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Minutes of Executive Board Meeting 85/140

3:00 p.m., September 12, 1985

J. de Larosière, Chairman
R. D. Erb, Deputy Managing Director

Executive Directors	Alternate Executive Directors
	Mawakani Samba
	M. Lundsager, Temporary
J. de Groote	
	G. Nguyen, Temporary
	T. Alhaimus
	K. Murakami, Temporary
	D. Hammann, Temporary
	A. Sirivedhin, Temporary
	L. Leonard
	J. R. N. Almeida, Temporary
	T. A. Clark
	H. Fugmann
E. I. M. Mtei	
	J. J. Dreizzen, Temporary
	J. E. Suraisry
P. Pérez	
J. J. Polak	
	A. V. Romuáldez
	O. Kabbaj
	A. S. Jayawardena
	L. Tornetta, Temporary
	Jiang H.

J. W. Lang, Jr., Acting Secretary
S. L. Yeager, Assistant

<u>Also Present</u>
IBRD: J. D. Shilling, Europe, Middle East, and North Africa Regional Office. African Department: M. Dairi, C. A. François, M. Frenkel, E. Sacerdoti. Exchange and Trade Relations Department: W. A. Beveridge, Deputy Director; J. Hicklin, S. Kanesa-Thasan, K. P. Regling, C. M. Watson. Fiscal Affairs Department: A. M. Abdel-Rahman, A. M. Mansour, R. R. Schneider, A. Tazi, V. C. Thai. IMF Institute: S. Fouad. Legal Department: A. O. Liuksila. Research Department: K.-Y. Chu, N. M. Kaibni, E. C. Meldau-Womack, A. Muttardy, H. H. Zee. Secretary's Department: J. L. Bungay. Personal Assistant to the Managing Director: S. P. Collins. Advisor to Executive Director: G. W. K. Pickering. Assistants to Executive Directors: H. Alaoui-Abdallaoui, S. Geadah, L. Hubloue, A. H. Mustafa, D. J. Robinson, M. Sarenac.

1. MOROCCO - 1985 ARTICLE IV CONSULTATION, STAND-BY ARRANGEMENT, AND PURCHASE TRANSACTION - COMPENSATORY FINANCING FACILITY - FLUCTUATIONS IN COST OF CEREAL IMPORTS

The Executive Directors considered the staff report for the 1985 Article IV consultation with Morocco and request for a stand-by arrangement in an amount equivalent to SDR 200 million, together with a proposed decision concluding the 1985 Article XIV consultation with Morocco (EBS/85/157, 6/21/85; Cor. 1, 7/5/85; Sup. 1, 6/24/85; and Sup. 2, 9/6/85), as well as a request for a purchase equivalent to SDR 115.1 million under the compensatory financing facility (EBS/85/159, 6/25/85; Sup. 1, 9/6/85; and Sup. 2, 9/11/85). They also had before them a report on recent economic developments in Morocco (SM/85/193, 7/3/85; and Cor. 1, 9/11/85).

The staff representative from the African Department explained that the design of the adjustment policies included in the 1986 program would depend crucially on two exogenous factors--namely, the evolution of the phosphoric acid market, which was very volatile, and the amount of external grants and concessional assistance. The staff's medium-term scenario for 1986 and beyond had been relatively conservative regarding the amount of available external assistance. For example, a decline of about SDR 200 million in disbursements had been projected for 1986; that projection would have to be reviewed. If the present weakness in the phosphoric acid market continued, if there was no prospect of external grants for 1986, and if concessional assistance were lower than envisaged, the 1986 program would require a considerable tightening of domestic demand, financial goals, and other policies. Thus, it was difficult for the staff, in August, to formulate a more precise policy for 1986. The prospects for 1986 would however be reassessed in the context of the first review in October, at which time agreement would be reached on the broad policy issues for 1986, particularly with respect to the budget. The precise policy package would probably be finalized in the context of the second review.

In 1985 national savings were expected to increase by about 3 percentage points, from 12 percent of GDP to 15 percent of GDP, the staff representative remarked. No additional contribution to savings was expected from the budget in 1985. The increase would instead come from three main sources: the recovery in agricultural production, which would lead to an increase in agricultural incomes and savings, including higher stocks of cereals; the increase in interest rates adopted in April 1985; and the increased transfer of remittances by Moroccan workers abroad as a result of the exchange rate depreciation. Already during the first part of the year time deposits had increased substantially, and the Government had been successful in mobilizing savings by issuing public bonds at relatively high interest rates. Also, workers' remittances represented about 0.5 percent of GDP in the projected 3 percentage points increase in national savings.

