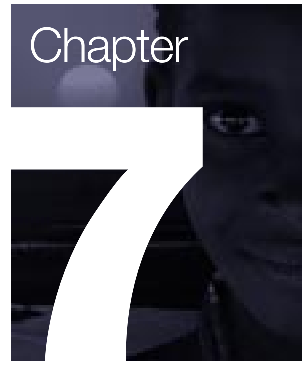


Morocco—Repositioning for Globalization

Morocco is the fifth largest economy in Africa. It is also one of the most weather dependent on the continent. Changes in the weather have been the main determinant of macroeconomic and social trends in the country. Along with the weather, slow adoption of policies for sustained growth and macroeconomic stability constrained economic performance in the mid-1990s. Recognizing the potential benefits of active integration with the world economy, the Moroccan government has shown increased commitment to opening the economy. This renewed commitment is reflected in policies to attract foreign direct investment from beyond the Middle East and North Africa—implementing a transparent privatization programme, removing tariff barriers, reforming financial sector regulations, and strengthening stock exchange operations. To ensure a more equitable distribution of the gains from trade, the government has intensified efforts to improve domestic competition, expand rural infrastructure, and reform agriculture.

> *"Trade and investment reforms remain a national priority"*

GDP growth rose from a low 0.9% in 2000 to an estimated 6.5% in 2001. This marked improvement was due largely to the recovery from drought, which allowed the agricultural sector to provide a much-needed boost to the economy. Agricultural output increased by an estimated 25% in 2001, contributing to more than half the growth. Non-agricultural output grew by 3.8%. Despite improvement in the supply situation, particularly in the food supply, inflation was expected to drop only marginally, from the 2.0% recorded in 2000 to 1.9% by the end of 2001. The decline was limited because of the devaluation of the currency (the dirham) in 2001 and the lagged effects of the oil price hikes of 2000.

Trade and investment reforms remain a national priority under King Mohammed VI. These reforms, along with the free trade agreement with the European Union, are expected to enable Morocco to reap greater benefits from globalization. For example, net foreign direct investment—which, at less than 0.1% of GDP in 1999, has been low compared with that in other African countries—was boosted by the privatization of the state-owned telecommunications company, Maroc Telecom, in December 2000. That transaction brought in more than $2.1 billion (6.3% of GDP) in 2001.

The dirham was devalued in April 2001 largely in response to its appreciation against the euro and the strident calls for devaluation from exporters—and despite the improved external position in 2001, strengthened by the successful sale of Maroc Telecom. Exports rose by an estimated 8.1% in 2001, thanks largely to an increase in exports of phosphate and phosphate by-products. The trade deficit was expected to improve from 9.5% of GDP in 2000 to 8.7% in 2001, and the current account balance from −1.7% of GDP to a small surplus of 0.7%.

Fiscal and monetary policies, which have been pro-cyclical, shifted slightly to an active stance of promoting macroeconomic stability and growth. Interest rates were brought down in 2001 to encourage private investment. This rate reduction was made possible by cuts in interest rates in the international money market, as attempts were made to reverse the global slowdown. Thus Treasury bill rates dropped from 6.3% in 2000 to 5.8% in 2001. Private investment increased only marginally, however, from 21.7% of GDP in 2000 to 21.8% in 2001.

"Fiscal and monetary policies shifted slightly to an active stance of promoting macroeconomic stability and growth"

The budget deficit increased to a projected 7.2% of GDP in 2001, up from 6.5% in 2000 (excluding privatization revenues), as a result of large retroactive wage payments, capital transfers to public enterprises, and investment spending under the Hassan II Fund. This extrabudgetary fund, set up in 1999/2000, is designed to protect up to 50% of privatization proceeds to promote infrastructure and social investment in partnership with the private sector.

The fiscal situation is emerging as a serious concern. The deficit has remained within an acceptable range only when privatization receipts have been taken into account. In the meantime, the expenditure side of the budget remains inflexible. In response to the vulnerability of the fiscal position, Standard and Poor's recently downgraded Morocco's country risk outlook from stable to negative. The rating agency maintained Morocco's foreign currency debt rating, however, at double-B/B.

Elections due in September 2002 pose a risk of weak fiscal control but also offer hope for revitalization of the economy. In the medium term fiscal consolidation and acceleration of structural reforms could produce higher and more stable economic growth.

Actions to improve governance and industrial competitiveness represent the main source of hope for further expansion of the Moroccan economy in the coming years. Towards this end, programmes to develop rural infrastructure and increase access to health, education, and other social services are critical and need to be pursued with renewed vigour. To address rural poverty, the government will need to continue its policy focus on reforming the land tenure system, expanding agricultural extension services, and improving rural infrastructure, such as irrigation and health services.

Unless promptly addressed, the growing poverty (particularly in rural areas) and the inequity in access to basic social services may pose a significant threat to the ongoing political transition. The Moroccan authorities have already acknowledged the importance of making significant strides in reducing poverty, particularly by establishing an enabling environment for private sector development. Nonetheless, continued progress in poverty reduction will depend, as in the past, on the government's success in stabilizing the economy, undertaking comprehensive reforms, and maintaining strong economic growth.

Recent economic trends—solid improvements

Trends in macroeconomic aggregates show solid improvement in the Moroccan economy in 2001. Much of the improvement was due to the 25% increase in agricultural output resulting from favourable weather conditions and the decline in oil prices. The estimated GDP growth of 6.5% in 2001 was a significant achievement given the high rural poverty and urban unemployment (table 7.1).

The improvement in terms of trade and export competitiveness following the April 2001 devaluation, along with the proceeds from the privatization of Maroc Telecom, helped shrink the current account deficit and external debt in 2001 (figure 7.1). External debt dropped from 48.3% of GDP to 43.1%, while debt service dropped from 20.8% of exports in 2000 to 19.3% in 2001.

