (SDR 966 million), that is 8.2 percent of GDP in 1985 to DH 2.4 billion (SDR 221 million) or 1.7 percent of GDP in 1986 and achieving approximate equilibrium in 1987. It also aims at eliminating all external payments arrears in 1987 and increasing external reserves by at least SDR 170 million during 1986 and 1987, so as to reach a level corresponding to about one month's imports. To achieve the planned balance of payments objectives for 1986

and 1987, the program gives high priority to adjustment measures in the areas of public finance, money and credit, and external payments. These measures will be implemented in conjunction with the structural actions defined with the World Bank in the areas of foreign trade, prices, public enterprises, agriculture, and education.

5. To support implementation of the program during the remainder of 1986 and in 1987, and to help solve the external payments problems currently facing Morocco, the Government requests from the Fund a stand-by arrangement in an amount equivalent to SDR 230 million for the period through March 31, 1988. The Fund's resources will reinforce the financial assistance provided by the World Bank and the aid Morocco expects to obtain from friendly countries, other multilateral development institutions, and the international financial market. Furthermore, the Government is currently negotiating with the commercial banks to finalize a rescheduling of external debt payments covering the period from January 1, 1985 to February 28, 1987. It also intends to request creditor countries and commercial banks to reschedule debts falling due from March 1, 1987. After taking into account expected external resources and debt relief already obtained or anticipated, a financing gap of SDR 200 million nevertheless remains at present for the period from October 1, 1986 to December 31, 1987. In order to fill this gap Morocco intends, with support from the IMF and the World Bank, to obtain financial assistance from commercial banks. Furthermore, to enhance the growth prospects for the economy, the Government will endeavor to raise additional resources of up to SDR 100 million on highly concessional terms to finance an additional program of public investments (as described in paragraph 16). The actual mobilization and use of these resources will be reflected in 1987 in a smaller reduction of the fiscal and external current account deficits than envisaged in the basic program. The Government has good reason to believe that it will obtain all the external assistance necessary for proper execution of the program under conditions consistent with the balance of payments objectives.

#### Public Finance

6. The structural improvement of public finance is one of the main elements of the Government's economic strategy, as progress in this sector contributes not only to reducing external disequilibria and to financial stability, but also to the reactivation of domestic output by increasing the resources available to the productive sector. The Government has thus set itself the objective of limiting the overall Treasury deficit on a commitment basis to a total of DH 9 billion in 1986 and DH 6.5 billion in 1987, equivalent to 6.6 percent and 4.3 percent of GDP, respectively. The programmed reduction of the fiscal deficit will be achieved through a package of measures to enhance government revenue and reduce expenditure in relation to GDP.

7. The Moroccan tax system is characterized by a high dependence on import taxation, the co-existence of high tax rates and a set of exemptions favoring various sectors of the economy, and by a certain degree of tax evasion. Over the years, these features have made the tax system rather rigid and created distortions which hamper economic development. Aware of these weaknesses, the Government has been involved since 1983 in a thorough reform of the tax system designed, *inter alia*, to reduce dependence on duties and taxes on imports. Measures taken to date have led to a reduction of the special tax on imports from 15 percent to 7.5 percent in 1985; it will be reduced to 5 percent beginning January 1, 1987. Other measures have included a lowering of the maximum rate of import duties to 45 percent, and elimination in 1986 of the statistical tax on exports. In addition, a value-added tax was introduced in April 1986 and a reform of the tax on companies was approved by Parliament in June 1986. A reform of the general income tax will be discussed in Parliament in the early months of 1987; the Government will make every effort to have this reform applied starting January 1, 1988, together with the new tax on companies. The Government intends to continue the reform of the tax system and the rationalization of the structure of import duties and taxes. A working group has been set up to study, with technical assistance from the IMF and the World Bank, the preparation and implementation of measures intended to broaden tax bases, reduce tax evasion, and introduce an appropriate balance between direct taxation, indirect taxation and duties and taxes on imports. The working group's initial conclusions and proposals will be submitted in late May 1987, and should lead to concrete measures to be introduced into the 1988 Budget Law.

8. During the first nine months of 1986, government revenue increased less than expected, largely as a result of delays in collecting the business profits tax and the levy on the petroleum products price differential, the lack of tax payments from the Office Chérifien des Phosphates (OCP), and shortfalls linked to the recent introduction of the value-added tax. Steps have been taken since July to correct these delays, and it is now expected that revenue for 1986 will reach almost DH 29 billion. For 1987, the Government will adopt a set of measures in the Budget Law to ensure revenue of at least DH 33.7 billion. Revenues will include DH 1 billion in contributions from the OCP (covering both business profits tax and dividends to the Government), to be paid in installments of DH 250 million before the end of each quarter. On the basis of an average oil price of US\$16.5 a barrel, the levy on oil products has been estimated at almost DH 4 billion. A mechanism will be introduced shortly to ensure the regular payment to the Treasury of the price differential. Other measures to be introduced will bring in additional revenues totaling DH 1.3 billion in 1987. These measures, which are intended principally to widen and harmonize the tax bases, include: (i) the abrogation of certain provisional waivers of import taxes and duties, as well as the application of the special import tax to cereals which were previously exempt; (ii) an increase of 2.5 percentage points in the rate of import duties of between 0 and 15 percent inclusive; (iii) the payment of a contribution by financial credit

institutions exempt from the business profits tax; (iv) the application of a minimum tax of 25 percent on interest paid on bearer CD's in order to harmonize the systems of taxation applicable to financial earnings; (v) an increase in the license fee for vehicles; and (vi) an increase in the retail price of tobacco. If these different measures do not produce the amount of revenue forecast for 1987, the Government will adopt new measures in the course of the year so as to limit the consolidated Treasury deficit to the amount programmed.