On average, the inflation rate had doubled in 1984 from 6 percent to 12 percent, the staff representative noted. That increase reflected largely the impact of the exchange rate depreciation and price liberalization, including the effect on a full-year basis of the increase in the prices of some food items which took place in July 1983. During the first six months of 1985, the rate of inflation had declined substantially to about 6 percent, but for the year the rate was expected to increase to about 12 percent as a result of the 15 percent depreciation of the dirham and the adjustment of food prices by 11-40 percent in early September.

The authorities had increased interest rates on key deposits and lending rates by 2 percentage points and had liberalized interest rates on deposits of more than one year, which had led to a substantial increase in net bank deposits, the staff representative remarked. The staff therefore considered the overall interest level to be appropriate because it was positive in real terms. The staff was encouraging the authorities to reduce the share of lending at preferential interest rates. Nonetheless, the Moroccan banks were concerned that profitability had declined substantially because the tight limit on credit expansion left no margin for increasing credit, and that development could slow down the banks' efforts to collect time deposits.

The difficulties between Morocco and the commercial banks had arisen with respect to the approval of legal clauses included in the debt restructuring agreement, not with respect to the financial terms of debt rescheduling, the staff representative from the African Department concluded.

The staff representative from the Exchange and Trade Relations Department commented that the program appeared to be anomalous because it related to calendar year 1985 and lacked detailed specification of policies and targets for 1986. As the staff report explained, although the program had initially been agreed in the early part of 1985, because of certain deficiencies and slippages, negotiations had been prolonged and had focused on the 1985 program and the remedial measures needed to keep adjustment on track. Consequently, the program was finalized only late in the year. The authorities had been aware of the need for an early opportunity to discuss and agree on additional measures and policies for 1986 and had reaffirmed the balance of payments targets not only for 1986 but also for the medium term. They had also confirmed their readiness to take additional measures in the context of the first review, which was only a month away. In view of the adverse exogenous developments in the export sector, the staff considered that the implications of those developments for 1986 had to be evaluated and that that evaluation might lead to more stringent fiscal targets than had earlier been agreed. Thus, as the staff report had pointed out, during the first review, measures necessary to attain the 1986 objectives would be discussed and might include a tightening of policies beyond what had previously been envisaged.

The supplementary staff paper had also reaffirmed the authorities' original objective of achieving balance of payments viability by 1988, the staff representative pointed out.

An Executive Director had asked why measures that could not be implemented in August were expected to be implemented at the time of the first review in October, the staff representative recalled. The staff did not expect that additional measures would be required in relation to the 1985 targets. However, in view of the slippages that had occurred in the first half of the year and the uncertainties concerning export performance and its impact on the budget, a large part of the budgetary adjustment envisaged in 1985 consisted of sharp reductions in expenditures, which might result in deferring some expenditures from 1985 to 1986. Thus, the adjustments being made in the context of the 1985 program could possibly compound adjustment problems for 1986. The October review would therefore focus on possibilities and problems for 1986.

The first review would cover a wide range of policies and measures deemed necessary in light of the evaluation of the outlook for 1986 and the medium-term balance of payments, the staff representative continued. From a practical point of view, those measures were more likely to be in the areas of exchange rate or monetary policy than in the area of fiscal policy, because fiscal adjustment would have to be linked to the 1986 budget. It would be difficult at the present stage to implement, on an ad hoc basis, fiscal adjustments on either the expenditure side or the revenue side. An important element of the first review would be an evaluation of the external financing results for 1985 and the outlook for 1986, based on the rescheduling arrangements concluded with the Paris Club and commercial banks. Moreover, before the end of the stand-by arrangement, the Government intended to hold discussions with the staff on economic and financial policies for 1987 to assure the continuity of the adjustment process.

As he understood Mr. de Groote's proposal on Bank-Fund collaboration in the area of credit policy, Fund programs should be designed to take into account the sectoral distribution of credit in order to assure that policy objectives under a Fund program were consistent with those in support of Bank structural adjustment programs, the staff representative remarked. In general, he subscribed to that view. However, Mr. de Groote was also suggesting that Fund programs perhaps include minimum levels of credit for individual sectors. That proposal raised a fundamental problem, because in practice great difficulties had arisen with regard to implementing credit targets for individual sectors. The problem would be compounded further if those targets were performance criteria.