> *The improvement in terms of trade and export competitiveness helped shrink the current account deficit and external debt*

Sectoral performance—not much change

The distribution of GDP among sectors remained around the same between 1998 and 2000, although agriculture's share fluctuated between 11% and 16% depending on the weather (table 7.2). The industrial sector's contribution has stagnated at around 30%, and the service sector's at 37–40%. The general government sector provided 17–18%. These figures suggest that the relative performance of different sectors has remained much the same over the years, resulting in no change in the structure of the economy.

Agriculture—output up 25% in 2001

Agriculture plays an important role in the Moroccan economy, contributing 11–16% of GDP and 18% of exports. In 1999 it employed more than 3 million people, accounting for 48% of employment, 80% of rural employment, and 62% of female employment.

Agricultural output grew an estimated 25% in 2001, indicating a recovery from the two-year drought of 1999–2000. The potential of this sector to contribute to growth and employment is constrained by many factors—most notably by frequent droughts, the complexity of real estate structures, the poor quality of human resources in agriculture, the low rate of investment in the sector, the high transport costs, and the limited use of improved technologies.

The production and yield of cereals, the main crop, declined significantly between the 1996/97 season, when there was no drought, and the 1999/2000 season (table 7.3). Dependence on the weather has resulted in large variations in the annual value of agricultural production, which has fluctuated between 10 billion dirhams (1982) and 24 billion dirhams (1992). Between 1996 and 2000 the range was 13 billion to 23 billion dirhams.

This volatility worsens poverty and unemployment in rural communities, where households have few alternative sources of employment and the lack of modern financial institutions severely constrains asset ownership. And it has serious implications for Morocco's economic fortunes, which are tied to the performance of agriculture.

Table 7.1

Selected macroeconomic indicators, Morocco, 1999–2001

Indicator	1999	2000	2001
GDP growth (percent)	0.0	0.9	6.5[a]
Unemployment rate (percent)	13.9	13.6	—
Inflation rate (percent)	0.7	2.0	1.9[a]
Nominal exchange rate (dirhams per dollar)	9.80	10.59	11.28
Current account balance as percentage of GDP	–0.5	–1.7	0.7[a]
External debt as percentage of GDP	50.1	48.3	43.1[a]
Terms of trade (percentage change)	–3.4	–10.2	2.5
Gross fixed capital formation as percentage of GDP	24.2	24.7	24.8[a]

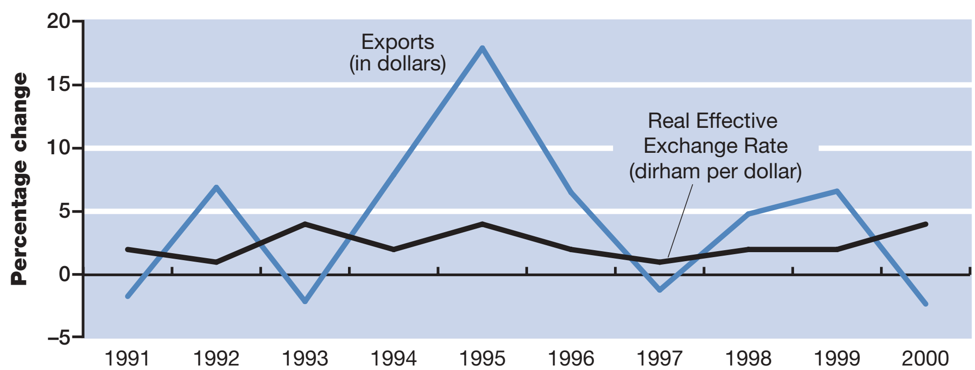
— Not available.

a. Estimated.

***Source:** Economic Commission for Africa; IMF 2001.*

Figure 7.1

Change in real effective exchange rate and exports, Morocco, 1991–2000



***Source:** Morocco, Ministry of Economy and Finance.*

Table 7.2

Distribution of GDP by sector, Morocco, 1998–2000 (percent)

Sector	1998	1999	2000
Agriculture, forestry, and fishing	16	13	11
Industry	30	30	31
Services	37	39	40
Market GDP	83	83	82
General government	17	17	18
Total	100	100	100

***Source:** Morocco, Ministry of Economic Planning 2000.*

Table 7.3
Agricultural production, Morocco, 1996/97–1999/2000 (thousands of tonnes)

Type of crop	1996/97	1997/98	1998/99	1999/2000
Principal cereals	4,015	6,549	3,764	1,943
Garden crops	4,538	4,615	4,608	4,266

Source: *Economic Commission for Africa from official sources.*

Rural areas are home to 45% of Morocco's population and 70% of its poor. Thus developing agriculture is crucial for developing the overall economy. Several efforts have been made to promote agricultural expansion, including subsidizing selected wheat seeds, developing irrigation, improving real estate structures, and undertaking projects for pastoral improvement. The irrigation projects have extended the irrigated area by around 19,000 hectares a year, bringing the total to more than 1.1 million hectares in the past five years. In addition, a drought insurance scheme has been established since 1999.

> *"The government has taken several measures to improve the capacity and readiness of local industries"*

While promoting the expansion of the sector is important, reducing the economy's overreliance on agriculture is equally important. Measures to promote the sector should be designed carefully. Past policies have encouraged the planting of crops such as cereals in climatically vulnerable areas, which led to more frequent and devastating crop failures. The rapid environmental degradation, deforestation, and overgrazing occurring in rural areas may exacerbate future fluctuations in agricultural output, with serious consequences for the performance of the economy.

Industry—net enterprise creation, falling

Industry's share of GDP has remained constant at around 30%, with manufacturing accounting for 54% of that. In the past five years, however, net enterprise creation has fallen, especially in the textile sector (Cherkaoui 2001). The deceleration in net enterprise creation is generally attributed to the liberalization of trade and the elimination of internal market protection and production subsidies in several sectors. Several factors have hindered industrial development in Morocco—poor managerial capability, inefficiencies in capital and money markets, lack of openness to foreign markets, lack of effective internal competition, poor entrepreneurial attitudes, poor industrial relations, and inefficient public services.

