

CHAPTER 12

Evidence from Two Countries That “Graduated” from Prolonged Use

Morocco

1. Morocco is one of the few recent prolonged users of IMF resources to have “graduated.” It had a series of nine arrangements between 1980 and 1993,¹ but has not had an IMF-supported program since then and completed repaying its borrowing from the IMF in 1997.

2. After a temporary sharp increase in phosphate prices in the early 1970s that led to a boom in expenditures, the Moroccan economy ran into major problems in the late 1970s, as the global recession and falling phosphate prices led to sharp declines in exports and budgetary revenues. At first, the government maintained spending and this resulted in very large current account and budget deficits, financed mainly through external borrowing on commercial terms. Consequently, the imbalances Morocco faced as it entered a series of IMF-supported programs were very large. In 1981, the external current account deficit (excluding grants) exceeded 12 percent of GDP, while the central government budget deficit reached 14 percent of GDP. Between 1982 and 1984, the stock of external debt averaged over 100 percent of GDP, while the external debt-service ratio, before rescheduling, averaged 50 percent of exports of goods and services. In addition, Morocco faced major structural weaknesses, with heavy government regulation, including on consumer prices and credit allocation, a strong inward economic orientation, and considerable vulnerability to exogenous shocks due to its dependence on the agricultural sector and on phosphate exports.

3. Programs in the early 1980s had only a moderate impact in reducing these imbalances. Fiscal adjustment was achieved mainly through expenditure reduction, but domestic payments arrears rose. At

first, progress on structural reforms was slower than planned, in part due to concerns over the social acceptability of a more rapid pace of reform. For example, there were serious riots over increases in the prices of some heavily subsidized consumer goods.

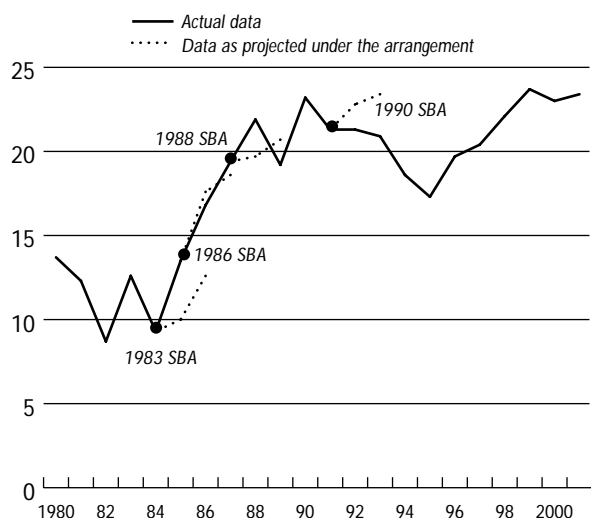
4. In the second half of the 1980s, as the structural reforms started to reach maturity, the contribution of the private sector to investment and growth increased as it benefited from deregulation and improved access to credit. Moreover, financial adjustment policies and structural reforms became mutually reinforcing, as for example tax reform contributed to a greater tax effort, and as export growth accelerated. Over the course of its IMF programs, Morocco eventually achieved significant structural changes, including the liberalization of most foreign transactions and consumer prices; reform of public enterprises; tax and public expenditure reform; and the removal of administrative impediments to private investment. Moreover programs were successful in raising saving: the ratio of gross national saving to GDP rose from an average of 16 percent during 1980–82 to almost 23 percent during 1990–92 (Figure 12.1). Tax reforms contributed to this change, with the tax effort rising from 19¼ percent of GDP to 22¼ percent of GDP over the same period.² Progress, while eventually substantial, was not smooth. There were a number of setbacks in the face of exogenous shocks and periodic slippages in policy implementation.

5. This experience suggests a number of questions. Were there elements of the design and implementation of programs that helped Morocco achieve greater external sustainability and dispense with IMF support more quickly than many other prolonged users? Why did core policies continue to move in the right direction? And compared with the other case studies, were there any differences in terms of “exit strategies” once Morocco had reached a certain threshold in terms of external viability? The following aspects help to cast light on these issues:

¹Two EFFs in the early 1980s, both of which quickly went off-track and were cancelled, followed by seven SBAs between 1982 and 1993 (see Figure 3.1 in Part I, Chapter 3). Morocco also had six nearly continuous annual SBAs between 1965 and 1972.