While performance criteria had been met under the 1984 program, the balance of payments results had been out of line with the original target, the staff representative from the Exchange and Trade Relations Department acknowledged. The divergence could be explained in part by the accumulation of domestic arrears; the staff had been unaware of the existence of those arrears when the performance criteria were established. In dealing with balance of payments in the proposed program, the staff had adopted indicative targets, with quarterly targets for reserves, which would be taken into account in the context of the periodic reviews of the program.

Mr. de Groote said that in seeking Fund-Bank cooperation in setting credit ceilings, he especially wished to avoid cross conditionality. Cross conditionality took two forms. In its direct form, for example, the Fund would refuse to give a member country financial assistance unless it had accepted some kind of macrodevelopment targets or had eliminated subsidies. Conversely, the World Bank would refuse to agree to a project or structural adjustment loan unless a member had first agreed on a program with the Fund. That kind of cross conditionality should be avoided. Another implicit form of cross conditionality arose in the course of agreements with the Fund or the Bank, because in trying to achieve the objectives of the Fund program to control global liquidity, the member found itself unable to put up the counterpart financing needed for a World Bank project. Consequently, the disbursement of Bank credits would be suspended. That form of implicit cross conditionality was precisely what his suggestion sought to avoid.

It would be desirable to establish some kind of cross complementarity between the two institutions, Mr. de Groote continued, in order to prevent the actions or decisions taken by one institution to negate or render inoperative those of the other. Specifically, in attempting to assure the availability of credit flows for development, the notion of a ceiling had to be excluded altogether, because ceilings established a maximum, while the purpose was to assure a minimum of credit for development financing. Instead, a general broad commitment of the authorities could be included in the letter of intent, with perhaps letters being submitted to the two institutions by the Minister of Planning and the Minister of Finance indicating the need to reserve a part of the credit allocations for development purposes. Although such statements of intent would not be limited to World Bank credit, they would recognize the need for the sectoral orientation of credit. Moreover, such commitments were not intended to form part of a Fund contract or performance clause, but were to be a general target establishing a form of coordination between the objectives of Fund programs and those of development institutions. However, his intention was not to offer a proposal, but to point to the need for substantive discussion of a serious problem.

The staff representative from the Exchange and Trade Relations Department, commenting on Mr. de Groote's remarks, noted that the problem was not dissimilar to that relating to fiscal credit limits in Fund programs, which the World Bank sometimes considered to be unduly restrictive vis-à-vis its investment programs and projects. In such situations, the Fund had tended to rely on the Bank's expertise and judgment concerning the priorities of the investment program. Also, in the past, letters of intent had included policy commitments to the effect that some kind of priority structure or criteria would be used in implementing credit policy, but not in a rigid manner. For example, it was not uncommon for letters of intent to indicate that a particular sector would have preferred access to credit; that practice would present no problem whatsoever.

The Deputy Managing Director said that Mr. de Groote had touched on an important issue. In some recent cases where a program contained a fiscal target, a deviation from that target had ended in a larger than expected deficit. Consequently, the authorities had cut back on the investment program to allow for other expenditures rather than reduce such expenditures. In addition, they had failed to take measures on the revenue side that would have permitted the mobilization of the counterpart funds that were needed to unlock foreign assistance or for investment spending. Thus, capital investment in the country had been reduced, which would certainly have implications for future growth prospects.

Mr. Jayawardena said that he was grateful for Mr. de Groote's clarification and agreed that the impact of Fund policies on World Bank programs and projects was a matter deserving or attention. Perhaps it would be helpful for the World Bank to identify instances where Bank projects had been derailed as the result of the implementation of policies under Fund-supported programs. Likewise, the Fund could identify instances where programs had gotten into difficulty because of measures implemented in support of World Bank programs and projects.

The staff representative from the African Department, responding to a question by Mr. Jayawardena, stated that a Fund-Bank mission would be undertaken in October to discuss with the authorities various measures for reducing the budgetary burden of subsidies. The authorities would be considering the option of targeting some support programs to the most needy in order to accelerate the elimination of subsidies.

Responding to a question by the Chairman, the staff representative from the African Department explained that the proposed tax reform had been submitted to Parliament a few months later than expected because of the need for further discussion among the social partners. The discussion of a main aspect of tax reform--the value-added tax--had taken place between May and July and had been completed before Parliament had recessed. The adoption of the tax reform was expected to be the first priority when Parliament reconvened in October. The staff expected that the tax reform would be implemented fully at the beginning of next year.