In the wake of increased globalization and trade liberalization, the Moroccan government has taken several measures to improve the capacity and readiness of local industries. The government developed an industrial strategy aimed at creating an economic environment favourable to private investment. To support this strategy, it promulgated an investment charter in 1995 that provides for promoting free trade zones, providing fiscal incentives favouring regional development, and reducing taxes on profits and capital investment. The government introduced one-stop investment shops—*guichets uniques*—to encourage private investment by simplifying bureaucratic procedures. It also created administrative and trade courts and enacted a competition law in June 2000 (effective July 2001) aimed at improving the investment environment and promoting industrial efficiency.

Finally, the government put in place a programme to strengthen the competitiveness of local firms, which were exposed to greater external competition by the trade liberalization. The programme supports export promotion activities, measures to improve vocational training, and the creation of centres for disseminating business information. It also includes sector-specific initiatives to strengthen professional associations and efforts to build information and communications technology infrastructure.

"The service sector has made significant gains since the government adopted its policy of economic openness"

The new competition law provides for the establishment of a competition commission, charged with enhancing price competition and transparency in trade relations. The law requires firms to notify the government about any merger that would give the new company a 40% or greater share of sales in a given market. Reports from the Competition Commission suggest that competition has increased since 1999.

Services—big gains

The service sector, which contributes 40% of GDP, has made significant gains since the government adopted its policy of economic openness in 1995. The main source of these gains has been tourism and telecommunications, which have benefited from major policy changes relating to trade liberalization, privatization and private sector development, capital market development, and the application of new technologies. All these policy measures have been aimed at improving the quality of services, increasing the use of modern, efficient management techniques, and developing competitive activities with high value added.

The tourism sector has shown strong potential to supplement the traditional sources of foreign exchange and GDP growth in the Moroccan economy. Between 1995 and 2000 the number of tourists increased by some 4%, allowing the sector to contribute 8% of GDP. This growth has been due in part to policy measures to increase investment in the sector. In 2001 the tourism sector was heading for a record year until the terrorist attacks of 11 September.

In 2001, in consultation with the main business association (the General Confederation of Moroccan Enterprises, or CGEM), the Moroccan government adopted a new tourism policy aimed at increasing tourist arrivals to 10 million a year by 2010. This goal will require building 80,000 new hotel rooms between 2000 and 2010, bringing the total capacity to 115,000 rooms (230,000 beds). To increase coastal tourism, Morocco will build five new seaside resorts, expanding the capacity of such resorts from 30,000 beds in 2000 to 160,000.

To support the achievement of these goals in the tourism sector, the government has granted hotel companies tax holidays during their first five years of operation and reduced the value added tax rate on catering services from 20% to 10%. Other actions have also been taken, such as restructuring the regional interest group for tourism, reviewing the tourism promotion policy of each region, supporting studies aimed at improving the competitiveness of the tourism sector, revising norms for hotel classification, simplifying local taxes, opening the air transport sector to competition, and strengthening training schemes for workers.

In the telecommunications sector, deregulation in 1999 was followed by a significant reduction in tariffs. The sector employs 47,000 people and generates value added of around 2% of GDP. In 2000 Morocco had around 4.35 million fixed line and mobile phone connections. The number of mobile phone connections has increased exponentially, from almost zero in 1995 to 2.9 million today. The number of Internet subscribers remains small, however, at around 200,000.

The state-owned telecommunications company, Maroc Telecom, was privatized in 2000, in a process hailed as a model of openness and transparency (box 7.1). The transaction brought in $2.1 billion (6.3% of GDP) in 2001, adding substantially to external reserves (IMF 2001). Other development efforts in telecommunications include creating a national industry in information technology and promoting the audiovisual sector. In addition, a contract was signed to launch the Moroccan Academic and Research Wide Area Network (MARWAN) to link universities.

"The reform in the policy-making apparatus and in the policy direction continued in earnest"

Macroeconomic policies and their impacts

The political opening associated with the transition to power of King Mohammed VI after the death of King Hassan II, and the recognition of the challenges of globalization and trade liberalization, have led to several economic policy changes in Morocco. Thus the reform in the policy-making apparatus and in the policy direction, as well as in fiscal and monetary policy in general, continued in earnest in 2001.

Fiscal policy—deficit targets met

Fiscal policy has been aimed at rationalizing and controlling spending and optimizing revenue, to keep the budget deficit below 3% (including privatization receipts). Nonetheless, the fiscal deficit (excluding privatization revenues) has been widening since 1999 (table 7.4). Special factors—such as drought-related spending, large retroactive wage payments, and increased investment funding through the Hassan II Fund—contributed to the widening of the deficit in 2001.

The fiscal policy stance is emerging as a serious threat to the government's medium-term objectives. Radical changes are needed to contain the fiscal deficit and address the inflexibility on the expenditure side. Standard and Poor's recently downgraded Morocco's country risk outlook largely on the basis of the fiscal outlook. A careful review of the revenue and expenditure structure reveals the underlying vulnerability.

Within the framework of trade liberalization and promotion of domestic investment, the government has continued to simplify customs duties, reduce corporate taxes, and lower customs duties on investment goods. The direct fiscal effect of these measures has been a drop in revenue relative to GDP, although this decline also reflects the fact that agricultural output is not taxed. Because of the lack of an agricultural tax, an increase in the share of agricultural output in GDP (arising from improvements in the weather) generally results in a fall in the ratio of revenue to GDP.

Box 7.1

A privatization success story—Morocco's telecommunications sector

Morocco's privatization programme began in late 1989, when Parliament adopted a privatization law. The programme presented an initial list of 112 "privatizable" public enterprises that were to be privatized by 1995 (this deadline was later extended).