9. If the price of oil falls below the level of US\$16.5 a barrel assumed in the program, the use of the additional revenue levied by the Government on petroleum products will be examined with the Fund and the World Bank during the regular program reviews. Pending adoption of a joint position on the allocation of this surplus, it will be used provisionally to reduce arrears and/or bank credit.

10. Efforts to decrease public financial imbalances since 1982 have included a sharp reduction in the share of public expenditure on a commitment basis in GDP. Public expenditure was cut to the equivalent of 32.8 percent of GDP in 1985, from 36 percent in 1981-82. All expenditure categories except interest on the debt have declined in relative terms, the most important cutbacks having been made in consumer subsidies and investment expenditure. The ceilings adopted in the 1986 budget and the supplementary measures planned for the fourth quarter of 1986, particularly as regards consumer subsidies and capital expenditure, should make it possible to reduce nominal public expenditure on a commitment basis by 3 percent in 1986. This contraction will entail a further sizable reduction of almost 5 percentage points in the relative weight of public expenditure, to 28 percent of GDP in 1986. Current expenditure will increase by only 5.5 percent on a year to year basis, largely because of the restrictions imposed on expenditure for materials and supplies and the savings made on interest and subsidies. Expenditure on consumer subsidies will be 46 percent less than in 1985, owing mainly to the price increases of September 1985 and declines in import costs. Investment expenditure on a commitment basis has been cut by about 30 percent, by delaying commitments relating to many Government investment projects.

11. The margin for further short-term reduction of government expenditure without affecting the functioning of the State administration and the development of the economy has become narrower. Nevertheless, in 1987, the increase in current expenditure will be limited to less than 6 percent and the basic envelope for capital expenditure will be held to the same level as in 1986. To this end, the Government intends to limit the growth of the wage bill to a ceiling of 7 percent by confining net recruitment exclusively to the priority sectors, in particular, education and national defense. No general increase in wages is planned for 1987. Expenditure for materials and supplies will increase by no more than 8 percent, apart from a DH 300 million adjustment in appropriations in order to cover government consumption adequately without generating new payments arrears.

Finally, expenditure for consumer subsidies will be reduced by 20 percent to about DH 1.4 billion through the measures planned in 1986 and 1987.

12. In recent years, management of the government investment budget has led to many problems owing, on the one hand, to the scale of the investments approved by the 1981 Budget Law under the 1981-85 Development Plan and the annual payments appropriations arising from it in subsequent years and, on the other hand, to the decrease in resources available for investment since 1982. This gap led to the accumulation of sizable domestic payments arrears toward public enterprises and the private sector. The measures adopted in 1985 and 1986 have narrowed the scope of this problem. They included canceling or postponing the execution of projects for which expenditures have not yet been committed, re-scheduling the implementation of others, and eliminating the automatic carry-over of unused payments appropriations outstanding at the end of the year. In order to avoid an increase in outstanding arrears under the capital budget between end-December 1985 and end-December 1986, the Government limited new expenditure commitments in 1986 to DH 15.7 billion (that is, an amount substantially below the payments appropriations authorized in the 1986 Budget Law). This ceiling includes the amounts set aside for settling payments arrears existing on December 31, 1985 in the Treasury as well as the amounts due on the military debt. The draft budget for 1987 provides for a 20 percent reduction in available capital appropriations for the ministerial departments, not including transfers to local governments of their share of value-added tax receipts. To limit payments for capital investment to the amount of resources available, the Government will limit the amount of commitments under the investment budget to DH 17 billion, of which DH 6.8 billion will be allocated to the settlement of payments arrears existing at end-1986 and DH 1.4 billion to military debt maturities.

13. The amount of payments authorizations (crédits de paiements) in the investment budget has been carefully scrutinized so as to reduce the government's expenditure on subsidies. Thus, for instance, as a result of the measures adopted in 1986 and envisaged for 1987 to reorganize the public enterprises and increase their tariffs (see paragraphs 27 and 28), subsidies for capital investment to these enterprises are expected to be reduced from DH 2 billion in 1986 to DH 1 billion in 1987, not including a sum of DH 1 billion in connection with the plan for the settlement of Government arrears (see paragraph 14). Subsidies and transfers to other sectors of the economy will also be progressively reduced through the elimination, beginning on January 1, 1987, of most of the interest rate subsidies borne by the Treasury and the introduction, as of July 1, 1986, of a mechanism for reducing exchange losses on external borrowings assumed by the Government on behalf of financial entities. Moreover, to improve the overall management of the investment budget, the Government is preparing, with technical assistance from the World Bank and the Fund, to reorganize the procedures for planning, budgeting, and monitoring investment expenditure. As part of this reorganization, the Ministry of Finance will prepare before end-December

1986 a quarterly program for commitments, payment orders, and payments by department and type of expenditure in order to ensure a more orderly execution of the 1987 investment budget. A new analytical classification of capital expenditure will also be prepared in 1987. Progress in these areas will be examined in the context of each review of the program. Account will be taken of the conclusions and proposals of this work in preparation of the 1988 Budget Law.