The staff representative from the Research Department, commenting on the effect of cereal pricing policies on cereal import requirements, noted that over the past decade Morocco's cereal production had lagged behind consumption. Consequently, domestic supplies at present accounted for only 60 percent of total requirements compared with 75 percent in 1975. Also, droughts had occurred in three of the past five years. During the last two droughts, production had declined from 4.8 million tons in 1982/83 to an annual average of 3.6 million tons during 1983 and 1984. Output for the marketing year 1985/86 was expected to recover to 4.8 million tons, or the level harvested three years previously.

Although output had declined on average by 1.5 million tons in 1983 and 1984, imports increased only by about 1 million tons, the staff representative continued. Stocks had been reduced and domestic consumption had slowed down. Thus, the increase in imports during the excess year was in response to a real need induced by droughts in two successive years.

Producer prices had been rising over the years, resulting in increased acreage planted, the staff representative added. But output had been largely determined by variations in the weather. Under the pricing system, the price of imports over a number of years had been lower than domestic producer prices. As indicated in Table 4 of EBS/85/159, the producer price of wheat had increased by 7 percent in 1984, while that of soft wheat had increased by about 27 percent. The difference between the increase in the domestic price of soft wheat--27 percent--and the increase in the world market price--33 percent--arose because the increase in the world market price was based on the actual unit value of cereals imported by Morocco. Because of the increase in world prices, in 1984 the price levels for imported and domestically produced cereals were about the same. However, owing to inefficient procurement and marketing arrangements in Morocco, only the largest cereal producers had benefited from the guaranteed producer price. Price reforms were being studied with World Bank assistance, but those reforms had not yet been implemented.

The supplement to EBS/85/159 issued in September had used data covering the period through June 1985, whereas the original paper issued in June had used data covering the period through December 1984, the staff representative noted. The original data had been collected by a mission in February-March 1984, and information received subsequently had enabled the updating of calculations through March 1984. By the time the compensatory financing request was scheduled to come before the Board, data through June 1985 had become available. The availability of data had been affected by the delays in negotiating the adjustment program for 1985 and 1986.

The phosphate market had changed substantially during the first half of 1985, the staff representative from the Research Department explained. Morocco was the largest supplier of phosphate rock, and its share of the world market for phosphoric acid--an intermediate product--was about equal to that of the United States. However, the United States was by far the largest exporter of fertilizers, accounting for 60 percent of the world total. In 1984/85, owing to global oversupply, the price of fertilizers on international markets had fallen sharply, while the price of acid had not changed much. As a result, many buyers had preferred to purchase fertilizer rather than acid. Morocco's largest market for acid, India--which accounted for one third of Morocco's total acid exports--had increased its fertilizer purchases significantly, thereby reducing substantially the demand for acid. The supply imbalance was expected to continue for some time, pending the scaling down of capacity. Because there was not much scope for increasing demand in the short term, the staff had reduced its original projection for fertilizer exports during the two postshortfall years by 20 percent.

The staff representative from the African Department, responding to a question by Mr. Tornetta concerning the relationship between fonds réservés, the government deficit, and domestic arrears, remarked that the program contained two performance criteria, one relating directly to the fiscal deficit and another to fonds réservés, which represented bills awaiting payment. Fonds réservés were clearly arrears and were designated as such in the accounts of the Treasury. Other domestic arrears and payments delays, which were the subject of the special technical memorandum, could not be identified as easily because they represented payments that had been authorized--an approved commitment--but had not yet been registered at the Treasury. Thus, a limit had been set as a performance criterion for fonds réservés, which could be ascertained, but it would be technically impossible to set a performance criterion for domestic arrears.

The staff representative from the World Bank explained that the Bank program had been adjusted over the past two years in response to the need for more structural reform in a number of sectors, particularly to increase supply and efficiency. So far, two industrial trade policy adjustment loans and one agricultural sector loan had been approved, and additional operations were being prepared for the public enterprises. To date, the performance criteria for both industrial trade policy loans had been met, and the response in the economy seemed to be satisfactory. A number of measures incorporated in those loans had aimed at increasing exports by increasing access to imports, facilitating the actual procedures for exporting goods, reducing price distortions, and eliminating bureaucratic impediments to the export of processed agricultural goods. For the affected categories, data indicated an annual rate of growth of about 20 percent. Unfortunately, those categories did not constitute the bulk of Moroccan exports; so the impact on total export performance was less marked, although it would continue to grow.

The second industrial trade policy adjustment loan was expected to be declared effective in a short time, the staff representative noted. The delay in disbursement merely reflected the delay in presenting the program to the Bank's Executive Board and the normal time required to declare a loan effective. A substantial proportion of the first tranche of $120 million should be disbursed before the end of the year.