Guaranteeing the transparency and accountability of the privatization programme has been a major goal. Towards this end, operating responsibilities have been separated, and careful attention has been paid to oversight. The Ministry of Public Sector and Privatization is responsible for managing the process. An interministerial Transfer Commission, appointed by the king, advises the ministry on privatization strategies for different enterprises and on the selection of bidders for open tenders and private placements. An independent Valuation Authority reviews the valuation of enterprises and sets minimum prices. Although the process has not been perfect, there is a general consensus among local and foreign investors that it has been conducted openly and professionally.

The privatization of telecommunications has been hailed as a success story for its exemplary openness and transparency. The government began to liberalize the sector in 1999 by awarding a mobile telecommunications licence through international tender—challenging the monopoly of the state-owned Maroc Telecom. The winner, Medi Telecom, paid $1.1 billion, one of the highest prices ever paid for a mobile licence relative to population size. (This transaction was followed by the sale of 35% of Maroc Telecom for $2.1 billion in December 2000.)

Getting privatization "right" put Morocco on the radar screen of foreign investors and enabled it to reap big rewards. In what ways did Morocco get it right? By establishing a credible regulatory framework, ensuring transparency in the tendering process, and making the terms of the licence attractive.

- The government set up the legal and regulatory framework—including an independent regulatory body, Agence Nationale de Réglementation de Télécommunications (ANRT)—before starting the tendering process. The law clearly defined the principles for licensing and competitive award. And it addressed regulatory risks, dispute resolution, and general principles of interconnection.
- The process for awarding the licence was transparent and conducted fairly by ANRT. The criteria for evaluating bids were clearly set out in the tender documents, and ANRT published a bid evaluation report on its Web site disclosing the scores for each part of the seven bids.
- The licence allowed the winning operator the flexibility to invest in and develop its own network and thus to overcome possible capacity and pricing bottlenecks in Maroc Telecom's network.

The new licence has already led to lower prices and better services. It also promises higher revenues for the government and new job opportunities. The $1.1 billion licence fee boosted fiscal revenues by 13% in 1999—and according to Wellenius and Rossotto (1999), total fiscal benefits (including future taxes and research and development) could be much larger, between $2 billion and $3.5 billion by 2008 in present value terms. Medi Telecom expects to employ around 3,000 people, and its operations may generate an additional 20,000 jobs.

Table 7.4

Public finances, Morocco, 1998/99–2001 (percentage of GDP)

Item	1998/99	1999/2000	2000[a]	2001[b]
Revenue	27.4	27.0	26.3	24.3
Tax revenue	24.6	24.7	24.2	22.2
Expenditure	29.9	31.5	32.4	31.5
Non-interest expenditure	24.8	26.1	27.2	26.5
Wages	11.8	12.1	11.9	12.6
Capital expenditure	5.1	5.0	6.0	5.9
Primary balance	2.7	1.2	–1.2	–2.2
Overall budget balance (commitment basis)	–2.5	–4.3	–6.5	–7.2
Privatization and mobile telecommunications licence revenue	0.1	3.2	0.0	6.3
Overall budget balance (including privatization and mobile telecommunications licence revenue)	–2.4	–1.1	–6.4	–0.9

a. Sum of realizations for the first half of fiscal year 1999/2000 and the second half of calendar year 2000. The fiscal year was changed from July–June to January–December in 2000.

b. Estimated.

Source: *Morocco, Ministry of Economy and Finance; IMF 2001.*

The government achieved its deficit target in 2001 thanks largely to privatization receipts and financial inflows from the World Bank and the International Monetary Fund (IMF). Privatization proceeds reached 6.3% of GDP in 2001, up from almost nothing in 2000. And in May 2001 the World Bank approved a new three-year country assistance strategy that will transfer $250 million a year to Morocco, to support poverty, unemployment, and human development programmes.

"The government achieved its deficit target in 2001"

Expenditures amounted to an estimated 31.5% of GDP in 2001. Non-interest expenditure, which accounted for close to 84% of spending, has been increasing both in absolute terms and as a percentage of GDP. By contrast, interest expenditure has remained around the same since 1996/97. Non-interest expenditure increased from 74.0 billion dirhams in 1996/97 to 91.0 billion dirhams in 1999/2000 and was projected to increase to 102.8 billion dirhams in 2001, while interest expenditure will increase from 18.9 billion dirhams in 1999/2000 to 19.4 billion dirhams in 2001. The main source of the spending increase is the wage bill (which rose by 16.1% in 2001) and capital spending (which increased by more than 30%).

The revenue and expenditure structure of the fiscal budget raises serious concerns. Fiscal revenues have been boosted in the past few years largely through the privatization receipts, a fair portion of which has gone to current spending rather than real investment. The public sector wage bill, which has risen steadily over the years, absorbed close to half of fiscal revenues. As a result, cutting spending will be very difficult if fiscal revenues should fall. To keep the fiscal deficit manageable, the government is relying increasingly on selling assets. The danger is that if the expected privatization receipts fail to materialize, as has happened in the past, the government will have no choice but to fall back on building up arrears to domestic suppliers and increasing government debt.

Monetary and financial policies—inflation kept low

The main monetary policy objectives have been to keep inflation below 3% and to offer sufficient financial support to private sector activity

The Moroccan government's main monetary policy objectives have been to keep inflation below 3% and to offer sufficient financial support to private sector activity. It has undertaken monetary policy reforms centred on adopting market instruments for conducting monetary policy (such as interest and discount rates), increasing the independence of the Central Bank (Bank al-Maghrib), and liberalizing the banking system.