14. The accumulation of payments arrears in recent years has severely hampered the operations of public and private enterprises and the management of credit policy. Aware of these problems, in 1984 the Government set up an Oversight Committee to prepare regularly a systematic statement of all reciprocal payments arrears between the Government, the public enterprises, and the private sector. A number of steps have been taken to slow down the emergence of new arrears; these include the establishment of very tight controls on Government consumption of utilities, the rapid settlement of bills, and the raising of budget appropriations to more realistic levels. New provisions will be included in the draft 1987 Budget Law for avoiding in future any new sources of payments arrears under the current budget and for settling most of the Government's payments arrears toward public enterprises. Arrears to public enterprises (other than those recorded in Treasury suspense accounts) will be regularized in 1987, in accordance with a plan which will shortly be worked out with the World Bank; the plan provides for offsetting reciprocal debts and claims, the long-term consolidation of some debts to public enterprises in a good financial situation, and the settlement of debts to enterprises in a weaker position. These operations will be carried out through a settlement account created at the Treasury and the issue of appropriate non-negotiable financial instruments. As regards other payments arrears, particularly to the private sector under the capital budget, which are recorded at the Treasury, the ceilings provided for commitment authorizations should stabilize them at about DH 6 billion by end-1986 and reduce them by DH 1.3 billion by end-1987. In order to permit monitoring of those Government arrears not recorded at the Treasury, the Oversight Committee will continue to draw up its quarterly statement, particularly regarding Government consumption of utilities, subsidies for capital investment, and consumer subsidies.

15. Taking into account the programmed evolution of payments arrears, the consolidated Treasury deficit on a cash basis will be limited to DH 9 billion in 1986 and to DH 8.5 billion in 1987, not including an additional program of DH 1 billion for investments to be financed from concessional external resources. The 1986 deficit will be covered by domestic financing amounting to DH 6.6 billion, including bank credit of no more than DH 4.5 billion, and net external financing of DH 2.4 billion (including the anticipated savings from rescheduling). In 1987, the deficit will be covered by domestic financing of DH 5 billion, DH 2.8 billion of which will consist of bank credit, and by net external financing in the amount of DH 3.5 billion. Taking account of contractual amortizations and of anticipated or agreed debt relief, net exter-

nal financing corresponds to gross drawings of DH 7.7 billion. The quarterly performance of the Government's consolidated cash deficit, credit to the Government, and outstanding payments arrears at the Treasury for the last quarter of 1986 and for 1987 are subject to quarterly ceilings which constitute performance criteria of the program. The development of those Government payments arrears not recorded at the Treasury is subject to indicative targets set forth in the attached Technical Memorandum of Understanding.

16. The basic budget deficit indicated in paragraphs 6 and 15 will be increased by the amount of additional foreign aid on highly concessional terms to be mobilized by Morocco in 1987 to finance an amount of DH 1 billion of public investments. The special investment program covered by this amount will be prepared in conjunction with staff from the Bank and Fund, and examined during the reviews of the stand-by arrangement.

#### Monetary and Credit Policy

17. Monetary and credit policy in the last quarter of 1986 and in 1987 will aim at holding domestic demand growth to a level consistent with achieving the objectives set for the balance of payments and the reconstitution of foreign assets. To this end, the authorities will limit the growth of domestic bank credit (excluding the counterpart of Treasury and postal checking deposits) to 10.8 percent in 1986 and 7.3 percent in 1987. In 1986, expansion of domestic bank credit in absolute terms will be limited to DH 6.7 billion, of which DH 4.5 billion in credit to the Government and DH 2.2 billion to the private sector. Taking into account the significant increase in domestic credit which has already occurred in the first eight months of the year in connection with the financing of Treasury operations and of the cereal harvest, domestic credit will fall by 1 percent during the last four months of the year. In 1987, the absolute increase will not exceed DH 5 billion, including DH 2.8 billion in credit to the Government and DH 2.2 billion to the rest of the economy. The development of total domestic bank credit and bank credit to the Government during the last quarter of 1986 and in 1987 will be covered by the quarterly performance criteria defined in the attached Technical Memorandum of Understanding. To ensure compliance with these ceilings, the monetary authorities will strengthen control of credit if necessary by limiting the Bank of Morocco's financing of deposit banks and financial institutions and by raising the required bank reserve ratio.

18. The amount of external payments arrears other than those of the Treasury is at present estimated on the basis of the total of applications to the Bank of Morocco for foreign currency purchases that have not yet been met on account of a foreign exchange shortage. Until now, banks have generally not required economic agents to set up a provision in dirhams when requesting a purchase of foreign currency. In order to determine accurately those foreign exchange purchase applications that represent trade arrears, and to better evaluate their impact

on credit and domestic liquidity, as from October 31, 1986 the Bank of Morocco has asked the commercial banks to require their customers to set up a provision of at least 25 percent of the equivalent value in dirhams of the foreign currency purchase applications submitted to the Bank of Morocco and not immediately met. Introduction of this measure was accompanied by a further increase in the bank reserve ratio, so as to neutralize an amount equivalent to the provisions constituted.

19. Despite the anticipated increase in the net foreign assets of the banking system (which will be equivalent to 3 percent of the money stock forecast for end-1986), the ceilings imposed on credit expansion will make it possible to reduce the rate of growth of broad money to about 10 percent in 1987, against 17.7 percent in 1985 and an expected 16.6 percent in 1986. Taking into account the expected increase in time deposits, the money supply (M1) will expand at a slightly slower rate than nominal GDP, and the liquidity of the economy in 1987, measured by the ratio of the average money stock to GDP, will be below the level reached in 1983-84.

