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Minutes of Executive Board Meeting 86/199

10:00 a.m., December 16, 1986

J. de Larosière, Chairman

Executive Directors	Alternate Executive Directors
	J. A. K. Munthali, Temporary
	Song G., Temporary
	M. K. Bush
	H. G. Schneider
	C. A. Salinas, Temporary
M. Finaish	
	M. Sugita
G. Grosche	
	A. Iljas, Temporary
	J. R. N. Almeida, Temporary
	M. Foot
H. Lundstrom	
	D. McCormack
	C. V. Santos
	K. Yao, Temporary
Y. A. Nimatallah	
	C. Noriega, Temporary
H. Ploix	
	J. de Beaufort Wijnholds
	A. V. Romuáldez, Temporary
G. Salehkhou	O. Kabbaj
	A. Vasudevan, Temporary
S. Zecchini	

L. Van Houtven, Secretary
S. J. Fennell, Assistant

Also Present

IBRD: J. D. Shilling, Europe, Middle East and North Africa Regional Office. African Department: A. D. Ouattara, Director; M. Dairi, C. A. François, R. A. Franks, A. Jbili, P. Lemain. Exchange and Trade Relations Department: S. Kanesa-Thasan, K. P. Regling. Fiscal Affairs Department: L. Garamfalvi, A. Ize, A. Tazi. Legal Department: A. O. Liuksila, J. M. Ogoola. Treasurer's Department: D. Berthet, D. Gupta. Personal Assistant to the Managing Director: R. M. G. Brown. Advisors to Executive Directors: A. Ouanes, I. Sliper. Assistants to Executive Directors: H. Alaoui-Abdallaoui, S. Binay, F. Di Mauro, R. Fox, M. Hepp, K.-H. Kleine, T. Morita, A. H. Mustafa, D. V. Nhien, S. Rebecchini, G. Schurr, S. Simonsen, E. L. Walker.

1. MOROCCO - REQUEST FOR STAND-BY ARRANGEMENT AND OVERDUE VALUATION ADJUSTMENT

The Executive Directors considered a request from Morocco for a stand-by arrangement in an amount equivalent to SDR 230 million, together with a paper on the need for a valuation adjustment as a result of late payments to the Fund (EBS/86/262, 11/24/86; Sup. 1, 11/26/86; Sup. 1, Cor. 1, 12/15/86; and Sup. 2, 12/16/86).

The staff representative from the African Department remarked that since the issuance of the staff paper on Morocco's request for a stand-by arrangement, the authorities had reached agreement with the commercial banks' Steering Committee on a restructuring package, covering the period January 1, 1985-December 31, 1988. That agreement, which was subject to ratification by all commercial banks with exposure in Morocco, should ensure the closing of the remaining financing gap of about SDR 200 million for 1987; the financing gap in 1988 would also be reduced from SDR 850 million to SDR 480 million. However, the restructuring arrangement with the commercial banks did not involve any new money. The staff expected that the agreement would be completed by end-February 1987, at the time of the first review of the stand-by arrangement.

Some additional economic and financial statistics on Morocco had become available since the preparation of the staff paper, the staff representative indicated. The data for October 1986 and some preliminary figures for November showed that fiscal policy was on track, with bank credit to the Government significantly below target, owing to larger than expected nonbank borrowing in November. The trade data through September 1986 were in line with the quarterly balance of payments projections underlying the program. However, while net official reserves, including Morocco's net position with the Fund, continued to improve in line with the program, there had been an increase in external arrears of about SDR 70 million between end-September and end-November, indicating that Morocco's external position was still under pressure. The information necessary to analyze the cause of that pressure was not yet available. However, it was possible that Morocco might be unable to meet the end-December performance criterion for external arrears.

Mr. Kabbaj made the following statement:

> The Executive Board had the opportunity to discuss fully on August 29, 1986, the Article IV consultation report on Morocco. The Moroccan authorities, informed of the recommendation made by the Executive Directors, have asked me to convey to the Board their appreciation for the keen interest shown by its members in the Moroccan case, and to management and staff their thanks for the continued assistance and support provided since acute financial problems emerged.

Shortly after the consultation took place and after clearance of all arrears, the Moroccan authorities and staff embarked on a long process of negotiations to put into place a realistic adjustment program that would put the Moroccan economy on a viable path of growth.

This process was facilitated by the clear improvement in the macroeconomic aggregates of the country after more than five years of acute problems. This improvement, as highlighted at our last discussion, was brought about by a record crop harvest and by the reversal of most of the exogenous factors which hit the Moroccan economy hard during the previous years, including high interest rates, the appreciation of the dollar, and the price of oil. However, some weaknesses remain and are related to the phosphate sector, which continues to suffer from weak demand and excess supply and to protectionist tendencies that hamper the prospects for higher exports.

Apart from the benefits derived from exogenous factors, the improvement resulted also from the effects of the adjustment measures taken in previous years, including the far-reaching structural measures implemented in the framework of Fund and World Bank programs in the field of trade, financial intermediation, agriculture, and education. Despite some delays, this adjustment policy, which has been vigorously pursued, has put Morocco in a position to benefit fully from the reversal of exogenous factors.

The most impressive results were obtained in the external current account position which changed from a deficit of 11.6 percent of GDP in 1984 to 8.2 percent in 1985, and to 1.7 percent in 1986. The adjustment in the Central Government's deficit on a payment order basis, although slower, is similarly impressive. The deficit of 12 percent of GDP in 1984 was reduced to 10.4 percent of GDP in 1985 and to 6.6 percent of GDP in 1986.

The negotiations took place while the Moroccan authorities were in the process of preparing the 1987 budget. The comprehensive program which resulted from these negotiations is a well-balanced one in the view of my authorities, and its objectives are such that their attainment will allow the Moroccan economy to be put on a self-sustainable course in the medium term.

The program aims at maintaining sustained and noninflationary growth and at achieving a further substantial reduction in the external imbalances of the economy. A strong package of measures has been put in place in order to reach these objectives in the budgetary as well as in the monetary and external fields.

The budget, which is shortly to be approved by the Parliament, is consistent with the program objectives and includes revenue and expenditure measures which should result in a reduction of the deficit from 6.6 percent of GDP in 1986 to 4.3 percent of GDP in 1987. Revenues will be raised by 17 percent as elaborated in the staff report. On the expenditure side, it is worth mentioning that total government expenditure as a proportion of GDP has declined from 37.8 percent in 1981 to 27.5 percent in 1986. The strong measures implemented during the previous years will be maintained. These include a limit on public sector recruitment and the freezing of general salary increases. It is unfortunate that the attainment of the program objectives necessitates further cuts in investment expenditure, especially considering the sharp cuts in the preceding years. In this regard, the assistance of Executive Directors in securing the additional SDR 100 million to finance high-priority public investment is most welcome.

On monetary policy the main measures already implemented aim at reducing liquidity, strengthening the net foreign asset position of the banking system, and eliminating external arrears. To this end, the bank reserve ratio has been raised substantially and the interest rates have been maintained at their high levels despite the easing of inflation. Furthermore, the banks are required, as of October 23, 1986, to block a minimum 25 percent provision from customers requesting foreign exchange and whose requests could not be immediately met.

On external policies the program includes the continuation of the trade liberalization policy and the elimination of all external arrears before end-1987. The authorities will continue applying a flexible exchange rate policy in order to preserve Morocco's competitiveness.

Together with these measures, Morocco will continue devising and implementing structural reforms in close collaboration with the World Bank and the Fund. As highlighted in the staff report, the policies in the areas of trade liberalization, fiscal intermediation, and agriculture will continue. The preparation of a comprehensive program of reform of public enterprises, which is to contribute to a better fiscal balance, is expected to be completed in 1987. With the technical assistance of the Fund and the World Bank, Morocco is addressing the other fiscal weaknesses in the fields of subsidies, investment budget, and classification of expenditures. Fiscal reform will also receive special attention and it is the intention of the Government to implement the changes contemplated by January 1, 1988.

The program as outlined is a comprehensive and ambitious one. Its implementation is not risk free. It implicitly assumes that the crop will be normal in 1987, that the price of oil will remain at its present levels, that the external environment for interest and exchange rates will not change greatly, and that the phosphate market will not further deteriorate.

The Government is determined to play its part in order to carry out its commitments and stands ready in the framework of the flexibilities built in the program to discuss with the Fund any slippage and to take all necessary and feasible steps to reach the objectives of the program.

It is heartening to note that, as the staff representative will confirm, the program is so far on track, except perhaps for the criterion on external arrears which is clearly beyond the authorities' control. It is also encouraging that an agreement has been reached with the commercial banks covering the period of 1985 through 1988. It will certainly contribute to a better medium-term prospect and to the normalization of relations between Morocco and the commercial banks, which in turn will reduce the pressures on the balance of payments.

Extending his statement, Mr. Kabbaj remarked that the Moroccan authorities would shortly be making a request to the Paris Club for a rescheduling of their debts to official creditors. The Consultative Group Meeting on Morocco had been tentatively set for February 2, 1987. Finally, he had been surprised by the issuance of a second supplement to the staff paper on valuation adjustment; in his authorities' view, the amount due did not represent an overdue obligation. His authorities were concerned about the legality of the practice followed by the staff regarding the valuation adjustment. They were particularly questioning the asymmetry of the practice; a number of payments had been made to the Fund for which they should have been compensated, based on the different exchange rates on the payment date and on the value date of the transaction. Furthermore, the valuation adjustment calculated by the staff was less than $200,000, a trivial amount compared with Morocco's total payments to the Fund in 1986 of more than $400 million, including charges.

Mr. Nimatallah stated that the late circulation of the supplement on Morocco's valuation payment was inappropriate, although he was grateful that the issue had been raised. Could the staff indicate why the Executive Board had not been informed of the overdue valuation payment at an earlier date?

The staff representative from the Treasurer's Department commented that the matter had been under discussion with the Moroccan authorities for several days. The staff had hoped that the payment would have been completed and the matter cleared before the present discussion. However, as the issue had not been resolved the previous day, the staff had issued the paper for the information of the Executive Board.

The problem had arisen because Morocco had made a number of payments a few days after the due dates, the staff representative indicated. In such cases, the established practice had been for the member to cover any shortfalls that arose from a late payment based on the exchange rate on the third business day before the value date of the transaction compared with the exchange rate on the third business day before the actual payment date. However, if the exchange rate moved in favor of the member paying late and the late payment by the authorities had led to overpayments, the member was not refunded the excess amount by the Fund. Those procedures had been set out in a staff paper discussed by the Executive Board in April 1984 (EBM/84/54, 4/5/84; EBS/84/46, 3/9/84), when no Director had objected to the procedures, and the staff had consistently followed them since that date.