The measures proposed for the first stage under the agricultural sector loan had been undertaken and the remaining actions were being taken on schedule, the staff representative commented. Those measures involved not only increasing producer prices but also increasing the access of smaller farmers to the government procurement process. In addition, the recent increase in the prices of subsidized foods would have a positive effect, changing relative prices and increasing the demand for locally produced cereal grains. The U.S. Agency for International Development, in cooperation with the Bank, had undertaken a detailed study of prices and subsidies in the agricultural sector. The study would be reviewed shortly by the Bank staff and might lead to additional measures and operations by the Bank.

The Bank was also conducting a study of the public enterprise sector aimed toward restructuring that sector, the staff representative explained. Restructuring would include a timetable for reducing and eventually eliminating arrears, improvements in the management of public enterprises and a better definition of their relations with the Government, improved pricing and tariff policies, restructuring enterprises where necessary, the improvement and better monitoring of investment programs, and possibly privatization. The areas for study had been identified with the Government and a preparatory mission was to depart at the end of the month for discussions with the Government. The objective was not only to reduce the arrears which had accumulated, but to set in place structures and measures that would ensure efficiency in the public enterprises and prevent the accumulation of additional arrears.

A second investment review was also planned, the staff representative from the World Bank remarked. A major review of the public investment program had been undertaken in early 1984, which had resulted in substantial reductions in projects in the investment portfolio of the Government and in expenditures. The second review would focus on setting priorities among and within sectors, improving the selection process to reduce problems of overbudgeting, and reducing the level of projected expenditures consistent with the budgetary target while maintaining development expenditures for projects of the highest priority.

Mr. Kabbaj commented that many of the observations that had been made by Executive Directors concerning the implementation of the adjustment program in 1984 had underestimated the effects of the drought in Morocco. Unfortunately, the stand-by arrangements with the Fund had coincided with four consecutive years of drought. According to the Moroccan authorities, a succession of droughts of such severity had not occurred for almost 400 years. The impact of the drought had thus distorted greatly the financial image of Morocco, and in particular had had a detrimental effect on the country's balance of payments.

Although progress on pricing policies related to subsidized foodstuffs had slowed over the past year and a half, since the implementation of the adjustment program in 1980, there had been considerable and continued movement, Mr. Kabbaj noted. On the occasion of the first review of the present program, the staff could perhaps present a table on the evolution of prices for subsidized foodstuffs in order to provide an overview of the progress made on that issue. Also, during 1983/84, price increases had been implemented for utilities and fertilizers, which indicated the flexibility of the authorities' pricing policies.

On the budgetary deficit, it must be borne in mind that in 1983/84 the reduction of the import tax had led to a revenue loss amounting to about 2 percentage points of GDP, Mr. Kabbaj pointed out. When looking at the fiscal balance, account must be taken of short-term drawbacks arising from the reforms that had been implemented. The budgetary deficit reflected one such drawback, which would be overcome in the future.

Most Directors had stressed that two factors--the drought and excess liquidity--had affected the outcome of the current account balance, Mr. Kabbaj recalled. He would add a third factor: the effect of trade liberalization. In the context of the adjustment program supported by the Fund, as well as the structural adjustment program with the World Bank, Morocco had taken a number of measures during 1983 and 1984--including the total phasing out of an import deposit equivalent to 25 percent of the value of imports--which had resulted in the reduction of the special tax on imports by 7.5 percentage points, or by nearly one half. The maximum tariff had also been reduced from 100 percent to 60 percent. Moreover, because of the delays owing to administrative restrictions introduced at the beginning of 1983, some imports had been registered only in 1984. All those factors had to be taken into account when explaining the causes of the slippages which had occurred in 1984.

In the fiscal area, the program for 1985/86 appeared to be on the right track, Mr. Kabbaj commented. Morocco had been undertaking an annual fiscal adjustment equivalent to some 2-3 percentage points of GDP. On the expenditure side, Morocco had taken the maximum measures and exercised the maximum restraint. Salaries had not been increased for two years, and in 1985 there had been a small increase, representing on average about 6 percent after inflation. Retirees were not being replaced and recruitments had been held to a minimum of not more than 2,000 in that term. In addition, the authorities were committed to phasing out subsidies over a period of five years.