20. The lending and borrowing interest rates applied by the banking system since April 1, 1985 have not been changed, and real interest rates remain positive. Effective October 1, 1986, the authorities raised lending rates on export credits by 1 percentage point to encourage exporters to mobilize their foreign claims. Furthermore, the interest subsidies on new investment lending will be eliminated as of January 1, 1987, except for those concerning the housing and coastal fishing sectors.

#### External Payments

21. To achieve the external current account objectives and improve the competitiveness of the economy, the Government will continue to follow a flexible exchange rate policy and will pursue the major liberalization of trade that has been undertaken since 1984 in accord with the adjustment program agreed with the World Bank. The main measures adopted include: (i) the elimination in 1986 of export licenses for practically all products; (ii) liberalizing importation of 76 products at the beginning of 1986; additional products will be liberalized in 1987; (iii) the simplification of administrative procedures concerning international trade, notably to reduce delays in clearing customs. The Government plans to continue the policy of liberalizing imports in 1988. The Government does not intend to impose or intensify restrictions on payments and transfers for current international transactions, nor to impose or intensify import restrictions for balance of payments purposes. It will not introduce new or modify existing multiple currency practices or conclude bilateral payments agreements which are inconsistent with Article VIII of the Fund Articles of Agreement. Furthermore, the Kingdom of Morocco is in the process of acceding to the General Agreements on Tariffs and Trade (GATT).

22. The balance of payments difficulties experienced by Morocco in recent years have led to an accumulation of external payments arrears estimated at US\$552 million at September 30, 1986, US\$89 million of which relate to the Government's direct debt, and US\$463 million to nongovernmental commercial transactions. The Government is extremely concerned at this situation and is intending to eliminate all arrears as soon as possible, in the light of the development of the balance of payments and mobilization of external aid. The timetable for the elimination of arrears, which is a performance criterion for the program, is set out in the attached Technical Memorandum of Understanding.

23. Considering the high level of external public debt and the sizable financial charges expected in coming years, the Government is determined to pursue a prudent external debt policy in order to reduce the debt service ratio from 70 percent (prior to rescheduling) in 1986 to less than 40 percent in 1992. To this end, in 1986 and 1987 the Government will hold its nonconcessional borrowing within the limits set forth in the attached Technical Memorandum of Understanding. These limits, which constitute performance criteria, take into account financing needs for wheat imports, the settlement of commercial arrears, and the need to ensure the continuation of productive investment projects essential to economic development. They also reflect the fact that new commitments have been extremely low during the first nine months of 1986, and that relatively large commitments, deferred until now, are needed to normalize Morocco's external financial relations.

24. To support the trade liberalization policy and ensure the regularization of external payments, the authorities have set themselves the target of improving the level of net foreign assets of the banking system, as defined in the Technical Memorandum of Understanding by SDR 51 million in the last four months of 1986 and by SDR 189 million in 1987. This target will make it possible to increase the level of international reserves by SDR 170 million during 1986 and 1987. The quarterly targets for net foreign assets are shown in Table 1 in the attached Technical Memorandum of Understanding. These targets are indicative and are not program performance criteria.

#### Price Policies

25. Since 1983, the Government has liberalized the prices of most products or brought them under the self-review adjustment scheme, in connection with the liberalization of imports. With the exception of a small number of products, prices that are still under administrative control are those of products supported by the Equalization Fund, those for public services, and products for which there is no adequate competition because of either a limited number of producers or an import monopoly. Additional products will be liberalized early in 1987, in parallel with the scheduled liberalization of imports. The Government intends to eliminate administrative control on practically all products, except for those categories mentioned above, by 1988.

26. To encourage agricultural production, particularly in the cereal sector, the Government has regularly increased producer support prices since 1980. These increases have considerably improved the agricultural sector's terms of trade. For the 1986/87 crop year, producer support prices will again be increased by 5 to 10 percent. The Government is in the process of finalizing with the World Bank a second program of structural measures for the agricultural sector. The main measures under discussion include: (i) the setting up, for the 1987-88 crop year, of a mechanism for fixing support prices for cereals by reference to developments in the world cereals market (excluding export subsidies); (ii) the liberalization in 1988 of the domestic marketing system for cereals, as well as the liberalization of external trade in maize and barley, (iii) increased private sector participation in the distribution of agricultural inputs; and (iv) the elimination of subsidies on fertilizers by 1989 at the latest, and on other agricultural inputs during 1987 and 1988. These latter measures could lead to an annual saving in the order of DH 500 million.

27. As regards the prices of subsidized food products, the Government is firmly committed to continue implementing policies leading to the elimination of subsidies before 1990. As a result of the measures adopted in September 1985 and in 1986, the overall cost of the subsidies has already been sharply reduced in 1986 and will continue to diminish in 1987. Over a two-year period, the Government intends to eliminate subsidies for edible oils and sugar, and to modify the variety and prices of cereal products offered for sale. For sugar, in 1987 the Government will implement, in the context of the structural measures in the agricultural sector, a program to reduce production costs at the agricultural and industrial level, which will make a substantial contribution to eliminating of the consumer subsidy. For cereal products, the reduction in the cost of subsidies would result principally from the increase in the rate of extraction of ordinary flour, the decrease in the share of ordinary flour in total consumption, and the liberalization of prices for all other flours.