A decision along the lines of the one included in Supplement 2 would be necessary in view of paragraph 5 of the decision on the stand-by arrangement for Morocco, which indicated that Morocco could not make purchases from the Fund while it had overdue obligations to the Fund, the staff representative from the Treasurer's Department stated. Such a decision was particularly necessary in Morocco's case, as the authorities had requested an early disbursement of the first purchase under the arrangement.

The staff representative from the Legal Department indicated that the Legal Department had only received notice of Morocco's overdue valuation payment the previous evening. The staff was currently working on the legal ramifications of that issue and would present its findings to the Executive Board before the end of the meeting.

After further discussion, Directors accepted the Chairman's suggestion that they come back to the question after concluding the discussion on the request for a stand-by arrangement, when a staff representative from the Legal Department could comment on the legal aspects of the overdue valuation payment.

The staff representative from the Exchange and Trade Relations Department, responding to a question from Mr. Grosche, stated that the staff was not certain about the factors explaining the increase in Morocco's external arrears. There was a possibility that some of those factors might be reversed in the month of December, enabling the authorities to meet the end-year performance criterion on external arrears. The staff felt that it was perhaps premature to modify the performance criterion at the present stage.

Mr. Nimatallah made the following statement:

> I support the proposed program with Morocco and endorse the proposed stand-by arrangement. I am convinced that the Moroccan authorities are committed to consolidating their efforts to improve their control over aggregate demand, while accelerating their supply-side efforts to strengthen economic growth. In the process, and as a third objective, they intend to liberalize the economy further and help the private sector to play a greater role in the

economy. I am in full agreement with these objectives, which I hope will soon take the Moroccan economy to a point where it should not need any more Fund resources for the foreseeable future.

This program will be timely because of the fortunate, sharp improvement in Morocco's terms of trade, lower interest rates, comfortable agricultural production, growth in the economies of trading partners, and, of course, the lower dollar. This is a far cry from the previous situation in which adverse exogenous developments had frustrated the authorities' efforts. Therefore, I am heartened to see that the Moroccan authorities are taking advantage of the present opportune moment with their determination to put their economy back on a sustainable growth path. The authorities are right in paying special attention to structural reforms on the fiscal front to reduce waste, reduce rigidities in tax collection, and strengthen public finances. Improving public finance management through better planning, budgeting, and monitoring of investment expenditure will go a long way toward enhancing growth prospects. The growth rate envisaged in the program of about 3 percent might turn out to be conservative if the authorities succeed in accelerating investment expenditure and in attracting foreign investment with the help of the Consultative Group. I am pleased to see also that a more favorable climate to encourage private investment is being promoted through the tax system.

Medium-term balance of payments viability seems to be attainable if Morocco and its trading partners play their roles successfully. The implementation of structural reforms in the areas of external trade, pricing policies, and agriculture should, with the help of the World Bank, help in reaching such medium-term viability. I am sure that the authorities will continue with their flexible management of the exchange rate and of import taxes, with a view to maintaining internal and external competitiveness. I am pleased to see, also, that all these efforts will be strengthened further by the regularization of external payments in order, eventually, to increase international reserves. It is very important that Morocco does not accumulate arrears particularly to the Fund, and I am heartened to see that all arrears will be eliminated by the end of next year. I wish that that were the case in, for example, Madagascar and Guinea, which instead were allowed to eliminate their arrears over several years.

To conclude, I am convinced that the long ordeal of harsh adjustment in Morocco is coming closer to an end. My optimism is based on the fundamental changes that have taken place in the Moroccan economy since the early 1980s, one of which is the narrowing of the resource gap, from a shortfall of 8 percent in 1983, to balance projections in the program year, 1987. The size of Government, as measured by government expenditure, declined from almost 40 percent of GDP in 1981 to almost 25 percent of GDP in 1987. This program shows the good intentions and the determination of the Moroccan authorities. They need only to sustain their structural adjustment efforts. This undoubtedly will help the smooth servicing of their external debt, the ratio of which will hopefully decline to less than 30 percent by 1994. Finally, I support the proposed decision.

Mr. Finaish made the following statement:

Morocco has been implementing a wide range of economic adjustment policies in recent years in the context of programs supported by the Fund and the World Bank. The focus of the adjustment effort has been on correcting the economy's financial and structural weaknesses caused by adverse exogenous developments and the pursuit of expansionary financial policies in the late 1970s. Although policy slippages have occurred at times under the pressure of an unforeseen worsening in external conditions, a good measure of success has been achieved in improving the economic situation over the past few years. The pace of improvement in economic performance has recently accelerated, particularly in the real sector, as adjustment efforts were aided by a number of favorable circumstances, including good weather conditions. However, the financial performance of the economy has continued to reflect weak fiscal and external positions, and some of the factors underlying the recent acceleration in economic growth may prove to be temporary. Moreover, the weakness in the world market for phosphate, the main export commodity, has continued to exert its negative impact on economic performance. For these reasons, the economic situation continues to warrant perseverance with the pursuit of adjustment efforts into the medium term, to which the authorities have reaffirmed their commitment as indicated in Mr. Kabbaj's helpful statement.

The proposed stand-by arrangement is formulated in a medium-term policy framework and emphasizes both structural reforms and demand management measures designed to accelerate the achievement of a sustainable rate of growth consistent with the country's potential and compatible with a self-sustaining external position. A number of structural reforms supported by the World Bank are already under way, and a major new reform program is expected to be launched. These reforms cover the areas of foreign trade, prices, public enterprises, agriculture, and education. The program also includes a broad range of demand-management measures covering the areas of public finance, money and credit, and external payments. It is comprehensive in scope and the targets being pursued represent a major step toward the aforesaid medium-term objectives. We therefore support Morocco's request for a stand-by arrangement.

I will focus the rest of my comments on public finance and on trade liberalization.

The program gives a high priority to fiscal adjustment, an appropriate emphasis given the problems faced in this area. The program seeks to achieve significant reductions in the budget deficit relative to GDP and in outstanding domestic arrears, particularly in 1987, mainly through a package of revenue measures and the maintenance of expenditure restraint.

Concerning revenues, a number of measures have already been introduced and others are envisaged for 1987. The Moroccan authorities have also agreed to take additional measures, if needed, to ensure the achievement of targeted revenues. However, it can be noted that projected revenue relative to GDP will remain in 1987 below the level achieved in 1985. In fact, revenue performance has been weak in recent years, and the tax system, as noted by the staff, lacks buoyancy. An important factor underlying the weakness in revenue performance is the dependence of the tax system on the taxation of imports. At the same time, substantial reductions have been made in import duties in recent years, and more progress is envisaged under the present program. In fact, import duty revenues declined as a proportion of imports by 7 percentage points in 1980-86. Meanwhile, the timely implementation of offsetting tax measures has not been fully undertaken since the approval and implementation of some of the taxes included in the tax reform have been delayed. This is an important matter that warrants further attention, along with a strengthening of the revenue system and an improvement in its buoyancy in line with the recommendations made in the staff report.

Turning to expenditure, the staff notes that the brunt of fiscal adjustment in recent years has been borne by expenditure, with most of the reduction occurring in investment expenditure. This has been due to the weak revenue performance and the difficulties encountered in cutting current expenditure. The authorities should, however, be given credit for the fiscal adjustment undertaken and the restraint maintained on current expenditure. In fact, consumer subsidies have been substantially reduced and a further reduction is envisaged under the program. There are also other important measures limiting the growth of various categories of current expenditures. Notwithstanding the achievement of fiscal adjustment, the substantial decline in the budget of investment expenditure relative to GDP in recent years is worrisome. This reduction could be one of the main factors underlying the modest growth projected under the program for 1987. The present program envisages no reductions in investment expenditure, which is projected to remain at least unchanged relative to GDP in 1987. Meanwhile, the programmed reduction in the budget deficit is to come from savings in current expenditure. It should be noted in this regard that it is becoming increasingly difficult to continue reducing current expenditure. Therefore, if future reductions in investment expenditure are to be avoided or if expenditure is to be increased, budget revenues must be significantly increased.

A major effort of restructuring has been taking place in the area of trade liberalization with the objective of promoting exports and efficient import substitution. In particular, import liberalization has been substantial over the past few years and is being continued under the present program. The special import tax and the maximum import duty have both been considerably reduced, and the share of freely imported goods in total imports has risen substantially. Further import liberalization envisaged under the program includes the elimination of the licensing requirement for additional import products. Moreover, a significant further reduction in the special import tax is envisaged in early 1987.

Import liberalization could make a significant contribution to improving economic efficiency in the medium to long term. However, the consequences of import liberalization, particularly in the short run, must be carefully assessed, and the needed offsetting measures must be planned and introduced in a timely fashion. This is particularly important at a time of weak fiscal and external positions. I have already referred to the substantial impact of import liberalization on import duties, which have declined significantly relative to budget revenue and relative to GDP in recent years. The impact of this decline has not been fully compensated by a timely implementation of other revenue-raising measures. Taxation of domestic production can be used to offset reductions in import duties. Taxation of domestic production can also be utilized to bring about a desired adjustment in the level and structure of effective protection without having to lower import duties. There are indications that trade liberalization, together with other adjustment efforts, have begun to exercise a positive effect on export promotion and efficient import substitution. However, the adverse short-term consequences of import liberalization on the fiscal and external positions have not been fully offset, calling into question the advisability of going ahead with further liberalization without adequate complementary measures.

Finally, Morocco has been implementing its import liberalization program while restrictions on its own exports in the common market of the European Communities (EC) have not been reduced, as the staff report for the 1986 Article IV consultation indicated. The Moroccan authorities are also concerned about the possible adverse consequences of the enlargement of the European Communities for agricultural exports. The uncertainty regarding future EC trade policies toward Morocco may also be adversely affecting current investment which could inhibit the country's future capacity to export. Adequate and assured access to the markets of major trading partners is an important requirement for liberalization and other adjustment efforts to succeed in promoting exports. The question of access to and the enlargement of the EC common market is important for Morocco and other North African countries. I would welcome additional comments by the staff on this question in today's discussion and propose that the matter be further explored in future Article IV consultation reports.

Mr. Schneider made the following statement:

After a one-year interruption, the Moroccan authorities and the staff have succeeded in reaching understandings on a new economic program to be supported by Fund resources. I welcome this development for several reasons. First, this new program will allow the authorities to make further progress with the comprehensive reforms initiated over the past years in the area of pricing, trade, and agriculture, thereby paving the way for a better resource allocation and a viable balance of payments position over the medium term. The authorities have already achieved commendable progress in a number of structural areas in recent years. The fact that these efforts can now be continued under favorable conditions, supported by an improvement in the country's terms of trade, good harvests, and, not least, a sound exchange rate policy, should encourage them to remain committed to the ambitious goals they have established for themselves.