²Morocco’s adjustment experience is described in more detail in Nsouli and others (1995).

Figure 12.1. Morocco: National Saving
(In percent of GDP)



Source: IMF staff reports.

No obvious differences in the time frame of programs from other prolonged users

6. As in Pakistan and Senegal (but less so in the Philippines), programs were initially overoptimistic about the time frame needed for external viability to be restored.³ For example, the 1983 staff report stated that despite large disequilibria, Morocco “must aim at reaching a sustainable position in a relatively short period. . . . the medium-term scenario in which the program is set aims at reaching this sustainability by 1988. . . . which, in the view of the staff, is an appropriate time horizon.”⁴ Later, programs appear to have become more realistic about the timetable for restoring external viability: by the 1986 program viability was not expected until about 1993. Medium-term projections in subsequent programs broadly maintained this time horizon.

7. Programs from 1982 onward were supported by 12–18 month SBAs, but there was some recognition on both sides that this was part of a more medium-term effort. Nevertheless, the Moroccan authorities have expressed the view that programs still had an overly short-term time horizon, particularly

³The first programs in 1980 and 1981 turned out to be particularly unrealistic, assuming as they did that commercial banks would continue to lend on a significant scale.

⁴However, even then the medium-term projections showed large overall balance of payments deficits (equivalent to 6 percent of GDP) persisting through 1987. The staff report claimed that “beyond 1987, the situation could be regarded as more sustainable in the light of the resumption of normal capital inflows. . . .”

as far as structural reforms were concerned and that, at least formally, staff could not candidly position programs within the longer-term framework. Thus, initial programs were too ambitious about the timetable for structural reform.

8. For example, the 1983 program called for a value-added tax (VAT) to be implemented by July 1984, and for draft bills for reform of the general income tax and the corporate income tax to be submitted along with the 1984 budget. In the event, the VAT was not implemented until 1986, after extended consideration in Parliament, and a global personal income tax was only implemented in 1989. Despite this initial “overpromising” on the timetable of tax reform—which appears to have reflected institutional pressures to demonstrate concrete progress within the time frame of the program—one factor that helped maintain progress was that an initial “Loi Cadre” adopted by Parliament had defined the overall framework for tax reform, so that the ultimate objectives remained clear despite slippages in the timetable of individual components. Indeed, officials and staff interviewed were of the view that, with hindsight, the additional time taken for preparation and debate, including in Parliament, on the VAT and the income and profits taxes contributed to their eventual successful implementation by helping to secure greater popular support.

Program design and the nature of conditionality showed no major differences in approach from that in other prolonged users

9. Until 1985, IMF-supported programs focused on fiscal adjustment, primarily through large reductions in capital spending and public sector wage restraint, tight monetary policy through credit controls, and a flexible exchange rate. Structural reforms were also envisaged, but in practice were largely limited to preparatory work. From 1986 on, programs gave greater emphasis to structural reform, including of the fiscal system and trade regime. Programs continued to target moderate strengthening of the fiscal position, while the nominal exchange rate was fixed in relation to a basket of the currencies of Morocco’s principal trading partners.

10. Programs generally took a fairly gradual approach to adjustment. On average, the six IMF-supported programs between 1983 and 1992 targeted a reduction in the fiscal deficit by an average of 1.3 percentage points of GDP between the year in which the program started and the next,⁵ while the current account deficit was projected to narrow on average by

⁵That is, between the projection or estimate for year T , and the projection for year $T + 1$.

Table 12.1. Morocco: Implementation of Fiscal Programs¹

Year	Program	T - 1	T		T + 1	
			Projected	Actual	Projected	Actual
1981	EFF	10.1	7.4 ²	14.5	...	12.4
1982	SBA	12.4	8.2 ²	12.5	...	12.1
1983	SBA	12.1	8.7	12.1	7.2	11.2
1985	SBA	11.2	6.0	9.6	4-4.5	5.4
1986	SBA	9.6	6.6	5.4	4.3	5.9
1988	SBA	4.6	4.5	4.6	3.5	6.0
1990	SBA	5.7	2.8	3.5	2.0	3.1
1992	SBA	3.1	0.8	2.2	0.0	4.0

Source: IMF staff reports.