#### Public Enterprises

28. Since 1983, an interministerial commission has identified and adopted a number of measures for improving the situation of public enterprises; execution of these measures has been monitored since 1984 by a Standing Oversight Committee. Significant measures adopted in 1985 and 1986 include price and tariff adjustments, the settlement of disputes between enterprises, the restructuring of certain mining companies, the privatization of a considerable part of the Government's interests in the hotel, fishing, and transport sectors, and other actions to improve management. In the early months of 1986, tariff adjustments were made for railroads (4.5 percent), electricity (5 percent) and water (10 percent), following increases of 6 to 10 percent in 1985.

29. The Government is now in the final phase of a large-scale structural reform project for public enterprises, for which financial support is expected from the World Bank. The main features of the program are: (i) a scheme for eliminating government arrears to public enterprises; (ii) a plan for multiyear tariff increases linked to specific financial objectives for self-financing; (iii) reforms in management and in methods of government supervision; (iv) preparation of contract-programs for six public enterprises (three oil companies and the electricity, water, and railroad companies); (v) the preparation of a program for restructuring the sugar, mining and transportation sectors; and (vi) the outlining of a policy for Government disengagement from nonstrategic sectors. A timetable for specific actions will be worked out with the World Bank during negotiations for this sectoral loan, scheduled for January 1987. Progress made in implementing this program will be assessed during the regular reviews of the stand-by arrangement. The measures envisaged will result in improved economic and financial performance by public enterprises and in reduced recourse to budgetary subsidies. It has already been decided that the payments authorizations available for public enterprises will be reduced by 20 percent in 1987. As a result of the measures taken or envisaged for 1987 to increase self-financing margins and to contain new investment, overall financing of public enterprises, as defined in the Technical Memorandum of Understanding, which was estimated at DH 5 billion (4.3 percent of GDP) in 1985 and at DH 4.3 billion (3.2 percent of GDP) in 1986, will be limited to DH 4 billion (2.6 percent of GDP) in 1987. This ceiling, based on data that are still provisional, will be reviewed during the first program review in consultation with staff from the World Bank.

#### Investment Policy

30. During the last ten years, the Government has endeavored to encourage private investment in the major sectors of the economy by granting generous tax advantages and simplifying approval procedures. Under this policy, private investment increased considerably, largely offsetting the decline in public investment since 1982. To create a climate even more favorable to private investment and promotion of private initiative, the Government intends, as part of its program of fiscal reform, to review rates of taxation while exercising greater selectiveness in granting tax exemptions. The Government also intends to encourage direct foreign investment. To this end, it has extended the advantages of the investment codes to foreign promoters. Previously, these advantages were reserved for investments involving a minimum of 50 percent Moroccan ownership of equity. In addition, it intends to study a mechanism for converting part of the external debt into equity in Moroccan companies.

Technical Memorandum of Understanding Annexed  
to the Memorandum on Economic and Financial Policies

1. The Government will monitor the execution of the program with reference to the performance criteria and indicative targets set forth in this technical Memorandum of Understanding and summarized in the attached Table 1. Purchases from the Fund under the stand-by arrangement will be contingent on the observance of the performance criteria, while nonobservance of the indicators will entail consultations with the Managing Director of the Fund with a view to determining the causes of the overruns and adopting such remedial measures as may prove necessary. In addition, provision is made for three reviews of program execution during the period of the stand-by arrangement. The ceilings indicated below (Section A) for September 1987, as regards the Treasury operations deficit and external payments arrears, and for September and December 1987, as regards the other performance criteria, constitute indicative targets that are subject to being revised and established as performance criteria during the second program review to be held before end-September 1987. The indicative targets mentioned below (Section B) for September and December 1987 will also be reviewed by end-September 1987. It is the Government's intention to request a modification of the performance criteria on net bank credit to the Government, total bank credit, and external arrears if reversible delays take place in the disbursement of the sectoral adjustment loans from the World Bank and the African Development Bank, and of the commercial bank loans as now projected in Tables 2 and 3 (attached).

A. Performance Criteria

2. The Treasury operations deficit, estimated at DH 8,430 million for the first nine months quarters of 1986, will not exceed DH 9,020 million as at December 31, 1986. For 1987, this deficit will not exceed DH 3,230 million as at March 31, 1987, DH 4,650 million as at June 30, 1987, DH 6,670 million as at September 30, 1987, and DH 8,500 million as at December 31, 1987. In accordance with paragraph 16 of the Memorandum on Economic and Financial Policies, these limits may be increased by the amount of use of highly concessional resources which may be mobilized in 1987 in order to finance the supplementary public investment package. For purposes of this paragraph, the total budgetary expenditure to be used in calculating the deficit shall not include repayment of debt principal. Interest charges on the external debt, including the military debt, will be included in expenditure, in the amount of interest payable prior to rescheduling. To the extent that they are not settled with funds from the World Bank, the issue of non negotiable financial instruments referred to in paragraph 14 of the Memorandum on Economic and Financial Policies will not be included in the definition of the Treasury operations deficit. Likewise, regularisation of government arrears financed by the issue of these instruments will not count toward the reduction of domestic arrears by the Treasury as defined in paragraph 3 below.

3. The Treasury's payments arrears, which amounted to DH 6,135 million on December 31, 1985 and DH 4,282 million on September 30, 1986, will not exceed DH 5,975 million on December 31, 1986, DH 5,975 million on March 31, 1987, DH 5,400 million on June 30, 1987, DH 4,800 million on September 30, 1987, and DH 4,710 million on December 31, 1987. For purposes of this paragraph, the Treasury's domestic payments arrears include all payment orders awaiting approval at the Treasury, fonds réservés awaiting payment, and outstanding external debt service payments due but not paid.