These monetary policy reforms, which began in 1995, have involved abolishing the credit support mechanism, eliminating the requirement for banks to hold treasury bonds, and liberalizing lending rates. In this new context the Central Bank has relied essentially on two instruments for monetary intervention since 1995: a weekly seven-day auction rate (a floor rate) and the five-day repurchase rate (a ceiling rate). Partly in response to cuts in interest rates in the international money market, the Central Bank lowered benchmark interest rates in 2001.

Monetary policy was eased in 2001 to support the economic recovery. The effects of this monetary policy action are reflected in an increase in credit to the economy and growth in the money supply (table 7.5). Foreign reserves also strengthened in 2001. Net foreign reserves, around $5 billion at the end of 2000, rose to around $7 billion by April 2001 as a result of the sale of Maroc Telecom. By the end of 2001 they were estimated to be at a comfortable $7.5 billion, equivalent to around 6 months of imports.

The broad money supply grew by a projected 9.5% in 2001. This growth rate, up from 8.4% in 2000, amounts to an overshooting of the Central Bank's target rate by 6 percentage points. But for now the loose monetary stance can support the economic recovery without putting pressure on prices. The Central Bank has established credibility in maintaining price stability. In 2000 consumer price inflation averaged 2.0%. In 2001, despite the marked improvement in the supply situation, inflation was expected to drop to only 1.9%, as a result of the devaluation of the dirham in 2001 and the lagged effects of the oil price hikes of 2000.

In the financial sector the Central Bank has taken steps to strengthen its supervisory and regulatory functions, mainly by imposing sanctions for non-compliance and extending prudential requirements to non-bank financial institutions. The Central Bank also intends to increase its independence as the supervisor of the banking sector and the stock market. As part of its efforts to reform the financial sector, the Central Bank is restructuring and recapitalizing two troubled development banks. It has introduced management changes in Crédit Immobilier et Hôtelier and taken steps to partially recapitalize the bank. The restructuring of Caisse Nationale du Crédit Agricole, which suffered serious repercussions from droughts, may include debt forgiveness and partial rescheduling of debt for small-scale farmers unable to make their loan payments.

Table 7.5
Monetary trends, Morocco, 1999–2001

Indicator	1999	2000	2001[a]
Billions of dirhams			
Domestic credit	268.2	297.9	317.4
Net credit to government	82.2	92.4	90.5
Credit to the economy	185.9	205.4	226.9
Percentage change from previous year			
Domestic credit	3.1	11.1	6.6
Net credit to government	–10.1	12.4	–2.1
Credit to the economy	10.3	10.5	10.5
Money and quasi money	10.3	8.4	9.5

a. Estimated.
***Source:** Morocco, Ministry of Economy and Finance; IMF estimates.*

Overall, the banking sector remains healthy. Private banks have sound balance sheets, strong branch operations, and the capacity to apply new technologies. Through stricter prudential requirements and prompt measures to address the troubles of banks, the Central Bank hopes to significantly strengthen the performance of the financial sector.

"To encourage transactions on the stock exchange, the authorities published a new law to promote initial public offerings"

Development of capital markets—plans to increase activity

Efforts to develop capital markets have centred on the Casablanca Stock Exchange, which has been substantially transformed since 1993. Before 1993 the exchange was a state institution under the authority of the Ministry of Economy and Finance. Banks were the only authorized dealers. The exchange was extremely illiquid, with the market limited mainly to a small circle of informed investors. Reforms in 1993 significantly altered the roles of different actors in the stock exchange and the conditions under which they operated.

The reforms consisted of three laws to restructure the management and organization of the exchange. The first made the exchange a joint stock company. The second established a securities commission to protect shareholders, oversee the operation of the market, and help the government regulate the stock exchange. The third law established mutual funds, which have steadily increased in number—from 12 in 1995 to 25 in 1996, 42 in 1997, and 116 in 2000. In addition, in 1997 a second-tier market with lower listing requirements was introduced to improve the supply of stocks. The exchange adopted the French screen-driven trading system.

Stock market transactions grew from 6.4% of GDP in 1996 to 10.9% in 2000, after reaching a record high of 28.2% of GDP in 1999. The stock market index appreciated by 47.2% between 1996 and 2000—11.8% a year on average. The trend since 1998 indicates a continual decline, however, with the index falling from 804 in 1998 to 777 in 1999, 658 in 2000, and 568 in October 2001. The authorities have therefore felt a need to boost investor interest in the stock market.

To encourage transactions on the stock exchange, the authorities published a new law in 2000 designed to promote initial public offerings. The law creates a third window open to companies with a capital of 5 million dirhams (rather than the 15 million dirhams required for the first window and the 10 million dirhams required for the second). To help increase the supply of shares, the authorities granted private firms newly quoted on the exchange a 25% income tax break for three years and a 50% tax break if this quotation involves an increase in capital.

One important element of the trade liberalization is the trade agreement with the European Union

Moreover, the exchange has devised a plan of action to increase activity by private and institutional investors. It has promoted information sections, share clubs, on-line services, and advertising to expand the share of stocks held by small private investors. That share is now 3%, compared with a world average of 25% (EIU 2001).

Trade and exchange rate policies—integrating with the world

Morocco's external trade policy is aimed at increasing the country's integration with the world economy and, in particular, promoting exports to the European Union. The country has liberalized the external sector substantially since the mid-1980s. It has reduced tariffs, unified the special import tax and customs tariff, and reduced the number of tariff bands. Despite these changes, the trade regime remains restrictive. For example, Morocco's most favoured nation (MFN) tariffs are higher than those of the other countries in the region (IMF 2001). Efforts are under way to reform the MFN tariffs, mainly by reducing the tariffs and the number of tariff bands.

One important element of the trade liberalization is the trade agreement with the European Union. This agreement includes commitments on good governance, free movement of goods, respect for private property rights, unrestricted capital flows, improved competition policy, and other macroeconomic measures. It also calls for the removal of quantitative restrictions and tariffs.