¹Central government deficit, payments order basis, excluding grants; unless otherwise stated.

²Budget deficit, excluding grants, and excluding changes in "Fonds réservés."

1.4 percentage points of GDP over the same period (Table 12.1 and Figures 12.2 and 12.3). In both cases, the targeted adjustment was somewhat greater in the earlier programs than in later ones, in part reflecting the scale of the initial imbalances. Although there was considerable slippage in individual programs, there was a substantial reduction in the fiscal deficit over the period of IMF-supported programs, from 14 percent of GDP in 1981 to a little over 2 percent in 1992.⁶

11. Conditionality in most programs concentrated on the standard macroeconomic quantitative performance criteria. Programs typically also included indicative benchmarks for government revenue, which would trigger consultations on corrective actions if they were missed. Conditionality on structural measures was exercised primarily through the review process, with little use of specific benchmarks. There seems to have been relatively limited use of prior actions even though the guidelines on prolonged use called for greater emphasis on such actions.⁷

12. Given the basic commitment of the authorities, the IMF's flexibility in exercising conditionality—with the focus on reviews to judge whether sufficient progress was being made in key structural areas—was probably appropriate. However, there is no evidence that the IMF was more "flexible" than

in many other cases; for example, programs with the Philippines also relied primarily on reviews for structural conditionality.⁸

Ownership and implementation: despite slippages in timing, political commitment to the broad direction of the reforms and good implementation capacity appear to have been the critical factors

13. Implementation of the programs was somewhat mixed, but despite periodic slippages, particularly in relation to fiscal targets, policies on core issues continued to move in the right direction, although not always at the pace envisaged in programs.⁹ Implementation of the monetary aspects of programs was generally strong. This consistent direction appears to have owed much to a high degree of commitment by the economic team to the underlying aims and content of successive programs, with the backing of the highest levels of government, and to a high degree of political stability. Interviews with staff also suggest that the strength of Morocco's civil service was a major factor in successful implementation of key reforms. Increasing transparency in putting information and policies out for public discussion also appears to have helped develop a broader consensus, although this consensus was by

⁶Year-to-year comparisons are complicated because of arrears and other data issues. Much of the fiscal adjustment apparently occurred in 1986, after the 1985 program went off-track and before a new program was approved in December of that year.

⁷However, they were used on occasion. For example, parliamentary approval of a revised budget, upward adjustment of retail prices of subsidized commodities, and partial reversal of recently introduced import restrictions were required as "prior actions" for approval of the 1983 SBA arrangement. The 1992 SBA also included a number of prior actions relating to fiscal issues and the reform of interest rate policy, open market operations, and consideration of a new banking law.

⁸The Executive Board did grant waivers of fiscal performance criteria in the 1983, 1986, and 1988 programs, in addition to waivers for primarily technical breaches of performance criteria relating to external arrears.

⁹Both the 1980 and 1981 EFF programs went off-track quickly and were cancelled, with less than 20 percent of the planned disbursements made. The remaining SBAs were more successfully implemented; on average 78 percent of planned disbursements were made. However, neither of the last two programs in 1990 and 1992 was completed as performance criteria were missed and program reviews were not completed.

no means complete since some measures—especially price increases on consumer goods—continued to meet considerable social resistance.

14. In this context, the pace of adjustment and reform was set to some degree by the authorities' perceptions of the domestic political acceptability of reform. In practice, the IMF accommodated this approach by tolerating minor policy slippages and taking a flexible attitude to progress on structural reform in completing program reviews. But this approach does not seem to have differed fundamentally from that in the case study countries where there was also considerable de facto flexibility. The real difference appears to have been made by strong domestic ownership, rather than by the structure of conditionality.