4. Outstanding net bank credit to the Government, which amounted to DH 38,848 million on August 31, 1986, will not exceed DH 38,950 million on December 31, 1986, DH 41,350 million on March 30, 1987, DH 41,750 million on June 30, 1987, DH 41,750 million on September 30, 1987 and DH 41,750 million on December 31, 1987. These ceilings will be automatically adjusted downward if the amounts of net external financing (including debt relief and net changes in arrears on debt amortization), and of the nonbank domestic financing exceed the quarterly projections indicated in the attached Table 2. For purposes of this paragraph, bank credit is defined as the sum of credit to the Government granted by the Bank of Morocco and the deposit banks plus the outstanding counterpart balances of drawings on the Fund transferred to the Treasury, but excluding the counterpart of the deposits with the Treasury and the postal checking system.

5. Total bank credit, which amounted DH 69,213 million on August 31, 1986, will be limited to DH 68,530 million on December 31, 1986, DH 71,450 million on March 31, 1987, DH 72,220 million on June 30, 1987, DH 73,110 million on September 30, 1987, and DH 73,530 million on December 31, 1987. This ceiling includes bank credit to the Government as defined in paragraph 4 and bank credit to the rest of the economy. The ceiling will be adjusted when credit to the Government is adjusted under the conditions set forth in paragraph 4. These ceilings may also be adjusted upward by (a) 40 percent of the amount of provisions initially established as counterparts to requests for foreign exchange purchases as indicated in paragraph 18 of the Memorandum on Economic and Financial Policies and by (b) 40 percent of the effective reduction in external commercial arrears in comparison to the amount recorded on the day the provision system is introduced. These two adjustments may not exceed a maximum of DH 700 million as at December 31, 1986, DH 525 million as at March 31, 1987, and DH 350 million as at June 30, 1987. This system for adjustment of outstanding credit will be reviewed before end-February 1987.

6a. Outstanding short-term external borrowings (up to one year) contracted, guaranteed or approved by the Government, with the exception of import and export financing, will not exceed US\$750 million during the program period. The outstanding amount of this debt will be automatically reduced by any amount of debts that are covered by a medium-term consolidation. It may be increased up to the amount of any short-term credit obtained from commercial banks to eliminate commercial arrears.

6b. The amount of new nonconcessional borrowings contracted, guaranteed or approved by the Government (excluding new loans contracted in the context of debt reschedulings) with maturities between 1 and 12 years will not exceed SDR 300 million for the period from October 1 to December 31, 1986, SDR 600 million for the period from October 1, 1986 to June 30, 1987, and SDR 750 million for the period from October 1, 1986 to December 31, 1987. Under these ceilings, new loans with maturities of 1 to 5 years will be limited to SDR 100 million for the period from October 1 to December 31, 1986, SDR 200 million for the period from October 1, 1986 to June 30, 1987, and SDR 250 million for the period from October 1, 1986 to December 31, 1987. These ceilings may be increased by a maximum of SDR 100 million if any financing obtained from commercial banks for purposes of eliminating commercial arrears should take the form of medium-term loans instead of short-term loans.

7. On the basis of the quarterly balance of payments projections for the period from October 1, 1986 to December 31, 1987, reproduced in the attached Table 3, total external payments arrears, which amounted to SDR 456 million on September 30, 1986, will not exceed SDR 375 million on December 31, 1986, SDR 375 million on March 31, 1987, SDR 350 million on June 30, 1987, and SDR 225 million on September 30, 1987, and will be eliminated by December 31, 1987. For purposes of this program, external payments arrears include the payments arrears on the Government's direct debt as identified by the Ministry of Finance and the commercial arrears of the rest of the economy as identified by the Bank of Morocco.

#### B. Indicative Targets

8. Total government current revenue, which amounted to DH 20.6 billion as at September 30, 1986, is estimated at DH 28.8 billion for end-December 1986, DH 8.1 billion for the first quarter of 1987, DH 16.5 billion for the first six months, DH 24.8 billion for the first nine months, and DH 33.7 billion for 1987 as a whole.

9. Commitments at the level of expenditure commitment control (CED) for the investment budget, which amounted to DH 13.2 billion on September 30, 1986, will not exceed DH 15.7 billion by December 31, 1986. In 1987, they will be limited to DH 8.8 million by March 31, 1987, DH 12 billion by June 30, 1987, DH 15.2 billion by September 30, 1987, and DH 17 billion by December 31, 1987. The indicative ceilings for June, September and December 1987 are still extremely preliminary and will be reviewed during the first program review to be completed by end-February 1987. These indicative ceilings will include commitments under the general investment budget and the special accounts, including the amount of payment authorizations committed but not issued during the previous year, recommitted payments arrears, funds earmarked for deferred settlements, as well as interest and principal payments on the military debt (after debt relief) and the settlement of arrears on that debt outstanding at end-1986.

10. Total outstanding domestic payments arrears of the Government other than those recorded at the Treasury (see paragraph 3), which were estimated at DH 5.5 billion on December 31, 1985, will not exceed DH 5.7 billion on December 31, 1986 and during the first nine months of 1987, and will be reduced to DH 4.7 billion by December 31, 1987. This indicative target will be adjusted downward by the amount of arrears regularized in the context of the arrears settlement plan mentioned in paragraph 14 of the Memorandum on Economic and Financial Policies.