Second, and most important, I welcome the present stand-by arrangement because it should assist Morocco in attacking vigorously the protracted financial imbalances from which the economy is suffering. These imbalances have culminated in growing and lasting external arrears and have prevented the country from translating its improved economic performance into a restoration of its external creditworthiness. Morocco's arrears problem has reached a worrisome dimension. The persistence of sizable arrears has contributed to a sharp shortfall in external financing, especially from official sources, and has prevented the authorities from developing an organized and efficient approach to the establishment of a sustainable debt servicing profile. In fact, the marked improvement in the current account expected this year will be offset by an equally large deterioration in the capital account. As a result, foreign exchange has remained very scarce giving rise to the periodic emergence of arrears to the Fund, and overall activity has been financed excessively through domestic liquidity expansion. Efforts to reverse this situation through a tightening of domestic demand policies has led to a reduction of resources available for public investments, resulting in even higher shortfalls in disbursements of external assistance because the domestic currency counterpart was not available. In sum, the Moroccan case is a striking illustration of the need to embody structural reform and the adjustment of the economy in consistent financial programs.

Their experience in recent years shows, by contradiction, that the financial programming model which is at the heart of the Fund program remains a powerful tool to pinpoint a country's adjustment policies even when these policies focus on the structural and supply-side sectors of the economy.

What the Moroccan economy clearly needs is a consistent and comprehensive fiscal program that would allow structural progress to bear fruit without the ever present risk of financial disarray in the public sector. This program should focus on cutting current expenditures, the establishment of a broad and fully operational basis for domestic taxation, and the protection of public investment plans from erratic capital spending reductions.

The staff has rightly considered these issues as the cornerstone of their discussions with the authorities. The staff's detailed assessment of the country's fiscal position is most relevant for the many political and operational difficulties which the authorities still encounter in establishing a sound fiscal program. While considerable progress has already been made and is probably still ahead, with projected reduction in current expenditures, particularly through the abolishment of the widespread system of food subsidies and the reform of the public enterprises, progress in implementing a sound tax system has been clearly lagging. It is regrettable that the urgently needed comprehensive tax reform is obviously so strongly resisted by Parliament and that the important measures such as the introduction of the individual income tax and the improvement of the tax administration will not be implemented before 1988 at the earliest. The achievement of the fiscal deficit objectives under the present program will therefore continue to rely heavily on ad hoc measures and the introduction of import tax measures, thereby partially reversing the process of trade and price liberalization, which is an important instrument of the authorities' medium-term strategy to establish conditions for a better allocation of resources.

Another unfortunate by-product of the postponement of the tax reform is the constant burden that continues to be placed on the public investment program for achieving the required minimum fiscal adjustment. The erratic changes in the execution of Morocco's investment program have for some time been the major weakness in domestic policy implementation. The staff report again highlights the many adverse spillovers of that weakness, not only with respect to its impact on growth and investment efficiency, but also with respect to the problems of arrears and of shortfalls in external assistance. I am pleased to note that understandings have now been reached on procedural arrangements to safeguard in the future the orderly execution of the investment budget, and I am confident that progress in this area will be carefully examined during the subsequent reviews under the present program. On previous occasions and especially on the occasion of the 1985 Article IV consultation with Morocco, I had suggested that a specific performance criterion to ensure a sufficient flow of domestic credit to development and investment outlays be incorporated in the framework of the general demand-management objectives of Fund programs. Bilateral contacts with the staff on the advantages and inconveniences of different techniques to pursue this objective have convinced me that it can be achieved most efficiently through the inclusion of targets on public investment in productive sectors in Fund programs, the implementation of which would preferably be assessed in the framework of periodic reviews. Given the inherent difficulty of monitoring Morocco's investment program, a further strengthening of the safeguards to protect the planned investment outlays might perhaps have been usefully considered. The same targets might have functioned as a trigger to prompt decisions on additional revenue-generating measures if needed.

In sum, I support the proposed decision because the conclusion of a new stand-by arrangement with Morocco is a further step in the country's comprehensive reform process. It demonstrates the authorities' intention to restore sound relations with foreign creditors, which in the light of the sizable financing gaps projected to persist over the medium term is of crucial importance to make Morocco's adjustment efforts successful. However, on the latter point, I cannot fail to be somewhat concerned that the financial policies put in place under the present program are not sufficiently comprehensive to deal efficiently with the elimination of Morocco's arrears problem. It should therefore be clearly understood that the authorities should continue to stand ready to take additional measures promptly if necessary.

Mr. Foot remarked that after the difficulties faced by Morocco in implementing the previous stand-by arrangement, and, subsequently in remaining current in its obligations to the Fund, it was encouraging to see the broad range of macroeconomic and structural measures included in the stand-by arrangement currently being considered by the Board. The program should be implemented fully and rapidly in order to maintain the confidence of the international financial community and to secure the required financing. The earlier the necessary measures could be put in place, the easier it would be to obtain that confidence. In that context, he would have welcomed the inclusion of more prior actions, particularly in areas that had proved difficult in the past. Additional prior actions would also have made it easier to justify the relatively generous amount of resources available under the stand-by arrangement. Although Morocco's overall access level was expected to fall during the life of the program, partly as a result of the net repayments arising from Morocco's drawing under the compensatory financing facility, under the credit tranches, Morocco's access would actually rise slightly during the course of the stand-by arrangement. He would appreciate the staff's comments on those issues.

He welcomed the broad range of structural and other policy measures included in the program, Mr. Foot indicated. Fiscal policy was central to the overall success of the program. Difficulties in that area in the past had led to the breakdown of the previous stand-by arrangement and had resulted in a buildup of domestic arrears to an alarming level of nearly 10 percent of GDP. Under the proposed program, Morocco was expected to pay off its external arrears in one year, although it would take many more years for domestic arrears to be eliminated. The main problem underlying those difficulties had been the weak revenue performance, forcing an excessive proportion of the authorities' adjustment efforts to be borne by expenditure, particularly capital expenditure. He agreed with Mr. Schneider's comments on that issue. It would be beneficial if the Moroccan authorities could eliminate consumer subsidies before the end of the 1990s, the deadline they had set for themselves. He wondered whether a more fundamental examination of employment levels in government services, perhaps with World Bank technical assistance, would have been justified or, indeed, was planned. The inclusion in the program of indicative targets for government revenue and expenditure was appropriate.

The weak fiscal position had placed strains on the implementation of monetary policy, Mr. Foot considered. The reduction in bank financing programmed for the second half of the current year and the next year should significantly ease the pressures in that area. The measures to increase the reserve ratio and to ensure that real interest rates remained positive were welcome. The restriction calling for banks to require a minimum provision of 25 percent from customers requiring foreign exchange should also help to improve the domestic liquidity situation, although there might have been a case for increasing that requirement, possibly even to 100 percent.

On the external position, Mr. Foot went on, the authorities had made significant progress in liberalizing the trade system, although the weak fiscal position had meant that progress in some areas had been slower than envisaged. The external position was likely to remain difficult over the medium term, not least because of the need to clear a significant amount of external arrears. As a matter of priority, the authorities should aim to achieve their goal of becoming current in their external obligations. The difficult medium-term debt position also suggested that a more active policy of promoting direct investment might have a useful role to play. He was therefore encouraged by the authorities' commitments in that area. It would be interesting to hear further details of the debt/equity scheme being considered by the authorities.

The adjustment program contained a number of important policy reform measures, Mr. Foot noted. In addition to implementing reforms in the public enterprise sector, reducing subsidies, and liberalizing trade, the authorities were taking steps to reduce price controls and reform the agricultural sector. Those measures amounted to a significant and important program of structural reform, which, if resolutely implemented, should improve the outlook for the economy in the medium term. The Fund and World Bank had supported Morocco's adjustment in the past and would continue to do so. He endorsed the proposed decision but reminded the Moroccan authorities that time was not on their side.

Mr. McCormack made the following statement:

I can support the proposed stand-by arrangement with Morocco. The economic and financial program proposed by the authorities contains a blend of far-reaching structural policies and the necessary monetary and fiscal measures designed to address Morocco's serious financial imbalances. Successful implementation of the program can be expected to consolidate the progress achieved in recent years, especially in the area of structural reform. However, one cannot ignore the fact that the previous stand-by arrangement became inoperative, in part at least, because of policy slippages which resulted in breach of a number of performance criteria. It is essential that such slippages be avoided on this occasion and I urge the authorities to expedite the implementation of a number of planned policy measures, particularly in the area of fiscal policy.

I wish to comment on four policy areas: structural, fiscal, monetary, and exchange rate policies. As what I have to say is, for the most part, supportive of the staff's analysis, I can be brief.

For a number of years, the authorities have been pursuing an ambitious program of structural reforms aimed at liberalizing the economy from direct controls and relying more on market mechanisms. Progress in the various sectoral reform programs, undertaken with World Bank assistance, has been quite impressive. The authorities intend to continue their reform efforts during the course of the proposed program in relation to pricing, trade liberalization--including membership of GATT--and agriculture. The new reform program, again supported by the World Bank, aimed at a comprehensive restructuring of the public enterprise sector is particularly welcome. It should promote the efficiency and financial viability of these enterprises and, over time, lessen their dependence on the government budget.

Fiscal policy remains a weak spot. In recent years, revenue performance has been quite disappointing with the result that the burden of fiscal adjustment has had to be borne by expenditure control; productive public investment was particularly hard hit. One source of difficulty was that the process of import liberalization, which inevitably had an adverse impact on revenue, ran ahead of the reform of the domestic taxation system. A better synchronization of the two processes would have minimized the loss of overall revenue yield. In the light of this experience, and in order to avoid a repetition of the delays which marked the introduction of the value-added tax, I join the staff in encouraging the authorities to expedite approval of the new individual income tax so that it can be implemented simultaneously with the new corporate income tax. These two taxes should be implemented as early as possible in the course of 1987, together with any further measures that might be called for to prevent short-term revenue loss. The other aspect of taxation which calls for vigorous and early action is a reduction in the number of exemptions under the various tax codes. In this connection, there would seem to be scope to increase significantly the tax contribution of the more dynamic and fast-growing sectors.