The economy was highly vulnerable to exogenous shocks, but the approach of programs to this uncertainty was not different from that in other prolonged users¹⁰

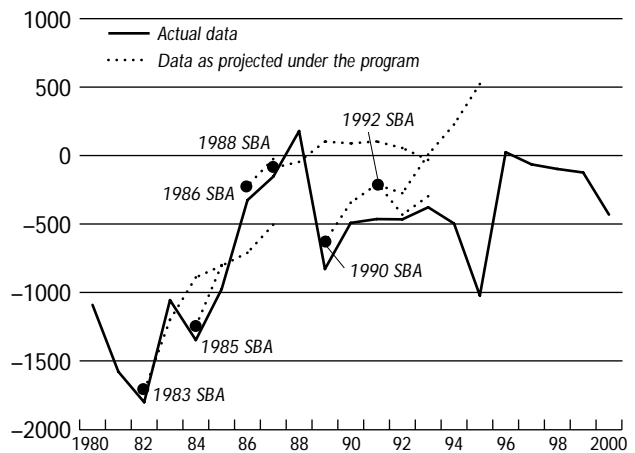
15. However, although exogenous developments led to some relaxation of adjustment efforts in 1981–82 and caused temporary problems in other programs, more generally, shocks do not seem to have distracted the authorities from their broad commitment to advancing reform. For example, there was no major erosion of earlier gains even in the face of the Middle East crisis in 1990–91 and episodes of severe drought. Nevertheless, in their questionnaire responses, the Moroccan authorities said that programs were insufficiently flexible with regard to exogenous shocks. In their view, advance agreement on how supply shortfalls would be dealt with in programs would have made the process smoother and programs less subject to interruption.

With regard to the exit strategy, the authorities and the IMF appear to have adopted a narrower rationale for continued program involvement than in some other prolonged users

16. The staff appraisal for the 1992 SBA request noted that Morocco was poised to achieve viable budgetary and external sector positions, and that with the help of the program in 1992 and a further concerted effort in 1993, Morocco would graduate from the use of IMF resources, restore normal rela-

¹⁰However, unlike, for example, in Senegal, there was only very limited use of automatic adjustments to quantitative performance criteria. The 1990 and 1992 programs did include adjusters in relation to net external financing and to privatization proceeds.

Figure 12.2. Morocco: Current Account Balance¹
(In millions of U.S. dollars)

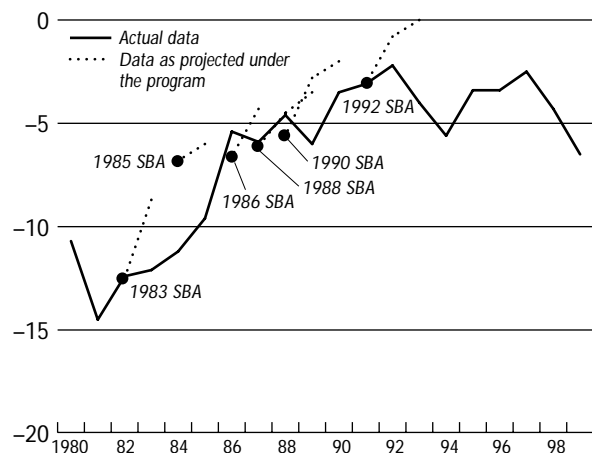


Source: IMF staff reports.

¹The starting point of projections is occasionally off the "actuals" line because of subsequent revisions to the data on which the projections were based.

Figure 12.3. Morocco: Central Government Balance¹

(Payments order basis; in percent of GDP)



Source: IMF staff reports.

¹The starting point of projections is occasionally off the "actuals" line because of subsequent revisions to the data on which the projections were based.

tions with its creditors, be able to service its future debt obligations, and achieve current account convertibility in 1993. This "graduation" certainly did not mean that all structural adjustment problems had been solved. Indeed, the economy continued to

face major challenges, including in the areas of public enterprise reform, the regulatory environment for private investment, and reform of the financial system. Moreover, the economy remained insufficiently diversified, with its heavy reliance on rain-fed agriculture leaving it still very sensitive to weather variations.

17. However, it is not clear that common standards were applied with respect to different countries when judging when an exit from IMF-supported programs was justified. For example, a comparison of Morocco's situation in 1993 with that of the Philippines, where the IMF judged that a further EFF arrangement was justified, does not suggest any obvious reasons for the differences in approach (see Box 5.3 in Chapter 5 of Part I).