11. The consolidated financing of nonfinancial public enterprises, which amounted to DH 5.1 billion in 1985, will not exceed DH 4.3 billion in 1986 and DH 4 billion in 1987. For purposes of this paragraph, such financing is defined as the sum of budget subsidies, bank credit, and credit granted by specialized financial institutions to the nonfinancial public enterprises, as well as their recourse to the domestic financial market, net external borrowing, and external debt relief.

12. The net foreign assets of the banking system, which amounted to minus SDR 495 million on August 31, 1986, will be not lower than minus SDR 445 million on December 31, 1986, minus SDR 480 million on March 31, 1987, minus SDR 420 million on June 30, 1987, minus SDR 355 million on September 30, 1987, and minus SDR 255 million on December 31, 1987. The net foreign assets of the banking system as defined in this Technical Memorandum of Understanding include the net foreign assets of the Bank of Morocco, the net foreign assets of the deposit money banks, and Morocco's net use of Fund resources.

### C. Program Reviews

13. The reviews scheduled during the period of the stand-by arrangement will be completed before end-February 1987, end-September 1987 (at the same time as the Article XIV consultation for 1987) and end-February 1988, respectively. The first review will be devoted to the examination of the 1987 budget as adopted by Parliament at end-year, the financial policies associated with it, and their impact on the program. It will also review progress with regard to mobilizing external assistance, including the rescheduling of debt service, and with the development of the program for reorganizing the public enterprises, in particular the plan for clearing government arrears. It will also be concerned with credit and exchange rate policy. Finally, it will examine any possible changes to be made in the indicative targets with respect to the commitment of investment expenditures and the financing of public enterprises for 1987. During the second review, there will be an examination of program execution during the first half of the year, the outlook for the remainder of the year, and the establishment of the performance criteria and indicative targets remaining to be set. The review will also touch upon the progress with the reform of the tax system and on the exchange rate policy. The third review will analyze program execution during 1987 as a whole and the overall package of economic and financial policies for 1988.

Attached Tables

1. Performance Criteria and Indicative Targets, 1986-87
2. Consolidated Government Operations, by Quarter, September 1986-December 1987.
3. Quarterly Balance of Payments Forecasts, 1986-87.

Table 1. Morocco: Performance Criteria and Indicative Targets, 1986-87

	1986		1987			
	Sept. Prov.	Dec.	March	June	Sept.	Dec.
<b>A. Performance criteria</b> (In millions of dirham)						
1. Treasury deficit (cumulative)	8,430	9,020	3,230	4,650	6,670 <u>4/</u>	8,500
2. Outstanding Treasury payments arrears	4,282	5,975	5,975	5,400	4,800 <u>4/</u>	4,710 <u>4/</u>
3. Net bank credit to the Government	38,848 <u>1/</u>	38,950	41,350	41,750	41,750 <u>4/</u>	41,750 <u>4/</u>
4. Total bank credit	69,213 <u>1/</u>	68,530	71,450	72,220	73,110 <u>4/</u>	73,530 <u>4/</u>
(In millions of U.S. dollars)						
5. External borrowing by the Government						
a. Outstanding short-term debt <u>2/</u>	585	750	750	750	750 <u>4/</u>	750 <u>4/</u>
(In millions of SDRs)						
b. New nonconcessional borrowing of 1-12 years <u>3/</u> ...		300	600	600	750 <u>4/</u>	750 <u>4/</u>
of which:						
1 to 5 years <u>3/</u> ...		100	200	200	250 <u>4/</u>	250 <u>4/</u>
6. Outstanding external arrears	456	375	375	350	225 <u>4/</u>	---
<b>B. Indicative targets</b> (In millions of dirham)						
1. Total government revenue	20,565	28,800	8,100	16,500	24,800 <u>5/</u>	33,700 <u>5/</u>
2. Commitments of investment expenditure	13,200	15,700	8,800	12,000	15,200 <u>5/</u>	17,000 <u>5/</u>
3. Domestic payments arrears outside the Treasury	6,687	5,700	5,700	5,700	5,700 <u>5/</u>	4,700 <u>5/</u>
4. Consolidated financing of public enterprises	n.a.	4,300	4,000	4,000	4,000 <u>5/</u>	4,000 <u>5/</u>
(In millions of SDRs)						
5. Net foreign assets of the banking system	-495 <u>1/</u>	-445	-480	-420	-355 <u>5/</u>	-255 <u>5/</u>

1/ End-August 1986.

2/ Excluding Kuwaiti deposit.

3/ Cumulative amounts since October 1, 1986 of new loan commitments.

4/ Indicative targets subject to revision and application as performance criteria at the time of the second program review to be completed by end-September 1988.

5/ Preliminary targets subject to revision during the second program review.