Morocco is dismantling its quantitative restrictions on imports in line with commitments negotiated in the World Trade Organization (WTO). Its tariff reduction programme is to eliminate tariffs on all industrial goods coming from Europe in three phases between 1 March 2000 and 1 March 2012. The first phase covers a list of essential investment goods for which taxes and tariffs are already very low. The second phase includes industrial raw materials not produced locally and industrial spare parts for which tariffs and equivalent taxes are being progressively eliminated in 2000–02. The third list includes sensitive industrial goods produced locally, for which taxes will be reduced by 10% a year starting in 2003.

Morocco's export promotion policy is aimed at increasing product and market diversification, with a large role for the private sector. A new investment code encourages investment in the export sector by both Moroccan and foreign investors. And the rules and regulations applying to international trade continue to be simplified.

Exporters have been given a number of incentives, including tax rebates, customs facilities, foreign exchange facilities, and free trade zones. Despite these incentives, the export sector's competitiveness has eroded over time as a result of high taxes, the strong dirham, and the high costs of labour and raw materials. During the reform period in the 1990s movements in the shares of the four major manufactured exports in total exports (the Herfindahl-Hirschman Index) indicated diversification in the products exported (Cherkaoui and Jalali 2001). But exports continue to be concentrated in a few markets in Europe.

After narrowing in 1996 and 1997, the trade deficit widened in 1998–2000, rising from 7% of GDP in 1999 to 9.5% in 2000 (table 7.6). Exports grew by only 1% in 2000, compared with 5% in 1999, mainly because of the poor agricultural harvest and the difficulties faced by the textile sector.

"Objectives include reducing the trade deficit and increasing tourism receipts and workers' remittances"

In the first eight months of 2001 imports fell by 0.4%, and exports by 0.7%, compared with the same period in 2000 (EIU 2001). A decline in equipment imports was the main factor in the low level of imports, while a fall in the sales of seafood and vegetables was the main cause of the low level of exports. During the same period, however, exports of leather and textiles grew by 4.1%, and exports of phosphate and phosphate by-products increased by 9%, mainly as a result of a public investment programme to promote the mining sector. On a year-to-year basis, exports rose an estimated 8.1% in 2001, thanks largely to the increase in phosphate exports. The trade balance was expected to improve from −9.5% of GDP in 2000 to −8.7% in 2001, and the current account balance from −1.7% of GDP to 0.7%.

The main objective of exchange rate policy has been to keep the real effective exchange rate of the dirham broadly constant relative to the currencies of Morocco's main trading partners, so as to maintain the country's export competitiveness. Other objectives include reducing the trade deficit and increasing tourism receipts and workers' remittances while taking into account the debt burden and the cost of oil imports.

These objectives are to be achieved, in nominal terms, by fixing the dirham against a basket of currencies and, in real terms, through a budgetary and monetary policy aimed at limiting inflation and dismantling foreign exchange controls. Despite the changing circumstances in both domestic and external markets, the nominal exchange rate was fixed during the past decade. The fixed exchange rate system had several adverse effects, including a 22% real appreciation of the dirham between 1990 and 2000 that led to rising pressures on the competitiveness of the export sector. Moreover, in the past two years the nominal exchange rate appreciated against the euro, which accounts for more than two-thirds of Moroccan export transactions (table 7.7). The textile and apparel sectors have been hit the hardest, since their exports are destined almost exclusively for European markets. Since 1999 the textile sector has reported a loss of 29,600 jobs—12% of its employment (IMF 2001). The sector's problems are not entirely due to the exchange rate appreciation, however.

In response to the deterioration in the export sector, in April 2001 the currency was devalued by 5%. In addition, the basket of currencies was revised to take into account the growing role of the euro in Moroccan trade. The currency devaluation may have contributed to the reversal of the worsening of the trade balance expected in 2001. Nonetheless, exporters have complained that the currency is still overvalued by around 10%. But the government contends

Table 7.6

External sector performance, Morocco, 1999–2001 (percentage of GDP, except where otherwise specified)

Indicator	1999	2000	2001[a]
Trade balance	–7.0	–9.5	–8.7
Current account balance	–0.5	–1.7	0.7
Debt service (percentage of exports)	20.8	20.8	19.3
External debt	50.1	48.3	43.1

a. Estimated.

Source: *Morocco, Ministry of Economy and Finance; IMF estimates.*

Table 7.7

Exchange rates, Morocco, 1997–2001

Exchange rate	1997	1998	1999	2000	2001
Official rate, dirhams per dollar, period average	9.527	9.604	9.804	10.588	11.277
Official rate, dirhams per dollar, end of period	9.714	9.255	10.086	10.641	—
Real effective rate, dirhams per dollar, end of period	114.734	117.478	118.684	122.173	—
Official rate, dirhams per euro, period average	—	—	—	9.82	10.20
Official rate, dirhams per franc, period average	1.63	1.62	1.59	1.49	1.53

— Not available.

Source: *Morocco, Ministry of Economy and Finance.*

“The high rates of poverty and unemployment could undermine the political transition”

that if the U.S. dollar continues to fall against the euro, as is expected, the dirham may soften against the euro. Moreover, the government is worried about the possibility of inflationary pressures resulting from further depreciation. The recent devaluations in Egypt may put further pressure on Morocco, however, as the two countries have similar export patterns. Even with further episodes of discrete depreciation of the dirham, the fixed exchange rate policy will remain a major barrier to improving the competitiveness of the export sector.

Human development—big improvements

Morocco has achieved significant improvements in human development in the past two decades. These advances are reflected in the human development index calculated by the United Nations Development Programme (UNDP); Morocco’s index rose from 0.539 (out of a possible 1.000) in 1990 to 0.596 in 1999. Despite the progress in several social indicators, two vastly different Moroccos coexist: a prosperous urban society to which all amenities are readily available and a poor rural society whose social conditions are closer to those of Sub-Saharan Africa than to those of other middle-income countries. Poverty and unemployment increased in the 1990s, and today one in five Moroccans lives below the poverty line and around 13.6% of the labour force is unemployed. Unless promptly addressed, the high rates of poverty and unemployment could undermine the political transition that started in the mid-1990s.