On expenditures, I have two points to make. First, I agree with the staff on the importance of strengthening the planning, budgeting, and monitoring system for investment expenditures. I note that in the report on the 1986 Article IV consultation (SM/86/197), the staff described this reform as "long awaited" and stressed that it "should be completed as soon as possible, and in any case before the new fiscal year beginning in January." Perhaps the staff might give an indication of what is the present target date for completion of this work. Second, I refer to the figure of 12,000 for net recruitment in the public sector. I wonder, is there any scope to reduce recruitment further. I note that in 1984, employment in the public sector actually fell by some 10,000.

Turning to monetary policy, the actions taken by the Bank of Morocco to absorb the counterpart of external payments arrears seem to be appropriate and well designed. In addition, the maintenance of positive real interest rates is clearly warranted in present circumstances and appears to be showing results in terms of an increased flow of financial savings. The further liberalization of the credit market planned for the beginning of next year is also welcome. In sum, the stance of monetary policy seems to provide solid support for Morocco's adjustment effort.

I welcome the intention of the authorities to exercise flexibility in the management of exchange rate policy. Understandings on the exchange rate policy to be pursued in 1987 are to be the subject of discussion in the course of the first review. While it might have been preferable to have reached agreement on the stance of exchange rate policy at the stage of program formulation--to revert to a theme of the discussion two weeks ago on program design and performance criteria--the factors by which exchange rate policy is to be guided have been identified, at least in general terms, and one hopes that the necessary understandings will, in the event, be reached without undue delay.

Finally, I join the staff and previous speakers in encouraging the authorities to make maximum progress in their adjustment effort while external and domestic circumstances remain relatively favorable. We can support the proposed decision.

Mrs. Ploix made the following statement:

Consideration of Morocco's request for a stand-by arrangement should be viewed as a follow-up of the Board's August discussion of the 1986 Article IV consultation with Morocco. Even if some delays have occurred, I commend both the staff and the authorities for having succeeded in putting into action the wishes expressed by the Board three months ago. As the Chairman indicated in his summing up of that discussion, Directors hoped that "the authorities could be in a position to implement a comprehensive and reinforced program which could be supported by the use of Fund resources." We are pleased to acknowledge the authorities' commitment and rapid action to achieve this result.

The Moroccan economy has experienced relatively favorable developments in the past few quarters. It is thus possible to focus on medium-term perspectives. The medium-term scenario appears highly ambitious in view of the choices the staff correctly presents. We welcome the ambitious objectives but stress that the authorities' strong determination will be required to reduce the remaining imbalances. Their willingness in this respect should be manisfested through a strong management of the economy as well as greater flexibility in reacting to changes in the external environment, particularly to avoid the emergence of difficulties in the relations between Morocco and the Fund during the course of the program. Above all, these qualities are indispensable for producing the projected results, particularly with regard to the large current account surpluses expected for 1988-93.

As for the specific aspects of the program, I will comment briefly on fiscal policy, monetary policy, and structural reform. The reduction of the fiscal deficit is of paramount importance. On the expenditure side, I welcome the authorities' commitment to confine public service recruitment strictly within the framework of renewed wage freezes. Likewise, limitations on other expenditures have to be strictly enforced and the reduction in subsidies carefully pursued. This is the only way to provide room for the planned investment budget, control over which would certainly be improved by reforms to be implemented by World Bank assistance.

On the revenue side, we consider that broadening the previously initiated tax reform is a necessary step. A rapid implementation of the new income tax and a re-examination of the tax base would be welcome. These measures are a crucial means for ensuring the ability to react flexibly to adverse developments, which is critical since the reduction of the fiscal deficit lies at the core of the entire program.

On monetary policy, I welcome the authorities' commitment to maintaining real interest rates within the context of declining inflation. The effectiveness of monetary policy and the program as a whole would be improved through the expected reduction in external and domestic payments arrears. In this respect I welcome the built-in flexibility of the performance criteria and strongly urge the authorities to reduce domestic arrears within the framework of the World Bank loan. As this measure is long overdue, it should be implemented according to the scheduled timetable.

The staff report gives us a very interesting description of the structural reforms to be included in the program. They constitute the clear continuation of progress already achieved in this area, particularly in the reform of public enterprises, in trade and price liberalization, and in increasing the efficiency of the agricultural sector. In these areas, World Bank support through various programs will be of great help. I hope that no further delays will arise in negotiations with the Bank.

Morocco's external debt burden is already heavy, and financing requirements will be important in the years to come. The greatest caution is therefore required with respect to borrowing under commercial terms.

I reiterate that my authorities welcome and support the proposed decision. They commend the Moroccan authorities for having embarked on a comprehensive program. Indeed, in pursuing the agreed policies, responding in a timely and flexible manner to future developments, and taking advantage of recent favorable external factors, the Moroccan authorities will build a base for the sustainable development of their economy.

Mr. Sugita stated that he welcomed the agreement between the Moroccan authorities and the Fund on the adjustment program, which aimed to rectify the slippages that had occurred under the previous stand-by arrangement and to reduce the financial imbalances, while maintaining adequate economic growth and keeping inflation under control. Considerable progress had already been made in addressing the structural problems related to pricing, trade, and agriculture. However, financial control, particularly in the fiscal field, remained weak. That weakness had been manifested in the recent slippages and in Morocco's external debt servicing difficulties. The authorities had taken advantage of the favorable conditions, including the record harvest, to strengthen their adjustment efforts.

However, he was somewhat concerned that the brunt of fiscal adjustment would be borne mainly by the expenditure side during the program period, given the delay in implementing far-reaching measures on the revenue side, Mr. Sugita commented. In view of the possible temporary nature of the favorable environment, it was essential that the authorities intensify their efforts to ensure fiscal control, more specifically, by designing and implementing tax reform at the earliest opportunity.

While he welcomed the programmed reductions in the fiscal deficit for 1986 and 1987, fiscal adjustment relied relatively heavily on expenditure restraint and trade-related revenue measures, Mr. Sugita noted. It was regrettable that measures of a more basic nature, addressing the narrow domestic tax base and poor tax administration, had not been specified in the program. The early introduction of an individual income tax was necessary both to strengthen the tax base and to avoid a short-run revenue loss arising from the introduction of a new corporate tax.

To avoid the recurrence of domestic arrears, the reform and rationalization of procedures for public investment needed to be expedited, Mr. Sugita considered. He welcomed the progress in the negotiations with the World Bank on the sectoral adjustment program for the public enterprise sector, the success of which would contribute to an improvement in the fiscal position in coming years.

On monetary policy, the reduction in bank financing of the Government should continue to slow the growth of monetary aggregates in the second half of 1986 and in 1987, Mr. Sugita considered. The restrictive monetary stance, as evidenced in the current year by an increase in the reserve ratio and the maintenance of positive real interest rates, needed to be continued to achieve an increase in the financial assets and to eliminate external arrears.

On structural reforms, he welcomed the continued efforts by the authorities to implement measures in the areas of external trade, pricing policy, and agriculture, in the context of the sectoral adjustment program with the World Bank, Mr. Sugita indicated. While it would take some time before the full benefits of those measures were reaped, they constituted the basic conditions for achieving adequate and sustainable economic growth over the medium term.

The importance of the flexible exchange rate policy was well illustrated by the contribution that the real effective depreciation of the currency, together with the decline in oil prices and the reduction in imports, had made toward reducing the current account deficit in 1985 and 1986, Mr. Sugita pointed out. It was also important that the authorities maintain an adequate level of gross reserves in view of the past buildup of arrears to the Fund. In sum, progress that had been made in structural reform and the balance of payments should be complemented by an improvement in the performance of the public sector, which had been the cause of the slippage of the previous program. He hoped that measures aimed at broadening the tax base and strengthening tax administration would be specified and implemented during the program period. Finally, he could support the proposed decision.

Mr. Grosche remarked that the Moroccan authorities appeared to be in a good position to implement vigorously a comprehensive and reinforced economic program. The decline in oil prices and the good harvest in 1986 had presented Morocco with a favorable environment within which to pursue economic adjustment. Nevertheless, the balance of payments position remained vulnerable, in part because of the heavy external debt burden. It was therefore of critical importance that adjustment measures be implemented forceably and that any slippages be avoided. The adjustment program represented a step in the right direction and deserved the Board's full support.

As he had commented on Morocco's economic performance at length on the occasion of the 1986 Article IV consultation and as he was in full agreement with the staff appraisal, he would make only three brief points, Mr. Grosche indicated. On fiscal policy, the most critical area of adjustment, it was important that the authorities speed up the reform of the domestic tax system, with a view to broadening the tax base and increasing the country's overall tax efforts. He welcomed the objective of lowering the government deficit to 4.5 percent of GDP in 1987, particularly as that was intended to be achieved without resorting once again to cuts in investment expenditure. In the past few years, investment expenditure had borne the bulk of fiscal adjustment--a matter for serious concern.

The authorities' efforts to liberalize prices of a large number of products were commendable, although more remained to be done, Mr. Grosche commented. For example, given the inflation rate of 7 percent, he wondered whether the increases in producer support prices for 1986/87 of 5-10 percent would be sufficient to encourage agricultural production. Likewise, the tariff adjustments in 1986 for rail transport, electricity, and water might be insufficient. Did the adjusted prices reflect cost developments or did they still contain major elements of subsidy? More generally, he had hoped for a precise and ambitious timetable for implementing a thorough price reform. Regrettably, there was only a vague indication that administrative controls on practically all goods would be eliminated by 1988. A precise timetable would be useful to help the authorities fulfill their commitment to eliminate all subsidies for food prices by 1990.

It was interesting to note that the Government intended to study ways of converting part of Morocco's external debt into equity, Mr. Grosche said. He commended the authorities for their intention to encourage foreign direct investment, but he wondered if the staff could indicate the possibilities for an equity swap in Morocco's case. In conclusion, he supported the proposed decision.

Mr. Romuâldez made the following statement:

A remarkable improvement has clearly been realized in the Moroccan economy. The progress, which Directors commended during the 1986 Article IV consultation discussion, seems to have been maintained. Much of this progress may be attributed to favorable external developments, notably the decline in petroleum prices and the continued drop in international interest rates. An improvement in the weather has also helped significantly. However, policy actions, especially in exchange rate management and price and trade liberalization, contributed to the improvement more than any other factors, resulting, inter alia, in increased nonphosphate exports, a rise in tourism receipts, and higher remittances from abroad. The external current account deficit has been reduced substantially. Bumper harvests have reduced imports significantly. The economy as a whole has registered a growth rate of about 5.5 percent, and this has been achieved without intensified inflationary pressures.

However, the authorities must be commended as much for their decision at least to address financial imbalances that continue to enervate the economy by adopting an adjustment program supported by the Fund as for their achievements to date. By so doing, they are taking the tide at its highest point, making full use of the room for maneuver that the favorable environment has afforded them.