Table 2. Morocco: Consolidated Government Operations, 1986-87 <sup>1/</sup>

(In millions of dirham)

	1986		1987			
	Sept. Prov.	Dec.	March	June	Sept.	Dec.
Revenue	20,565	28,791	8,183	16,467	24,833	33,700
Direct taxes	4,988	6,258	1,710	3,440	5,600	7,235
Customs duties	3,430	4,628	1,248	2,450	3,540	5,075
Indirect taxes	7,585	10,756	2,940	5,916	8,844	12,187
Registration and stamp duties	1,708	2,237	685	1,236	1,798	2,445
Monopolies	182	550	183	504	722	840
Property income	51	70	20	38	58	90
Other revenue	493	820	159	353	541	840
OCP	--	--	250	500	750	1,000
Petroleum products	2,148	3,440	990	2,020	2,980	3,980
Total expenditure	27,302	37,812	11,217	20,088	29,602	40,200
Current expenditure	24,067	31,577	8,867	17,188	24,752	33,410
Goods and services	15,895	20,799	5,700	11,220	16,150	22,161
Public debt	6,839	8,978	2,667	5,068	7,352	9,849
Domestic	(1,820)	(2,070)	(752)	(1,920)	(2,570)	(3,569)
External <sup>2/</sup>	(5,019)	(6,908)	(1,915)	(3,148)	(4,782)	(6,280)
Consumer subsidies	1,333	1,800	450	800	1,100	1,400
Capital expenditure	3,235	6,235	2,400	3,000	5,000	6,790
Deficit, commitment basis	-6,737	-9,021	-3,034	-3,621	-4,769	-6,500
Change in arrears	-1,693	--	-193	-1,028	-1,899	-2,000
Deficit, cash basis	-8,430	-9,021	-3,227	-4,643	-8,668	-8,500
Financing	8,430	9,021	3,227	4,649	6,668	8,500
Domestic	7,480	6,592	2,594	3,922	4,019	5,000
Bank	5,182	4,500	2,400	2,800	2,800	2,800
Nonbank	2,298	2,092	194	1,122	1,219	2,200
External (net)	1,350	2,429	633	727	2,649	3,500
Grants	140	140	--	--	--	--
Net borrowing	-8,666	-11,003	-3,770	-4,424	-4,971	-5,205
Drawings	(3,254)	(5,439)	(1,292)	(2,797)	(5,155)	(7,634)
Of which: exceptional financing	(--)	(--)	(790)	(1,630)	(3,110)	(4,573)
Amortization <sup>2/</sup>	(-12,321)	(-16,442)	(-5,062)	(-7,221)	(-10,126)	(-12,839)
Debt relief <sup>3/</sup>	9,878	13,292	4,403	5,151	7,620	8,705
Interest	(1,239)	(1,452)	(604)	(775)	(1,077)	(1,357)
Principal	(8,637)	(11,840)	(3,799)	(4,376)	(6,543)	(7,346)

Sources: Ministère des Finances; and Fund staff projections.

<sup>1/</sup> Cumulative amounts since beginning of year.<sup>2/</sup> Contractual amounts.<sup>3/</sup> Including bank debt rescheduling for 1986 and 1987 not yet finalized and projected debt rescheduling by official creditors after February 1987.

Table 3. Morocco: Quarterly Balance of Payments Projections, 1986-87

(In millions of SDRs)

	1986					1987				
	Q1+Q2	Q3	Q4	Year	Q1	Q2	Q3	Q4	Year	
Trade balance	-462	-195	-133	-790	-271	-235	-249	-66	-820	
Exports, f.o.b.	987	475	611	2,073	481	547	503	656	2,188	
Imports, f.o.b.	-1,449	-670	-744	-2,863	-752	-782	-752	-722	-3,008	
Services	-367	-110	-154	-631	-191	-123	-101	-70	-486	
Freight and insurance	-93	-42	-37	-171	-46	-45	-45	-33	-168	
Other transport	21	11	10	42	10	12	12	11	44	
Travel	230	188	192	610	143	144	204	209	700	
Investment income	-454	-236	-278	-968	-259	-190	-235	-210	-893	
Government services	-132	-65	-66	-263	-74	-74	-73	-73	-294	
Other services	61	34	25	120	34	30	35	26	125	
Private transfers	600	320	280	1,200	282	345	345	308	1,280	
Current account (before debt relief)	-229	15	-7	-221	-180	-13	-5	172	-26	
Nonmonetary capital	-415	-451	-223	-1,089	-435	-171	-213	-143	-962	
Private (incl. e & o)	-26	-45	--	-71	25	25	21	--	71	
Official transfers	14	--	--	14	--	--	--	--	--	
Loan disbursements	453	107	289	849	92	108	150	163	513	
Amortization	-856	-513	-512	-1,881	-552	-304	-384	-306	-1,546	
Debt relief <sup>1/</sup>	682	487	414	1,583	462	143	282	165	1,052	
Rescheduling obligations	-97	-18	--	-115	--	--	--	--	--	
Overall balance	-59	33	184	158	-153	-41	64	194	64	
Net foreign assets	-84	-122	-133	-339	-6	-98	-108	-137	-349	
IMF (net)	-135	-60	-79	-274	-62	-81	-36	-65	-244	
Purchases	--	--	--	--	--	--	--	--	--	
Repurchases	-135	-60	-79	-274	-62	-81	-36	-65	-244	
Gross reserves	37	-62	-40	-65	56	-17	-72	-72	-105	
Other	14	--	-14	--	--	--	--	--	--	
Financing gap	143	89	-51	181	159	139	44	-57	285	
Possible financing	--	--	30	30	159	164	169	168	660	
IMF	--	--	30	30	40	40	40	40	160	
IBRD/ADB	--	--	--	--	44	49	104	103	300	
Commercial banks	--	--	--	--	75	75	25	25	200	
Change in arrears	143	89	-81	151	--	-25	-125	-225	-375	
Memorandum item:										
Arrears outstanding end of quarter	367	456	375	375	375	350	225	--	--	

Sources: Ministère des Finances; Office des Changes; and Fund staff projections.

<sup>1/</sup> Including bank debt rescheduling for 1986 and 1987 net yet finalized and projected debt rescheduling by official creditors after February 1987.