On the revenue side, Mr. Kabbaj continued, pending the adoption of the tax reform, efforts had been made to improve the collection of taxes as well as revenues from state monopolies. The small delay in implementing tax reform had been used to inform the social partners and would greatly speed up the process of moving the tax reform through Parliament. Although the authorities were doing their best to obtain approval of the tax reform before the end of the year, consensus would have to be reached among the six political parties represented in Parliament. Nevertheless, the Finance Minister and the Prime Minister had reaffirmed their commitment to enacting the tax reform.

It should be pointed out that the Moroccan authorities had drawn the question of domestic arrears to the attention of the World Bank and the Fund, Mr. Kabbaj remarked. By improving the relationship between planning and budgeting, the dangers of recurring arrears would be greatly reduced. The Moroccan authorities had requested technical assistance from the Fund to help them devise corrective policies and, in the meantime, had agreed with the Fund to monitor and to reduce present arrears. In 1985, Saudi Arabia had contributed some $300 million toward reducing those arrears, and it was hoped that with the assistance of friendly countries the reduction of a second tranche could be incorporated in the program for 1986.

The commitment to phase out subsidies over five years in the context of the program for 1985/86 was unique, Mr. Kabbaj observed. The Moroccan authorities hoped that in the framework of the review of the subsidy policy to be undertaken with the help of the Fund and the World Bank, they would be able to carry out their commitment to smaller and more frequent price increases than had been done previously. The price increases introduced in September 1985 would represent almost 1 percent of GDP in 1986.

The authorities recognized that some of the public enterprises were a drain on the budget, Mr. Kabbaj acknowledged. Tariffs had been adjusted, and other measures would be decided in the course of the first review. The bulk of the reform was expected to be worked out in the context of a structural adjustment program with the World Bank. Morocco had some 600 public enterprises, most of them established prior to Morocco's independence. Many continued to play an important and useful role, so caution and patience would be required to ensure that the reform would be beneficial. It should be noted that Morocco had requested World Bank and Fund assistance in reforming the public enterprises as early as 1982, but such assistance could not be provided at that time because of the lack of personnel.

Morocco had an understanding with the World Bank that the next structural loan would address education costs, which represented one third of the current budget, Mr. Kabbaj continued. Major reforms had already been undertaken, including a shift toward vocational training. Civil servants were supporting the authorities' efforts; for example, all teachers were now performing three to four hours' overtime a week without compensation.

The banking system was working well, Mr. Kabbaj considered. The system was largely private, and the control exercised by the central bank was flexible enough to allow fair distribution of credit to the economy, except perhaps for medium- and long-term debt. A far-reaching reform of interest rates had been put in place in the framework of a structural adjustment loan with the World Bank. The structure of the Moroccan banking system had historically been oriented toward short-term lending activity, and the authorities therefore had some reservations about transforming savings into investments. Perhaps some work remained to be done in collaboration with the Fund and the World Bank to prepare the banking system to accept more responsibility in financing investment. Increasing interest rates for short-term purposes would not, in his authorities' view, serve their purposes. The new system put into place earlier in the year provided for three rates for deposits of more than one year. As credit rates were expressed in minima, the banks would exceed the minima set by the central bank. Thus, interest rate policy had been flexible, and perhaps the next step would be to lower the one-year limit.

It was difficult to promote a liberal and open economy and at the same time limit imports, Mr. Kabbaj observed. The usual instruments for achieving external balance, such as the exchange rate and credit limitations, did not always produce the expected results within the time frame of an adjustment program, especially if strong exogenous factors had a negative impact. At present, external policy was affected by instability in the commodities market, the volatility of exchange rates, and rising protectionism in industrial countries. Also, Morocco had to continue to honor its external commitments. In that regard, it should be noted that existing external arrears represented less than 1 percent of annual external payments and were due mostly to the delays in putting in place the present program, which had in turn delayed other disbursements.

As for the program for 1986 and medium-term prospects, he wished to confirm the willingness of the authorities to take the measures required, Mr. Kabbaj added. However, the medium-term projections were based on assumptions about the world economy, which were uncertain. The medium-term projections were working hypotheses and the Moroccan authorities would try to adhere to the policies underlying those projections. However, if circumstances changed so that the world economy deteriorated further, the medium-term projections would have to be revised. The conclusion of the financing agreement with commercial banks for 1983/84 and the opening of negotiations for 1985/86 depended on Fund support for Morocco's adjustment program, Mr. Kabbaj observed. Once those preconditions had been met, the Moroccan authorities expected a rapid conclusion of the negotiations for additional external financing.