The medium-term policy framework is appropriate: further trade and price liberalization, efficiency in the agricultural sectors and in financial intermediation, and training and development of manpower. In order to improve external competitiveness and increase productivity, greater reliance on market mechanisms should be cultivated and administrative controls loosened, if not entirely eliminated. The problem of subsidies needs to be addressed much more vigorously than has been envisaged. The authorities have done well in approaching the reform of the public enterprises in a comprehensive manner. Moreover, we are pleased that the need for World Bank assistance and support has been recognized. Progress in this area is crucial to the program's success, and consequently, we look forward to its launching in 1987. It is equally urgent if the fiscal reform--the core of the program--is to succeed that efforts be intensified to improve the tax system, reduce the growth of nonessential public expenditures, and raise productive public investment.

We can go along with the strategy proposed for 1986-87, namely, to maintain control over inflation even as adequate economic growth in realized, while reducing external imbalances further. Implicit in this must be the elimination of external arrears and some increase in international reserves. Like the staff, we believe it appropriate to focus adjustment efforts on the fiscal sector. The fiscal program outlined seems formidable and leaves no room for slippages, especially in the area of improving revenue prospects. In this connection, the need to improve the buoyancy of government revenue gains in significance. We particularly welcome the authorities' intentions to scrutinize and reform government procedures for planning, budgeting, and monitoring public investment expenditure. By recognizing the need ultimately to reduce and eliminate subsidies and transfers, the authorities have begun addressing, albeit in a relatively small way, what seems to constitute a major drain on the public finances. However, we are somewhat concerned about the slow pace they have set for dealing with those problems.

Monetary policy seems sufficiently supportive of the program envisaged for 1986-87. The staff's discussion of the authorities' monetary policy is especially thorough.

The short paragraph in the staff report on the exchange rate seems to indicate hesitation or a posture that is somewhat short of the flexibility that we think is appropriate in Morocco's present situation. We were consequently pleased to learn from Mr. Kabbaj's opening statement that the authorities are indeed committed to applying a flexible exchange rate policy.

The agenda for the first review, to be undertaken by end-February 1987, strikes us as heavy, although necessarily so. The issues to be dealt with are fundamental to the success of the adjustment effort and, therefore, need to be in place sufficiently early to be truly effective. The particular areas of concern are the 1987 budget as adopted by parliament, the financial policies associated with it and their impact on the program; the progress in external assistance mobilization, including debt service rescheduling; the program of reform for public enterprises; the plan for clearing government arrears; and credit and exchange rate policies. This review is also expected to deal with possible changes in indicative targets for investment expenditures and the 1987 financing of public enterprises. It would have been preferable if some of those issues had been settled by now, especially those relating to the exchange rate policy. We were heartened to learn from the staff about the progress achieved so far on the rescheduling arrangements. In the meantime, we are content to await the first review for clearer and more definite presentation of the authorities' approaches to these other problems.

Medium-term prospects are extremely uncertain; much depends on very close adherence to the program, on strict and responsible debt management, and on decisive action regarding structural reforms and prudent demand management. The financing gaps projected over several years can be covered only with concerted support from various sources, namely, the World Bank, the African Development Bank, bilateral sources, and commercial banks. The likelihood of successful aid efforts from these various sectors of the international community depends on the commitment shown by the authorities in the coming months to this program of adjustment. It will require very fine orchestration, but it can be achieved with help from the World Bank and the Fund. At the moment, we are convinced of the authorities' commitment. We support the proposed decision.

Mr. Noriega made the following statement:

The progress made during 1985 and 1986 in correcting the internal and external imbalances of the Moroccan economy, together with the recent agreement with the commercial banks, represents an opportunity for further adjustment, which will lay the ground for sustainable improvements in social welfare. The economic program proposed by the Moroccan authorities takes advantage of that opportunity, and we therefore support their request for a stand-by arrangement.

However, we agree with Mr. Kabbaj that the program is not risk free. We need to be cautious in our optimism, since in spite of the progress made thus far, previous programs have faced obstacles preventing the observance of performance criteria and causing the cancellation of the adjustment program. In fact, Morocco has made prolonged use of Fund resources. It is thus important to embark on a realistic program, which may inspire the confidence of all interested parties, including particularly, the creditors and donors whose support for this program is crucial. As the Board reviewed economic developments in Morocco only last August, at which time this chair commented extensively on recent developments, and as we are in broad agreement with the staff report, I will limit myself to raising a few points.

With respect to public finances, given the limited scope for a prompt reduction in current expenditures, special attention should be directed to the implementation of the tax reforms envisaged in the program. It is important that the new sources of revenue associated with foreign trade contribute simultaneously to reduce the dispersion of import and export tariffs so as to avoid undesirable biases in the system and, thereby, to encourage investment in the most productive sectors of the economy. Other types of biases may result if the timing of the adoption of fiscal measures is disrupted. Therefore, the authorities must consider introducing an individual income tax if public revenue falls short of the objectives for 1987.

Regarding the external sector, the exchange rate appears to have contributed to the promotion and diversification of nontraditional exports, and the assumptions underlying the evolution of imports and exports seem to be realistic. Nevertheless, prospects are not very reassuring: foreign debt will remain relatively high, though decreasing, imposing a heavy service burden on the productive capacity of the economy; the trade balance will continue to depend critically on international prices and on the weather; and the recent agreement with the commercial banks only postpones for a couple of years the problem of covering the financing gap.

To cope with these risks, the authorities will have to rely increasingly on flexible demand-management policies to react promptly to exogenous developments. The phasing out of direct trade restrictions and the promotion of a progressively open economy precludes the use of the exchange rate as an instrument for permanently enhancing export competitiveness without endangering price stability.

In the financial sector, efforts to reduce external trade arrears should not lead to an overexpansion of domestic credit. Perhaps a mechanism could be designed to channel resources to those sectors that are reducing their net foreign indebtedness. Instead of linking the quarterly credit ceilings to the reduction in arrears, the ceilings could be related to the evolution of net foreign reserves at the central bank. This could be a more direct and healthy indicator of excess liquidity in the economy. I invite the staff to comment on this issue.

Finally, regarding the arrangement itself, it seems that the Moroccan authorities are well aware of the fact that one underlying constraint to economic growth is the availability of foreign exchange, in part owing to the heavy burden of external debt. Therefore, the performance criterion establishing a ceiling on contracting new nonconcessional debt might be redundant if concessional financing is available, or difficult to comply with if concessional financing is not available. My authorities support the economic program proposed by the Government of Morocco.

Mr. Lundstrom made the following statement:

Morocco's request for a stand-by arrangement covering the last quarter of 1986 and the year 1987, is a positive development and is in line with the recommendations made by the Executive Board at its discussion of the 1986 Article IV consultation with Morocco. The request is made against the background of Morocco's substantial level of external indebtedness and its need to reduce the high debt service ratio. The comprehensive program being considered follows the 1985 stand-by arrangement, which became inoperative after the authorities failed to satisfy the performance criteria. Moreover, understandings could not be reached on the corrective measures needed to put the program back on track. It is, therefore, important that the new program will be closely monitored through quantitative performance criteria and indicative targets, and that additional measures be taken if required to ensure adherence to the program. The three reviews scheduled for February and September 1987 and February 1988 seem to be appropriately timed in order to monitor budget policies and the general execution of the program.

I am in full agreement with the aims of the program. Like previous speakers, I want to stress that the success of the program will largely depend on the successful implementation of fiscal policies. It is encouraging that the authorities have already taken steps in this area, including improving collection of the petroleum levy, freezing the expenditure commitments in the investment budget, and reducing the backlog of uncollected profit taxes. However, as the authorities are fully aware, much more remains to be done. Given the disappointing revenue performance in 1984, they intend to introduce a new package of revenue measures. In this context, it is reassuring that the program includes a quarterly indicative target on government revenue. I note that owing to the lack of buoyancy of government revenue, the brunt of fiscal adjustment in recent years has been borne on the expenditure side of the budget. The question is whether past reductions in current expenditures have not made further significant decreases on the expenditure side very difficult to achieve or perhaps even unattainable. Could the staff or Mr. Kabbaj comment on this?

As for monetary policy, it is encouraging to note that most interest rates are positive in real terms. This factor, combined with the authorities' intention to maintain unchanged the current interest rates in the face of easing inflationary pressures, will certainly support efforts to retain the growth of credit and liquidity. I welcome the steps toward liberalization of the credit market, including the elimination of subsidies on new lending, although I note the housing and coastal fishing sectors are still eligible for such subsidies.

The exchange rate has remained constant in real effective terms for most of this year, with a possible marginal appreciation in the last quarter. The exchange rate will have to be kept under constant review to ensure that the balance of payments targets can be achieved.

I welcome the comprehensive structural reforms envisaged in the program. I am pleased to note that in addition to a combination of programs of reform in pricing, trade, and agriculture, a major innovation in 1987 will be the launching of a comprehensive restructuring of the public sector, a program to be supported by the World Bank.

In order to finance an additional program of public investment, the Government is seeking additional external resources on highly concessional terms of up to SDR 100 million, and for this purpose, the World Bank will convene a Consultative Group meeting in February. There is strong competition between developing countries for concessional finance, and it is important that the limited funds available flow to those countries where they can be put to the most productive use and where an increase in domestic savings is not a realistic alternative in the short term. In this connection, the sharp improvement in the terms of trade and other favorable circumstances highlighted by the staff should be taken into consideration. I would, therefore, appreciate any comments Mr. Kabbaj may wish to make in this regard, for example, on the yield potential of the additional program of public investment and on the calculations underlying the amount of external resources sought--SDR 100 million. I should add that I do not raise this question in a negative spirit. I fully agree with Mr. Kabbaj that "it is unfortunate that the attainment of the program objectives necessitates further cuts in the investment expenditure especially considering the sharp cuts in the preceding years." Obviously, such further cuts should be avoided to the extent possible, be it through an enhancement of revenues and savings or by securing additional external resources.

The proposed stand-by arrangement is a positive development and I fully support it. A strong commitment on the part of the authorities is required to implement the envisaged measures, particularly in the fiscal area. The program also needs close monitoring, as well as the support of the international financial community.

Mr. Song made the following statement:

The Moroccan authorities are to be highly commended for the policy measures they have taken in the fiscal and monetary areas, and for the structural reform they have pursued in the past several years to correct the macroeconomic imbalances in their economy. In taking advantage of the current relatively favorable external environment, the authorities are ready to continue to pursue a more comprehensive adjustment program for 1986/87. Their strong determination to continue the adjustment process has been fully reflected in the letter of intent, in which they request a stand-by arrangement with the Fund. I fully support the authorities' request and endorse the proposed decision.