Lessons from Jamaica: Implications for Ownership and the "Seal of Approval"

18. Jamaica is a former prolonged user of IMF resources that made a decision not to seek further financial support from the IMF. The current evaluation has not attempted to investigate all aspects of IMF-supported programs with Jamaica, but focuses on two issues: (i) how did the authorities' decision not to enter into new lending arrangements with the IMF affect the nature of the policy dialogue and "ownership"; and (ii) what lessons does Jamaica's recent experience suggest for the IMF's role in signaling a "seal of approval" on the macroeconomic framework to donors, including other IFIs? The evaluation is based on reviews of internal and published IMF documents, interviews with IMF staff and a senior Jamaican representative as well as written responses by the authorities.

19. Since the 1960s, Jamaica has had nine SBAs and four extended arrangements with the IMF. The last EFF expired in March 1996, after which the Jamaican government announced its "independence from the IMF," indicating that it would not borrow again. The authorities explained in interviews with the IEO that this decision was taken in large part because of their assessment that previous IMF-supported programs had not achieved success and that they had consequently prepared a "homegrown" macroeconomic program.

20. At the time the EFF expired, Jamaica still faced large adjustment challenges. Public debt was high (over 100 percent of GDP, with over two-thirds external); inflation was over 20 percent; the real effective exchange rate was appreciating under the combined impact of sizable wage increases in the public and private sectors and an anti-inflationary

monetary policy that had pushed up real interest rates;¹¹ growth remained weak (recorded GDP rose by only 3 percent during the decade of the 1990s);¹² and the first stage of a major financial sector crisis was under way. The IMF policy advice at the time was that (i) a major adjustment of the exchange rate was necessary in order to restore competitiveness and thereby contribute to higher sustainable growth, along with (ii) some fiscal adjustment (i.e., small overall surpluses). Later, IMF staff also recommended a workout strategy for the financial sector that involved the separation of banks from insurance companies and the intervention and closure of all insolvent institutions. The authorities strongly rejected the advice on the exchange rate, arguing that, with a wage formation process that was heavily influenced by the exchange rate, a sizable devaluation would only accelerate the wage-price spiral so that the best way to assure competitiveness was through a tight monetary policy. The IMF staff initially doubted that, in the likely protracted low-growth environment that such a stabilization strategy would involve, the authorities would be able to maintain the sizable fiscal effort necessary to avoid unsustainable public debt dynamics. On the financial sector, the government feared that outright intervention and closure of banks would lead to a crisis of confidence and capital flight. They opted instead for a strategy based on guaranteeing all deposits and other liabilities; keeping all institutions open; and dealing with problem institutions more gradually, albeit at a high fiscal cost. An off-budget institution, FINSAC, was created and gradually acquired shares in a number of institutions in return for official liquidity support until it effectively controlled all domestically owned commercial banks; a process of merger, reorganization, and gradual privatization then followed.

21. In the event, the government did manage to generate and maintain large primary fiscal surpluses (Figure 12.4), involving some difficult budgetary decisions, including a squeeze on capital spending. As the authorities' "homegrown" policy strategy was seen to be implemented quite forcefully, and the IMF backed away in subsequent Article IV surveillance reports from its previous insistence on an initial large depreciation while still encouraging greater exchange rate flexibility, the nature of the policy dialogue gradually improved. In July 2000, it was agreed that there would be staff monitoring of the government's economic program. The authorities have indicated that they sought the SMP specifically

¹¹The real effective exchange rate appreciated by over 20 percent in the two years prior to March 1996 and appreciated by a further 30 percent in the next two years, before leveling off.

¹²However, GDP growth was probably under-recorded because the sizable informal sector appears to have grown much faster.

in order to obtain policy-based loans from the multi-lateral development banks by sending a signal on their macroeconomic framework.¹³

22. The authorities' program achieved some important results, although Jamaica's problems are far from resolved.¹⁴ High primary fiscal surpluses prevented the public sector debt dynamics from deteriorating further; real interest rates declined moderately, although they are still extremely high; and the cushion of external reserves improved. However, the public sector debt (at around 130 percent of GDP) remains a major source of vulnerability and real GDP growth has only recently begun to recover moderately, after a number of years of stagnation. Nevertheless, given the extremely difficult starting conditions and the consequences of the financial sector crisis, any adjustment was bound to be protracted and difficult, with or without IMF support.