In concluding, the supply side of the economy had not been ignored in Morocco, Mr. Kabbaj remarked. Investment codes existed for almost every sector of the economy and offered exemptions that reduced the real effective tax rate. Also, when discussing pricing policies, it should be remembered that the Moroccan agriculture was very sensitive to the weather. Although 7 million hectares were usable for agricultural purposes, only about 10 percent was irrigated, and even that 10 percent had suffered during the previous drought. At present, even following good rainfalls, the dams were filled only to 30 percent of capacity. Also, the cereal prices set by the parastatals were floor prices. Difficulties arose in administering those prices because of problems associated with transport, storage constraints, and sometimes financing. The access of small farmers to the buying organization also needed to be improved. Improving the administration of pricing policies would be addressed in the framework of an agricultural sector loan with the Bank.

Mr. de Groote remarked that his preoccupation was not the introduction of subceilings or sectoral credit policies in Fund programs, but the need to reconcile the implementation of Fund programs with the disbursement of existing World Bank loans. While he recognized the limitations of sectoral policies, he hoped that the staff would try to find a way to design programs that would allow members to continue to enjoy the benefits of World Bank disbursements for development purposes while at the same time implementing Fund-supported programs.

The Chairman remarked that the problem outlined by Mr. de Groote was very important. In various cases in the recent past, a World Bank program with a member country had been interrupted because the global credit ceiling established under a Fund-supported program had been reached and the authorities had not made sufficient allowance under that ceiling for the counterpart credit needed for implementing Bank and other development operations. The question was how to devise a program in such a way that the country would not use its margin under the global ceiling for deficit financing rather than for important capital outlays. The staff would reflect on Mr. de Groote's comments and try to find a way to address the problem.

The Chairman made the following summing up:

Executive Directors expressed their concern about the developments in Morocco's external current account and the large accumulation of domestic and external arrears during 1984 and the first part of 1985. While acknowledging that the large shortfall in the outturn compared with the program targets was partly the result of continued adverse climatic conditions during the 1983/84 crop season and other exogenous factors, Directors noted that there were also serious policy weaknesses, particularly in the areas of government finance, the public enterprises, and price policy. A number of Directors expressed concern about the slow progress in preparing and implementing essential structural policies such as the tax reform, the restructuring of the public investment program, and the rehabilitation of public enterprises. Directors commended the authorities for the trade liberalization policy aimed at improving the efficiency of the industrial sector but emphasized the need to complement that policy by appropriate demand policies and continued exchange rate flexibility so as to avoid an unsustainable import expansion.

In reviewing the main features of the adjustment program for 1985, Directors welcomed the additional measures adopted recently to achieve a reduction in the fiscal deficit in 1985 and to reduce the domestic arrears carried over from previous years. They stressed the urgency of implementing the long-awaited tax reform and reducing the extended system of tax exemptions granted to important economic sectors under various tax codes. The tax reform could go far in increasing the savings rate and the incentives for a more productive economy, given the unsustainable character of the present fiscal deficit and the magnitude of the adjustment still needed to correct it. In addition, Directors urged the authorities to continue to limit severely and durably the increase in expenditures, particularly on wages and current transfers. Just postponing expenditures, as had been done too often in the past, was clearly not a solution. The appropriateness of the recent wage increase was also questioned. Directors stressed the importance of completing, before the end of the year, the reform of the planning and budgetary process in order to improve the management of available budgetary resources. The introduction and, more important, the firm implementation of a new system to monitor expenditures and arrears was considered by most Directors as an essential step toward improved management of public finances. The accumulation of domestic arrears had been one of the major weaknesses of the budgetary policy over the past years and must be eliminated. With regard to public enterprises, Directors emphasized the need to accelerate the rehabilitation of public enterprises in order, inter alia, to reduce their heavy recourse to government transfers. In this respect Directors were encouraged to note that comprehensive reform measures are to be elaborated and implemented with World Bank assistance in the coming months. Speedy implementation of such measures is called for and will be carefully scrutinized by the Board in the framework of the 1986 program.

A number of Directors stressed the importance of developing the agricultural sector by appropriate supply-side policies, and they welcomed the role of the World Bank in that area. The authorities were commended for their recent decision to increase the price of subsidized consumer goods, which had remained unchanged for over two years. Given the remaining distortions in the price structure, prompt action is needed to move toward a system that provides adequate and frequent enough adjustment in administered prices to reduce further the budgetary cost of subsidies and improve incentives for domestic production. Some Directors considered that a more rapid target than the five-year schedule for the elimination of subsidies might be called for.