In addition, I would like to draw the attention of the staff to the following two points. First, the economic and financial program designed for Morocco is based mainly on the relatively favorable external environment prevailing at present, and it is assumed that this favorable external environment will continue during the program period. However, exogenous factors may change at any time beyond our expectations, undermining the program assumptions. Therefore, changes in external factors should be taken well into account when the forthcoming reviews are conducted, especially if questions regarding the nonobservance of performance criteria or eligibility for phased drawings by a member are raised.

Second, since there will be financial gaps over a number of years and nonconcessional external borrowings are restricted by limits in the program, it is imperative that, in addition to the structural adjustment loans being considered by the World Bank, the Fund, in close cooperation with the World Bank, assist the authorities in mobilizing more concessional flows of capital from other official sources as quickly as possible in order to facilitate the successful implementation of the program.

Mr. Zecchini remarked that the Moroccan economy had made considerable progress in 1985-86: the inflation rate had eased, real GDP growth had increased, and the current account deficit had been reduced. In spite of such positive results, progress had been slower than expected in the fiscal sector. The fiscal deficit on a cash basis would remain larger in 1986 than originally projected under the previous stand-by arrangement. Moreover, by end-1986, domestic arrears would not be reduced from the amount outstanding at end-1985, amounting to almost 8.6 percent of GDP. The adjustment program currently being considered by the Board correctly addressed the key imbalances of the Moroccan economy by emphasizing the objective of ensuring a reasonable and lasting rate of growth, and the need for a quick restoration of financial equilibrium. It therefore deserved the Board's support.

On more specific aspects of the program, Mr. Zecchini went on, he would touch on fiscal, monetary, and external policy measures, as well as structural adjustment. Fiscal developments indicated that the authorities needed to concentrate their adjustment efforts on the revenue side. He supported the objective of increasing tax revenues to 22.2 percent of GDP by 1987, although such a target would barely match the 1985 ratio. The most important measures in that respect would be a 2.5 percentage point increase in import duty rates and the application of a special import tax on cereal, which had been exempted previously. Such measures would yield immediate significant benefits in terms of government revenues. However, it seemed a step in the wrong direction in the process of promoting further liberalization of imports and reducing effective protection. The Moroccan authorities had expressed their willingness to pursue both of those objectives, and significant progress had been made in the recent past, as import duty revenues had declined as a proportion of imports to 16 percent in 1986. The prompt implementation of the reform of domestic taxation was essential, and he agreed with the staff that the approval of the new individual income tax should be accelerated so that it could be introduced simultaneously with the new corporate tax. He also commended the initiative of the Government to establish a working group on fiscal reform with the technical assistance of the Fund and the Bank. The weak revenue performance had placed the burden of adjustment on domestic budget expenditures in recent years. In that respect, the future consequences of the significant reduction in investment budget expenditures that had occurred recently was a matter for concern. Owing to the high level of recurrent expenditures in the domestic budget, the impact of those reductions on productive public investment had been even stronger. He therefore endorsed the objective of the present plan of maintaining investment expenditures as a percentage of GDP and, in 1987, of concentrating the expected budget cuts on current expenditure. The planned reform on the planning, budgeting, and monitoring procedures of public investment expenditure was also welcome.

As for the reduction of the domestic arrears, an essential element in the process of correcting fiscal imbalances, the targets included in the present plan were somewhat less than satisfactory, Mr. Zecchini considered. The current program aimed only at maintaining the level of arrears outstanding between end-1985 and end-1986, while the previous stand-by arrangement had envisaged a significant reduction by end-1986. Moreover, such an objective implied that given the substantial payment of arrears that had taken place in the first part of 1986, an accumulation of new arrears of a similar amount would be permitted in the last quarter of 1986. Such an accumulation would amount to about DH 1.7 billion, equal to almost 15 percent of outstanding arrears at end-1985. Therefore, in spite of the envisaged reduction of treasury arrears in 1987, established as a performance criterion under the present arrangement, arrears would remain at a level that was significantly higher than that reached in September 1986. It would be useful to hear the staff's views on that aspect of the program, especially on the rationale for allowing a buildup of domestic arrears in the second part of 1986 after the significant improvements obtained in the first part of the year.

On monetary policy, a major deceleration in the rate of growth of domestic credit expansion would be required in order to slow the growth of domestic liquidity and improve the external position of the country, Mr. Zecchini remarked. Hence, he agreed on the 10.4 percent target for the rate of growth of domestic credit for 1986, compared with the 15.4 percent increase in 1985. In spite of the deceleration of credit growth to the private sector, including some public enterprises, from 16.5 percent in 1985 to 7.4 percent in 1987, private sector liquidity was expected to ease in 1987 through the programmed reduction of government arrears to the public and private sectors. He would be interested to learn from the staff whether if the reduction in government arrears turned out to be lower than expected, the tightening of liquidity to the private sector might be too severe, taking into account that nominal GDP was projected to be over 10 percent by end-1987. He commended the authorities for maintaining unchanged the nominal interest rate in 1985 and 1986 and for allowing a rise in real interest rates. Those measures had helped to restrain the growth of credit and liquidity in the system and to strengthen monetary policy management, which had been greatly complicated by the buildup of external payments arrears.

With respect to external policies, he supported the authorities' commitment to continue the trade liberalization progress begun in 1984, which was based on the simplification of procedures and the reduction of import duties, Mr. Zecchini indicated. He also recommended the pursuit of an exchange rate policy aimed at maintaining external competitiveness in order to improve the performance of manufactured exports and to foster the diversification of exports in nontraditional areas.

His chair attached considerable importance to structural policy measures in order to bring about a lasting improvement of the Moroccan economy, Mr. Zecchini reiterated. He therefore recommended the inclusion in the program of reforms in pricing, trade, and agriculture, as well as the launching of the comprehensive restructuring program for public enterprises. He acknowledged the efforts undertaken since 1983 with respect to price liberalization and noted the authorities' firm commitment to eliminate all subsidies by 1990.

Mr. Yao made the following statement:

> Since recent developments in the Moroccan economy were reviewed in August during the Board's discussion of the 1986 Article IV consultation, I will focus my remarks on the objectives and policy content of the proposed stand-by arrangement. However, before doing so, I would like to commend the Moroccan authorities for implementing the necessary measures that paved the way for the negotiations which led to this adjustment program.
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> I found the objectives of the program--the restoration of a sustainable rate of economic growth and achievement of financial balances--realistic and attainable in view of the decisive measures the authorities have adopted and intend to adopt under the program. The emphasis placed on both demand management policies and structural measures will encourage economic growth while bringing about internal and external balance in an orderly manner. In that context, I encourage the authorities to undertake the structural reform of the state enterprises promptly. This reform, which aims at either making them more profitable or transferring them to the private sector, is a step forward and its implementation will have a beneficial effect on the budgetary outlook. I also welcome the introduction of a more flexible producer pricing policy and the liberalization of the prices of a large number of goods. The dismantling of major restrictions coupled with the granting of tax incentives to small businesses would lay the foundation for the development of a dynamic private sector.
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> As reported by the staff, the financial position of Morocco has remained weak and has led to the accumulation of internal and external arrears. To cope with these unfavorable developments, the authorities have appropriately made fiscal policy a central element of the adjustment program. Their efforts to increase revenues through an efficient tax system is consistent with the medium-term fiscal objectives of the program. In that regard, I note with interest their intention to broaden the tax base by introducing a minimum tax on interest income. I also welcome the authorities' intention to explore ways to cut back fiscal exemptions and improve tax administration, and I hope that the implementation of the tax reform will be accelerated. However, I have a question about the nontax receipts to be raised through transfers

from publicly owned enterprises to the Treasury. Can the staff elaborate on the advantages of this option, compared with taxes on profit or distribution of dividends?

Regarding the Government's efforts to contain expenditure, I welcome the fact that total government expenditure in relation to GDP is expected to fall in 1986 and to fall further in 1987, but it is regrettable that investment is bearing the brunt of the adjustment. The share of investment in total expenditure declined from 24 percent in 1985 to about 17 percent in 1986 and 1987. I urge the authorities to reverse this trend by continuing to contain the growth in current expenditure. For example, the reduction in subsidies and the cap set on recruitment in the public sector are steps in the right direction.

As for monetary policy, I welcome the tightening of credit envisaged under the program and hope that sufficient resources would be available. In that regard, the reduction of the fiscal deficit contemplated under the program could free more resources for the private sector. Furthermore, by continuing to maintain positive interest rates, the authorities will be able to curtail capital flight and mobilize adequate financial savings, including remittances.

In conclusion, I recognize that the Moroccan authorities have shown a great deal of determination in carrying out their adjustment program. I am greatly encouraged by Mr. Kabbaj's indication that his authorities are committed to pursuing their adjustment efforts. They therefore deserve the support of the international financial community. I support the proposed decision.

Mr. Munthali made the following statement:

I support Morocco's request for a stand-by arrangement. The authorities have put together a strong and comprehensive adjustment program, which deserves the support of the Fund. The immediate aim to reduce the internal and external imbalances is appropriate. I also agree with the authorities' approach to place the short-term stabilization measures in the context of a medium-term strategy, since Morocco's problems are deep seated and, therefore, of a long-term nature.

Recent developments in Morocco's economic situation provide a good basis for implementing a strong adjustment program successfully. Since 1985, there have been some favorable developments, both on the domestic and external sides, which could facilitate the task of implementing the planned measures. For example, agricultural production, particularly cereal output, was boosted by good weather conditions. This provided the impetus for a more rapid growth of the economy compared with previous years. Real GDP grew by 4.3 percent in 1985 and was expected to grow even faster in 1986, by 5.5 percent.

With an improved food supply situation, the rate of price increases was expected to slow somewhat. On the external front, the sharp reduction of the current account deficit was assisted by a fall in the price of petroleum, a decline in interest rates, and increases in receipts from tourism and workers' remittances. These favorable developments place the authorities in a better position to implement measures that would prove difficult during periods of adverse developments. It is also my belief that under these conditions, the measures adopted and being contemplated under the program could yield results more rapidly. I therefore encourage the authorities to press ahead with their adjustment efforts and to strengthen the program wherever necessary in order to achieve the desired results.