Although the government has emphasized the importance of the social sector problems and initiated some actions, there has been no consistent vision for financing or implementing the different policies. Thus policies remain rather ad hoc and poorly integrated. Still, the brighter economic performance in 2001 could significantly bolster the capacity for addressing poverty, unemployment, and weak rural infrastructure.

Population—low dependency ratios

Morocco does not appear to suffer the rapid population growth that continues to obstruct growth in per capita income in other African countries. The fertility rate declined from 6.9 births per woman in 1970–75 to 3.4 in 1995–2000. And the population grew by an average 1.7% a year in 1995–2000, increasing from 26.3 million to 28.7 million. Morocco's population is young, with those under 15 representing 32% of the population and those over 60 around 7%. Thus a large share of the population is productive and the dependency ratio is low, with favourable implications for raising savings and capital per worker.

> *A large share of the population is productive, with favourable implications for raising savings and capital per worker*

The population living in urban centres increased from 51.9% in 1995 to 55.0% in 2000. This large share in urban areas—high compared with that in other developing countries—has put significant pressure on urban infrastructure and employment requirements.

Education—attainment up substantially

Educational attainment in Morocco has improved substantially since the mid-1980s. The adult literacy rate rose from 45% to 48% between 1985 and 1999, while the net primary enrolment ratio increased by 31%. Around 30% of tertiary students are enrolled in science, mathematics, and engineering programmes. Despite the progress, these indicators remain lower than those in other middle-income countries and elsewhere in the Middle East and North Africa.

Morocco's education system includes nine years of basic education, consisting of six years of lower basic education for students ages 7–12 and three years of higher basic education for students ages 13–15. After completing basic education, students move on to secondary and technical education, which lasts three years.

Between 1995 and 2000 the number of students in lower basic education grew by an average 4.1% a year, reaching 3.6 million in the 2000/01 school year. The number in higher basic education grew by 2.1% a year in the same period, to 1.04 million. And the number of students in secondary education grew by 6.2% a year on average during that period, reaching 483,720 in 2000. Still, the dropout rate is high in Morocco.

The national enrolment ratio for children ages 6–11 was 80% in 2000, according to the Economic and Development Plan. Disparities were apparent between urban areas (89.7%) and rural areas (69.5%) and between boys (83.8%) and girls (74.1%). There are also large differences in skill attainment between rural and urban schools.

Under the new education reform programme adopted in 1999, all students who pass the baccalaureate examination at the end of high school have the right (in the year in which they pass the exam) to enrol in one of the public universities free of charge. Based on the French model, the higher education system includes 14 public universities, 1 university with a special status, 33 specialized institutions, many teachers colleges, and 83 small private institutions.

The best students usually go to public institutions, where entrance is highly selective. The private institutions offer training in a small number of fields, such as business and computer science; these institutions charge fees and some have a selection process. The public universities enrol some 250,000 students, of which around half are registered in the faculties of law, economics, and political science. The rest study at private institutions (9,000 students) or teachers colleges (16,000 students).

Morocco has one of the highest life expectancies in Africa

The inadequacy of the training provided by the higher education system, and its failure to meet the needs of the labour market, led to attempts to adjust the system, then to a conviction that a reform of the entire system was needed. The reform was aimed at matching the output of the education system to the needs of the labour market and economic development—while reducing the cost per student. Public spending on education has declined as a share of GNP in recent years, however, falling from 6.2% in 1985–87 to 5.3% in 1995–97 according to the UNDP (2001). Even so, it has increased as a share of government expenditure during the same period, from 21.5% to 24.9%.

Health—left to the private sector

Morocco has one of the highest life expectancies in Africa, at 67 years (UNDP 2001). But it has one of the lowest levels of public spending on health, at 1.2% of GNP in 2000. As a result, private spending on health care, at 3.2% of GNP, is higher than that in most developing countries. The low level of public spending on health has created serious problems in the access to and quality of health services, especially among vulnerable groups. Public health spending has benefited mostly affluent groups in urban areas, favouring expensive curative services rather than primary and preventive health care for the rural poor. An estimated 66% of the population has access to essential drugs.

The prevalence of HIV/AIDS in Morocco is among the lowest in the world. In 1999, 0.03% of adults in Morocco were infected, compared with an average 8.7% in Sub-Saharan Africa and 0.2% in Arab countries. The country's infant mortality rate dropped from 119 per 1,000 live births in 1970 to 45 in 1999, indicating a significant improvement in the health status of Moroccans over the past two decades.

Unemployment and poverty—urban unemployment, beyond 20%

The slow GDP growth in 1992–2000, combined with an increase in the wage-rental ratio in the formal sector (resulting from an increase in wages and a decline in the cost of capital), has led to growing unemployment. The unemployment rate has been especially high in urban areas, where it rose from 14.4% in 1987 to 21.5% in 2000. Job losses have been particularly large in the textile industry, as a result of trade liberalization and years of real appreciation of the dirham.

Urban unemployment was higher among women (26.7%) than among men (19.9%) in 2000. It was higher among youth than among older workers—37.6% for those ages

15–24. And it was higher for those holding a university degree, at 29.2%. But the rural unemployment rate, at 5%, was much lower than the urban rate, pulling down the overall unemployment rate in 2000 to 13.6%.

Around 19% of Moroccans live below the national poverty line, but less than 2% live on less than $1 a day. Although the standard of living deteriorated in the initial years of structural reform in the mid-1990s, the decline has been partially reversed as income and consumption have increased, thanks to policies aimed at raising farm productivity and producer prices and better access to productive resources in rural areas. Even so, income poverty and unemployment remain higher than in the early 1990s, and social sector problems are still a major concern (box 7.2).