Regarding monetary and credit policy, some Directors stressed that, in view of the weak balance of payments position and the very low level of international reserves, the authorities should pursue a restrictive credit policy. Directors welcomed the increase in interest rates in early 1985. Some Directors, however, questioned the adequacy of interest rates in real terms given the need to encourage savings, and they recommended that the authorities act to reduce further the relatively large share of lending at preferential rates. Directors welcomed the development of the money market, which should permit the carrying out of a more flexible and effective monetary policy.

With regard to the balance of payments, Directors stressed concern at the weakness of Morocco's external position, the increased current account deficit now projected for 1985, the additional uncertainties about the availability of external financing for 1985 and more so for 1986, and export performance in 1986 and beyond. In this context they emphasized the importance of continued application of prudent financial policies and an appropriately flexible exchange rate policy, as well as the need to implement more decisively structural reforms in the areas of agriculture, public enterprises, and prices so as to improve the medium-term economic situation. Although the socially difficult decision to increase prices of essential foodstuffs together with the exchange depreciation already implemented this year will contribute significantly to the required external adjustment, the authorities' readiness to take additional adjustment measures in the context of the first review of the program was welcome.

All in all Directors considered that the revised program for 1985 should enable Morocco to reduce its domestic and external disequilibria, but several Directors expressed some concern and uneasiness over a perceived lack of specificity regarding the adjustment measures to be implemented in 1986. Given the existence of an unfinanced gap for 1986 and the need for the authorities to take additional firm action in that year, the next review under the program will thus be of crucial importance. A number of Directors stressed the importance of rapid progress on all fronts of the program, including the completion of agreements with the commercial banks for 1985-86 and with the Paris Club, and the implementation of the projected reduction in arrears. In view of the track record of Morocco under past arrangements and the magnitude of the slippages that occurred in the first half of 1985, Directors emphasized that continuity in the conduct of the adjustment process was of the essence. There was, indeed, no room for slippages.

It is expected that the next Article IV consultation with Morocco will be held on the standard 12-month cycle.

The Executive Board then took the following decisions:

Decision Concluding Article XIV Consultation

1. The Fund takes this decision relating to Morocco's exchange measures subject to Article VIII, Section 2(a), and in concluding the 1985 Article XIV consultation with Morocco, in the light of the 1985 Article IV consultation with Morocco conducted under Decision No. 5392-(77/63), adopted April 29, 1977 (Surveillance over Exchange Rate Policies).

2. Morocco maintains restrictions on payments and transfers for current international transactions under Article XIV, as well as an exchange restriction giving rise to payments arrears which is subject to approval under Article VIII, Section 2(a). In the circumstances of Morocco, the Fund grants approval for the retention of that restriction until March 31, 1986 or the completion of the next Article IV consultation with Morocco, whichever is earlier.

Decision No. 8074-(85/140), adopted
September 12, 1985

Stand-By Arrangement

1. The Government of the Kingdom of Morocco has requested a stand-by arrangement for the period from September 12, 1985 to February 28, 1987 in an amount equivalent to SDR 200 million.

2. The Fund approves the stand-by arrangement set forth in EBS/85/157, Supplement 4.

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

Decision No. 8075-(85/140), adopted
September 12, 1985

Purchase Transaction - Compensatory Financing Facility

1. The Fund has received a request by the Government of Morocco for a purchase of SDR 115.1 million under the Decision on Compensatory Financing of Fluctuations in the Cost of Cereal Imports (Executive Board Decision No. 6860-(81/81), adopted May 13, 1981, as amended).

2. The Fund notes the representation of Morocco and approves the purchase in accordance with the request.

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

Decision No. 8076-(85/140), adopted
September 12, 1985

DECISION TAKEN SINCE PREVIOUS BOARD MEETING

The following decision was adopted by the Executive Board without meeting in the period between EBM/85/139 (9/12/85) and EBM/85/140 (9/12/85).

2. THE GAMBIA - AID DONORS' MEETING - FUND REPRESENTATION AND RELEASE OF INFORMATION

The Executive Board approves Fund representation at an aid donors' meeting on The Gambia, to be held in London, and also approves the release of the staff report for the 1985 Article IV consultation with The Gambia (SM/85/244, 8/23/85) and the report on recent economic developments in The Gambia (SM/85/258, 9/6/85) to participants in the aid donors' meeting, as set forth in EBD/85/238 (9/10/85).

Adopted September 12, 1985

APPROVED: May 23, 1986

LEO VAN HOUTVEN
Secretary