23. This experience suggests some interesting lessons:

On ownership

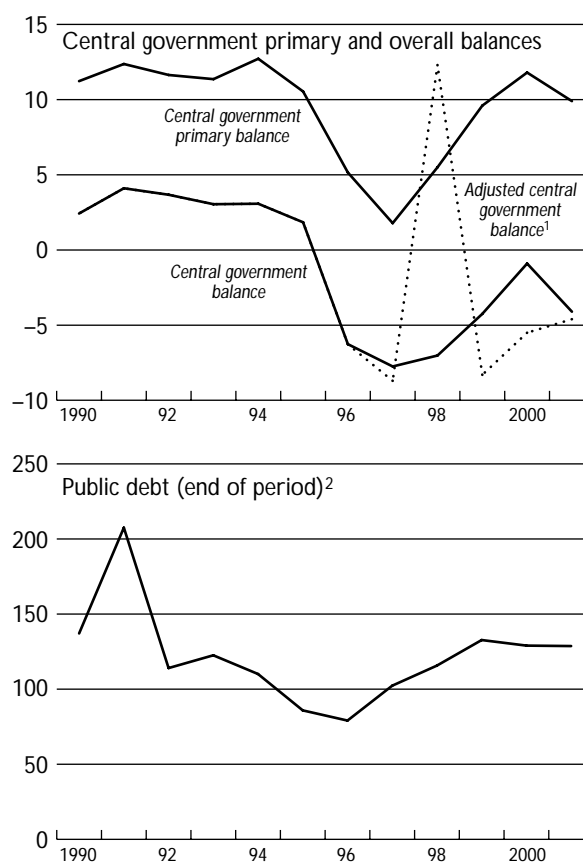
- The staff's own assessment was that one of the main reasons earlier programs had failed to achieve their objectives was a lack of ownership. In their view, as reflected in an internal review prepared in 1998, the authorities' agreement to programs had been mainly motivated by the need to obtain foreign financing and debt relief—a view shared by the authorities. Under these conditions, program implementation, when it was successful, was geared to meeting specific quantitative performance criteria rather than to the implementation of the underlying policy approach. Indeed, a principal conclusion

¹³A staff-monitored program (SMP) is an informal agreement between the authorities and the IMF staff to monitor the implementation of the authorities' economic program; such monitoring does not imply endorsement of the program by the IMF Executive Board, management, or staff, but management and staff should consider that the program is capable of achieving its targets if it is consistently implemented. See "Guidelines for the Use of Staff Monitored Programs." While SMPs can serve several purposes, the objective of Jamaica's SMP was to serve as a signal to official lenders—specifically, the World Bank, as the text notes, and the Inter-American Development Bank (IDB) and the Caribbean Development Bank (CDB)—about the authorities' commitment to sound macroeconomic policies. While the minimum requirement of the World Bank to proceed with policy-based adjustment (as opposed to project) lending is that IMF management provide a "comfort" letter indicating that, in its view, macroeconomic policies are being conducted in a satisfactory manner, in the case of Jamaica the World Bank had initially indicated that it preferred an IMF-supported program to be in place. It eventually agreed to accept the SMP as the necessary seal of approval.

¹⁴See the staff report for the 2001 Article IV Consultation and Review of Staff-Monitored Program, available on the IMF's website, for further details.

Figure 12.4. Jamaica: Trends in Fiscal Balance and Public Debt

(In percent of GDP)



Source: IMF staff reports.

¹Includes FINSAC interest payments on a full year base. Fiscal year starts in April.

²Excluding Bank of Jamaica's external debt and net of public enterprises' holding of FINSAC and government securities.

of the internal assessment was that unless the authorities made a future economic program a matter of national political priority, it was unlikely that any such program would achieve the stated objectives.