I am aware that these adjustment efforts are being severely complicated by a very large overhang of external debt. Although the magnitude of Morocco's debt is small compared with that of more heavily indebted countries, it is nevertheless equally burdensome and places severe constraints on the performance of the economy. Total debt outstanding is equivalent to over 100 percent of GDP, while debt service payments represent well over 50 percent of receipts from exports of goods and services. At this level of indebtedness, a durable solution to the problem would obviously imply certain sacrifices by the Moroccan authorities and, more important, by their creditors. In that regard, efforts should also be directed at raising Morocco's debt servicing capacity as quickly as possible. This would provide the assurance that obligations falling due in the future would be met without interruption. It is in this regard that we have looked at the proposal to transform some of the debt into equity with great interest. I wonder how actively this proposal is being considered by the authorities and their creditors. I would appreciate if the staff could give some indication of the feasibility of the proposal. It is certainly true that a more durable solution to Morocco's external debt problem will take some ingenious proposals, perhaps going beyond the scope of traditional rescheduling arrangements, which have been included in the program.

I note that apart from the normal quantitative ceilings, the program includes a series of indicative ceilings which are intended to initiate consultations with the Fund. On fiscal operations, in particular, there are quarterly indicative ceilings on both expenditure and revenue. All this is in addition to the review clauses established under the program. Ceilings of this sort constitute a very tight monitoring of the program. I could well understand this mode of monitoring the program in instances where the country's administrative capacity is thin and where a program is not clearly specified. I am not so sure whether this is true in the Moroccan case. The need to include these indicative ceilings, which would spark off consultations with management, was perhaps influenced by Morocco's track record. However, I wonder what these ceilings are expected to achieve, since reviews have already been provided for in the program. I would have thought that those review provisions would provide the basis for assessing the evolution of the assumptions underlying the program. I would appreciate any comments that the staff may have on this matter.

Ms. Bush stated that the adjustment program presented by the Moroccan authorities could lay a sound foundation for a strengthened external payments position over the medium term. Economic performance had already recovered strongly owing in part to past policy adjustments, including exchange rate changes, and owing to some favorable exogenous developments. The close cooperation among the Fund, the Bank, and the Moroccan authorities in formulating an integrated set of economic policy measures was a central aspect of the program. The Bank's support for overall reform of the public enterprise sector and other sectors such as agriculture, finance, and education were important to the program. In addition, the Bank and the Fund had encouraged trade liberalization, an effort that might finally have paid off by strengthening the competitive sectors of the economy, as evidenced in the high growth of manufactured exports. The structural reforms were welcome and would lay the foundation for continued growth and a sustained improvement in the external accounts in the medium term.

She welcomed the reduction in the fiscal deficit in 1986 and the expected further reduction to a targeted deficit of 4.4 percent of GDP in 1987, Ms. Bush indicated. She was disappointed that the fiscal deficit for 1985 had been more than 10 percent of GDP, compared with the target of 6 percent of GDP. She encouraged the authorities to maintain their fiscal efforts in the medium term, in particular, through tax reform, an area in which performance had been disappointing. The problems arising from the present extensive set of exemptions, which narrowed the tax base, required prompt attention. She urged the authorities to implement the tax reform package as soon as possible, although it appeared that the best that could be hoped for was for the corporate and individual income tax packages to be initiated in 1988. She would appreciate comment on why the revenue measures for 1987 emphasized increases in import duties, when the Moroccan tax system was already characterized as being overly dependent on import taxation.

The authorities' intention to maintain stricter control over expenditures in 1987 was also welcome, Ms. Bush remarked. There had been a sharp drop in the ratio of expenditure to GDP from 37 percent in 1981 to about 27 percent at present. Unfortunately, the brunt of that reduction had fallen on investment expenditure. Some of the concerns raised by Directors in earlier discussions of Morocco's economy, in particular with respect to investment budgeting, appeared to have been addressed in the present program. However, she wondered if there was perhaps more room for savings on current expenditures. There had been continued reductions of some consumer subsidies and more cuts were planned for next year, including some consumer subsidies, but the authorities also intended to hire more government employees and she wondered about the effects of that move on the budget. The public enterprise reform was an important element of the planned overall fiscal improvement. With the help being provided by the World Bank, that reform package could set the stage for a broad reorientation of the roles of the public and private sectors in Morocco. She would be interested in hearing the views of the Bank staff on the projected implementation of that project once the World Bank and Morocco had reached agreement. The increasing interest of the authorities in promoting foreign direct investment could be meshed with their reform program in the enterprise sector. The advantage of the investment code would be extended to foreign investors and not only to those investments that had 50 percent Moroccan ownership, as in the past. She welcomed that development. She would be interested to learn any further details on the study to be carried out on the potential for debt equity swaps.

A number of the concerns expressed by her chair at the Board discussion of the 1986 Article IV consultation with Morocco had been addressed in the current program, Ms. Bush noted. She supported the efforts of the authorities to implement broadly based trade liberalization measures, while adjusting the exchange rate and interest rates. Those policies appeared to be paying off, with strong growth of manufactured exports expected, together with a strong influx of workers' remittances and tourism receipts. She also welcomed Morocco's intention to join the GATT. Based on those adjustment efforts, Morocco's debt profile was projected to improve significantly. She hoped that the measures taken by the authorities were indicative of a continued strong commitment to the macroeconomic and structural measures that could lead Morocco to a future of strong growth and financial stability, as well as a return to voluntary support in the private financial markets. Given Morocco's prolonged use of Fund resources, the Fund should play more of a catalytic role in the future, with Morocco's traditional creditors and donors providing financing.

While she hoped to support the proposed stand-by arrangement, she was concerned about the performance criterion on external arrears and the overdue valuation payment, Ms. Bush indicated. It would be difficult to support the proposed decision while Morocco had an outstanding payment to the Fund. In addition, it was questionable whether Morocco could meet the end-year performance criterion on external arrears. She would welcome the staff's comments on those issues.

Mr. Salinas stated that he was in broad agreement with the staff appraisal and supported the proposed decision regarding Morocco's request for a stand-by arrangement. The adjustment program presented by the authorities represented the appropriate combination of macroeconomic and structural policies that were required to ensure the continuation of the adjustment process and the achievement of a sustainable rate of economic growth in the medium term. The timing of the renewed effort was most appropriate, given the favorable external and domestic environment, characterized by a sharp fall in the price of oil, a reduction in interest rates, a continued growth in tourism receipts, an increase in workers' remittances, and a record harvest, which virtually eliminated the need for any cereal imports in the second half of 1986.

On the specific measures embodied in the program, fiscal policy remained central to the adjustment process, particularly in view of the high level of domestic arrears, which reflected the relatively weak performance of revenues in the past several years, Mr. Salinas considered. A major and comprehensive effort would be needed in that area, in particular, by the full implementation of a tax reform program aimed at broadening and rationalizing the tax base. He agreed with Mr. McCormack on the need to make the process of trade liberalization compatible with the reforms being adopted in the tax system. Could the staff comment on whether it would be possible to liberalize the trade system in a relatively short period, while putting into effect a new tax system that would compensate for lower import receipts? The increases in import duties planned for 1987 were inconsistent with the major objective of trade liberalization. There was room for a further increase in revenues by reducing current tax exemptions granted in the framework of the investment code applied to a number of sectors in the economy. The elimination of such tax exemptions would not only boost revenues, but also help to improve the efficiency of resource allocation. If the revenue-raising measures were not accelerated, the bulk of fiscal adjustment would continue to fall heavily on expenditure restraint, endangering the achievement of a minimum level of public investment and thereby undermining the basis for economic growth, at least in the short term. He welcomed the current stance of wage and salary policies and the intention to reduce or eliminate subsidies on a number of items.

On the external side, the improvement in the current account of the balance of payments was welcome, Mr. Salinas stated. He was also encouraged to note the authorities' commitment to liberalize the trade system. However, the outstanding levels of debt would call for a further strengthening of the external accounts, and exchange rate management should therefore be kept under permanent review to promote export competitiveness. It was also essential to ensure that the authorities secured sufficient external financing on concessional terms to close the remaining financing gap. That process would be facilitated if external arrears were eliminated as envisaged.

Progress had already been achieved in liberalizing some prices in the economy, and the authorities had made commitments to eliminate most controls on subsidies by 1990, Mr. Salinas noted. However, like Mr. Grosche, he was concerned that no timetable had been established for the achievement of that objective. In sum, the authorities' intention to increase reliance on market mechanisms in the context of a well-balanced and appropriate adjustment program was most commendable, and he could support the proposed decision.

Mr. Vasudevan observed that Morocco's program was strong and well designed. He agreed with the comments of Mr. Nimatallah and could support the request for a stand-by arrangement. However, he was concerned about the introduction of indicative targets in the program, which seemed to be supplemental to performance criteria, rather than in place of performance criteria that were difficult to establish, as was the standard practice.

The staff indicated that "failure to observe any indicative target will entail consultation with the Managing Director as to whether additional measures may be required to ensure adherence to the program." He would appreciate the staff's comments on the full implications of that statement. The foreign assets of the banking system were also subject to indicative targets. It would be useful if the staff could indicate the rationale for those targets.

The staff representative from the African Department remarked that the staff shared the concerns expressed by some Directors about the sharp cut in public sector capital expenditure over the past few years to a level that was equivalent to 4.5 percent of GDP at present, compared with 14 percent of GDP in 1981. However, it should be borne in mind that private sector investment had increased at the same time, partly offsetting the reduction in public sector investment. Nevertheless, he agreed that it would be inappropriate to reduce capital expenditure further. As for the possibility of achieving further savings on current expenditure, food subsidies, which had already been reduced in the past two years, could be cut even more sharply and eventually eliminated before the authorities' deadline of 1990. However, savings on other current expenditures would be difficult. The authorities felt that some increase in recruitment in the public sector was essential for social and political reasons. They considered that an increase in recruitment was more important than an increase in the minimum wage in the public sector, although the latter had been reduced substantially in real terms in the past five years. The emphasis of fiscal adjustment would therefore have to be on the revenue side. As to measures to rationalize import duties in 1987, those would not increase the share of import duties in total revenues but would change the structure of import duties. For example, the special import tax would be reduced further from 7.5 percent to 5 percent. However, the import tax base would be broadened. Cereals and imports that had not previously been taxed would be taxed at a minimum level of 2.5 percent, while other imports with low duties would be taxed at a slightly higher level. Consistency between the rationalization of import duties and the balance of payments adjustment could be ensured through the pursuit of a flexible exchange rate policy.

Based on discussions with the authorities at the beginning of 1986, the staff had expected that total outstanding arrears would be reduced by year-end, the staff representative commented. However, in mid-July, after reassessing the situation and the evolution of revenues, it had become clear that despite the levy on petroleum imports, there would be a substantial shortfall in revenues and a buildup of arrears. Therefore, taking into account likely developments in 1986 and the objectives of the program with respect to the budget deficit, the balance of payments position, external reserves, and domestic credit, it had been agreed that domestic arrears should remain at the same level at end-1986 as at end-1985. The implicit ceiling for credit to the private sector took into account the expectation not only that domestic arrears of the Government would be reduced by DH 2 billion in 1987 but also that the economy, particularly the private sector, would remain relatively liquid. Even if Morocco's arrears were not reduced as much as expected in 1987, the private sector would remain sufficiently liquid.

The staff had felt that the performance criteria and indicative targets relating to the public sector had been necessary given the previous difficulties of monitoring fiscal adjustment in Morocco, the staff representative commented. Experience had demonstrated that the fiscal deficit, defined on a cash basis, was not a significant measure of adjustment. The staff had therefore established a monitoring system of arrears under the previous stand-by arrangement. In the current program the staff had included both performance criteria and indicative targets as part of the effort to monitor arrears. The variable relating to the performance criterion could be easily measured at the level of the Treasury, while some arrears were either not recorded or were recorded only at the level of the creditor. The latter type of arrears were reported only with the substantial lag of three to six months and would therefore need to be monitored through indicative targets. The staff also considered that an indicative target on commitments for investment expenditure would be appropriate for a more careful analysis of investment. Those indicative targets included in the program would not determine whether a drawing could be made from the Fund but would simply trigger consultation with management to review developments and determine whether further action was required.

With respect to inflation, about 20 percent of the weighting of the consumer price index was influenced by subsidies of food products, while about 10 percent of the weighting was related to the pricing policy of the public enterprises, the staff representative commented. The rate of inflation was projected to be 7 percent in 1987, taking into account some adjustment in food subsidies and in the tariffs of public enterprises. Nevertheless, the rate of inflation in Morocco would remain significantly higher than in its major trading partners.

A number of Directors had stressed the importance of the debt-equity swap, which was part of the agreement to be finalized between Morocco and the commercial banks, the staff representative recalled. That innovation was being developed in a number of other countries. He hoped that the staff would be able to report on details of that arrangement at the time of the first review under the stand-by arrangement.

The staff would address the question of the effect of EC policies on Morocco at the time of the 1987 Article IV consultation discussions with Morocco, the staff representative indicated. Both Morocco and Tunisia were extremely concerned about the European Communities' agricultural policies. The entry of Spain into the EC would have unfavorable effects on Morocco's citrus and tomato exports, and the authorities were discussing with the EC the possibility of maintaining those exports at their average level during 1980-84, a level that would, nevertheless, reflect poor export performance owing to the severe drought in Morocco. The authorities would have to diversify their exports to the EC to take into account a possible shortfall in agricultural exports.

Nontax receipts were expected to increase as a result of the contributions from the phosphate company (OCP) and profits tax from two publicly owned financial institutions, the staff representative remarked. The OCP would make transfer payments before the end of each quarter. The two financial institutions would make a fixed contribution to government revenue in 1987, following which an appropriate level of profits taxes would be established.

The staff representative from the Exchange and Trade Relations Department stated that there were two types of indicative targets. One type covered variables that would ideally have been monitored through performance criteria but which, because of substantial uncertainties, had to be monitored through indicative targets. The second, and more common type, was where indicative targets were specified as a kind of early indicator of the emergence of slippages that would trigger consultations, not with the Fund, but with management and staff. Such indicators would help the country to avoid reaching a situation where further purchases might be interrupted. The staff had generally included such indicative targets in programs of countries that had had a poor track record. Under the previous program, Morocco had experienced difficulties in meeting the balance of payments objectives even though it had met the performance criteria. The staff and the authorities had therefore felt that as balance of payments adjustment was the primary objective of the program, it would be useful to include an objective standard of Morocco's performance in the form of an indicative target on net international reserves. In a number of programs, net international reserve targets had been incorporated as performance criteria, particularly in countries that were pursuing a flexible exchange system. In Morocco's case, while net international reserve targets were not performance criteria, as indicative targets they would be used, over the course of the program, as an objective standard to help in the dicussions on exchange rate policy, particularly during reviews of the program.

Information on external arrears for end-November indicated that the end-December performance criterion on external arrears was unlikely to be met, the staff representative remarked. However, the staff did not have detailed information on the reasons for the increase in external arrears in November and it was possible that the increase had been due to reversible factors, particularly movements in the capital account. Furthermore, there was a very marked seasonal pattern in Morocco's balance of payments, which resulted in a strong balance of payments performance in the last month of the year. There was a possibility that the end-December performance criterion could be met, although it would require a reduction in arrears of about SDR 150 million. It was premature to modify the performance criteria at the present stage.

The staff representative from the Legal Department stated that the decision included in Supplement 2 to the staff report pertained to paragraph 5 of the decision on Morocco's request for a stand-by arrangement, according to which Morocco would be unable to make purchases under the arrangement during any period of the arrangement in which Morocco had an overdue financial obligation to the Fund. The valuation adjustment obligation, which Morocco had not yet paid, arose under Article V, Sections 10 and 11(a), which required that the currencies of members in the General Resources Account should be valued in accordance with the valuation of the SDR as laid down in Article XIX, Section 7. The Executive Board had implemented Article XIX through the O-Rules of the Rules and Regulations of the Fund. Executive Board Decision No. 5990, effective April 1, 1978, established the exchange rates for various operations and transactions of the Fund (pp. 130-131 of Selected Decisions of the International Monetary Fund, Twelfth Issue). He understood that Mr. Kabbaj considered that the procedures set out in Decision No. 5990 should be followed rather than the procedures and practices that had been established at the staff level and described in a subsequent Board paper (EBS/84/46). Based on the procedures that had been followed by the staff of the Treasurer's Department in determining valuation adjustment payments, the staff had requested that Morocco pay a valuation adjustment. As the authorities had not made that payment, they were in arrears to the Fund and, owing to paragraph 5 of the stand-by arrangement, would be unable to make a purchase under that arrangement. The Executive Board might decide to permit the first purchase to be made, notwithstanding that Morocco had not made its overdue valuation adjustment payment, by setting aside the legal effect of paragraph 5 of the stand-by arrangement decision.

Mr. Kabbaj recalled that the staff had specifically recognized that there were no rules or procedures for dealing with valuation payments adjustments in EBS/84/46, in which it was stated that "the rules and procedures of the Fund presumed that operations and transactions will take place on a scheduled or prescribed value date and do not explicitly provide for dealing with cases where payments are not made on time." The Moroccan authorities were right to raise the issue. They were not refusing to make the overdue valuation adjustment payment but were questioning the legal basis for that payment.

The staff representative from the Legal Department commented that Mr. Kabbaj was raising a fundamental question of rule making. The Fund had adopted certain rules and regulations under the provisions of the Articles of Agreement. The procedures established in the staff paper dealing with the experience and procedures regarding overdue payments to the Fund (EBS/84/46) constituted an exception to the practices laid down in Decision No. 5990, which would apply if members made their payments to the Fund on time. The question before the Executive Board at the present meeting was one of the appropriate form of rule making. Did the Executive Board wish to have the Fund's rules and guidelines expressed in the form of clearly drafted legal rules, or did the Board want to follow the practice of adopting decisions that referred to procedures described in a staff report? From a legal viewpoint, both of those approaches were valid. It should be noted that on page 15 of EBS/84/46 the staff had pointed out that the execution of the guidelines had not given rise to difficulties in practice and that there had never been any attempt by the staff to depart from the guidelines or to apply them in some cases but not in others.

Mr. Kabbaj stated that there was a great danger in the approach outlined by the staff, as there were numerous staff papers dealing with various aspects of procedures on overdue payments to the Fund, including the six-monthly reports on overdue obligations, which always included a number of suggestions for ways to deal with overdue payments. Furthermore, in the Managing Director's summing up of the Board's discussion on the experience and procedures on overdue payments to the Fund, it had been stated that "the Executive Board unanimously reaffirmed the existing practices described in paragraph 7 on page 17 of EBS/84/46." The paragraph referred to by the Chairman did not cover the question of valuation adjustment payments. His authorities did not consider that they were overdue in payments to the Fund, as there was no established rule for determining valuation adjustment payments.

The staff representative from the Legal Department reiterated that the Board had in the past, on many occasions, established procedures in an informal manner in the sense that the staff had followed the procedures outlined in staff papers to the Executive Board even though they had not been explicitly adopted as a formal Board decision.

The staff representative from the Treasurer's Department commented that several other members had been in situations similar to that of Morocco. Those countries had made payments that were a few days overdue and had been required to pay the valuation adjustment to the Fund, even though earlier payments that had been overdue had given rise to overpayments on the part of the members, in which case they had not been refunded. The procedures established in EBS/84/46 had been applied to all members.

The Chairman noted that Morocco was the first member that had objected to the application of those procedures and, as a result, the issue had come before the Executive Board.

Mr. Sugita inquired whether the staff representative from the Legal Department considered that the overdue valuation adjustment payment clearly constituted an overdue obligation. If so, had that fact been indicated to the Moroccan authorities? Finally, if the member had been late in making the payment owing to a technical delay, would the late payment be considered as an overdue obligation that would lead to the interruption of purchases by the member?

The staff representative from the Legal Department indicated that, in accordance with procedures and practices of the Fund as described in EBS/84/46, the overdue valuation adjustment payment represented an overdue obligation to the Fund. He assumed that the Moroccan authorities, or at least Mr. Kabbaj, had been informed of that fact. Consequently, according to paragraph 5 of the decision on the stand-by arrangement, Morocco would be unable to make any purchases under that arrangement until it became current with the Fund.

The staff representative from the Treasurer's Department confirmed that the Moroccan authorities had been informed of the overdue valuation adjustment payment. The staff had brought the matter to the Executive Board, as there had been concern that Morocco would be unable to make a purchase under the stand-by arrangement, should it be approved, until the overdue obligation had been cleared. If his understanding was correct, should the procedure followed by the staff regarding valuation adjustments and outlined in EBS/84/46 be approved by the Executive Board at the present meeting, the Moroccan authorities would settle the obligation. The authorities were not unwilling or unable to pay the obligation but were concerned about the application of the procedures.

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/86/198 (12/15/86) and EBM/86/199 (12/16/86).

2. APPROVAL OF MINUTES

The minutes of Executive Board Meetings 86/52 and 86/53 are approved. (EBD/86/319, 12/9/86)

Adopted December 15, 1986

3. EXECUTIVE BOARD TRAVEL

Travel by an Executive Director as set forth in EBAP/86/312 (12/12/86) is approved.

APPROVED: August 5, 1987

LEO VAN HOUTVEN
Secretary