- In this case, the move away from a financial arrangement with the IMF—at the authorities' initiative—was associated with much stronger domestic ownership, which proved critical. The policy strategy they pursued, while not in accord with the IMF's recommendations on some key points, does not appear to have been a less appropriate strategy in Jamaica's circumstances, especially since it was implemented with commitment. Although any counterfactual cannot be

assessed with rigor, it seems likely that, if Jamaica had been obliged at that time (e.g., in order to unlock other sources of financing) to adopt a program along the lines proposed by the IMF staff, the eventual outcome would have been worse than the current situation, especially because a lack of ownership would have led to weak implementation. It is more difficult to judge which set of policies might have been preferable, abstracting from political commitment.¹⁵

- With the benefit of hindsight, the IMF should not have been so dogmatic in insisting upon its preferred strategy, which also involved substantial risks. However, the IMF was prepared to modify its position, once it was clear that the authorities had a strong commitment to an alternative strategy and were prepared to back it up with action, especially on fiscal policy. Indeed, records of the surveillance Board discussions in May 2001 suggest that a number of Executive Directors expressed sympathy for the authorities' position on the exchange rate/monetary policy framework.
- The authorities' strong commitment to transparency was a major advantage. They agreed to the publishing of a (rather critical) Public Information Notice (PIN) following the 1997 Article IV consultation—an action that had a favorable effect on private financial markets (reflected in quite narrow spreads)—and have consistently agreed to the publishing of Article IV consultation missions' concluding statements, including information on performance relative to SMP targets, as well as staff reports for the consultations and SMPs. Their normal practice has been to issue, around the time of publication, their own “commentary” on the staff reports, emphasizing both points of agreement and disagreement, which has helped foster a more open debate.

On the seal of approval

- Internal IMF documents and staff interviews suggest that the need for an IMF arrangement in order to have access to Paris Club rescheduling was a major motivation behind the authorities'

proceeding with many earlier programs.¹⁶ But, as noted above, many of the programs appear to have been weakly owned. By the time the government decided to forgo any further lending arrangements with the IMF, any further rescheduling of (pre-cutoff date) official debt would have had little impact, and Jamaica was able to access private financial markets without an IMF-supported program. Therefore, the initial lack of a “seal of approval” from the IMF mainly affected program lending by the multilateral development banks.

- The ambiguous nature of the staff-monitored program (SMP) as a seal of approval on the macroeconomic framework caused some initial problems. On the one hand, the authorities were concerned that the IMF might become an impediment to their access to much needed resources from other sources, notably the World Bank and the IDB, while the latter institutions were concerned that the IMF staff might not be as rigorous in their policy advice and assessments if no IMF financial resources were involved. The World Bank also had burden-sharing concerns. Eventually, both institutions did undertake lending for financial sector restructuring, using the SMP as the basis for the signal on the macroeconomic framework.
- Despite these initial concerns about the role of the SMP, it does appear to have played a useful role in the case of Jamaica—allowing some room for maneuver to combine a strong domestic policy formulation process with a healthier policy dialogue with the IMF. IMF staff expressed the view that the authorities became more receptive to a discussion on alternative policy mixes—within their own overall framework—once the SMP route became an option, and the authorities have also indicated that they found the approach useful. The point is not that the SMP as an instrument necessarily had any major advantages over a lending arrangement. Although the IMF did have initial reservations about the authorities' approach, these reservations diminished, and the IMF might have been willing to agree to a lending arrangement in support of the authorities' program rather than a SMP. But in this case a SMP did provide an alternative approach to signaling on the “seal of approval” that was more acceptable to the authorities, and hence more likely to foster ownership.

¹⁵Kirkpatrick and Tennant (2002) attempt to assess what the outcome would have been if an alternative financial sector strategy, closer to one like that recommended by the IMF, had been adopted. However, their counterfactual assumes that the IMF strategy would have led to a major currency crisis and output collapse and hence an obviously inferior outcome. There is no way to test this assertion. It is also possible that the counterfactual would have been a stronger flow of funds into foreign-owned domestic banks.

¹⁶Jamaica reached seven rescheduling agreements with the Paris Club between 1984 and 1993.