"The Moroccan economy is expected to do better in 2002"

King Mohammed VI has emphasized giving priority to poverty, unemployment, and illiteracy. The Hassan II Fund, financed by privatization receipts from the telecommunications sector, addresses unemployment. And the government, in cooperation with the World Bank and non-governmental organizations, has increased its efforts in tracking poverty, identifying vulnerable groups, and improving access to health and other social services, especially among women in remote areas.

Medium-term outlook and policy challenges—real GDP growth unlikely to exceed 3.5%

Two main factors account for the fluctuations in macroeconomic aggregates for Morocco: the weather and oil prices. With good weather in place and oil prices remaining below $20 a barrel, the Moroccan economy is expected to do better in 2002, with the improvement in GDP growth expected to continue into 2003. Growth is projected at 4.5% in 2002 and 4.4% in 2003 (table 7.8). Nevertheless, since the country's economic fortunes are still tied to weather patterns, these growth predictions need to be interpreted with the underlying uncertainty and variability of the weather in mind.

Inflation is expected to remain significantly below the 3% target as long as fiscal deficits are kept within the target range and oil prices remain stable. Interest rates in the money and capital markets are expected to move up with the accelerated growth and the rise in government borrowing. The dirham is expected to weaken against the euro as a result of realignment in international currencies in 2002. That could improve the competitiveness of Moroccan exports, especially in Europe, helping to narrow the trade deficit incurred in 2000 and 2001. The trade deficit is forecast to be 7.6% of GDP in 2002 and 7.4% in 2003. And the current account deficit is expected to be 0.4% of GDP in 2002 and 0.2% in 2003. These projections may change, however, if the textile and apparel sector undergoes further structural adjustment because of the phasing out of textile and apparel quotas under the WTO agreement.

Under the 2000–04 fiscal plan, the 2002 budget is expected to include measures to simplify the fiscal system, such as modifying the customs code, aligning the fiscal incentives for companies, and strengthening the mandates of local tax commissions. In addition, the gov-

Box 7.2

Rising poverty and inequality in Morocco

Morocco's slow growth over the past decade, accompanied by frequent droughts, has led to a significant worsening in the living standards of its population. According to the Living Standards Measurement Study survey in 1998–99, 19% of Moroccans lived below the national poverty line, up from 13% in 1991.

Poverty is most prevalent in rural areas, where most people depend on agriculture for their livelihood. In the rural population 1 in 4 is poor, compared with 1 in 10 in the urban population. Moreover, poverty is more severe in rural areas and became increasingly so in the 1990s.

Urban poverty is also on the rise, because of rural-urban migration and the poor performance of manufacturing. A third of the poor now live in urban areas. Urban unemployment rose from 15% of the labour force in 1991 to 22% in 1999. Most affected are young university graduates.

Although poverty worsened in the 1990s, access to basic social services has improved. Nonetheless, serious disparities remain in the equity and efficiency of service delivery.

While Morocco has achieved one of the highest life expectancies in the Middle East and North Africa, infant and maternal mortality rates are significantly higher than the regional averages. Its public spending on health is among the lowest in the region. And there is a large gain in health indicators between rural and urban areas. In some rural areas the proportion of the population with access to health services is only a fourth that in urban areas. This gap is exacerbated by the urban bias in government health spending, with urban hospitals absorbing close to 70% of the recurrent budget.

Although the government devotes significant resources to education—amounting to 6% of GDP—the quality and equity of education are serious concerns. Morocco has one of the highest illiteracy rates in the region, at around 52%. But among rural women 83% are illiterate, reflecting stark disparities by gender and between rural and urban areas. Even though enrolment ratios are rising, around 2.5 million children—most of them rural girls—do not go to school.

Inequalities in education spending are partly responsible for the disparities in attainment. For example, around 20% of resources go to secondary education, and 17% to tertiary education, where spending disproportionately benefits urban and better-off segments of the population. The problems in the quality of education are reflected in poor retention and the mismatch between higher education and the needs of the labour market.

Since the mid-1990s the government has sharpened its focus on regional and gender disparities in poverty and in access to basic services. It has expanded public investment in rural infrastructure programmes, introduced social programmes in the poorest regions through such initiatives as the Social Priorities Programme, and taken measures to promote girls' enrolment. While it is still early to measure the full impact of these initiatives, preliminary results are encouraging. Girls' primary enrolment in rural areas is reported to be increasing. And some progress has been made in improving basic rural infrastructure.

***Source**: World Bank 2001.*

Table 7.8
Medium-term outlook, Morocco, 2002–03 (percent)

Indicator	2002	2003
Real GDP growth	4.5	4.4
Export growth	8.2	7.3
Trade balance as percentage of GDP	–7.6	–7.4
Current account balance as percentage of GDP	–0.4	–0.2
Inflation rate	2.8	2.3

Source: *Economic Commission for Africa from official sources.*

ernment will grant institutional investors a 50% tax break on profits on the sale of shares and exempt individual investors from income taxes on such profits. And it is expected to reduce the value added tax on some products used in the pharmaceutical industry from 20% to 7%.

> *The government must address the pressing needs of boosting economic growth and reducing poverty and unemployment*

The government is expected to further widen the tax net and reduce spending on the civil service and on consumption subsidies. Even so, the budget deficit is expected to rise slightly above the 3% target in 2002 given the national elections in September 2002 and the increase in capital spending in rural areas and the coastal tourism sector.

The 2000–04 economic plan sets three main macroeconomic objectives:

- Maintaining GDP growth of at least 5% a year.
- Reducing the external debt burden by lowering the debt-to-GDP ratio to 3.5% and the debt service ratio to 20% of exports by 2004.
- Keeping both the inflation rate and the budget deficit below 3%.

Achieving these objectives will require policy changes in key sectors of the economy. The Moroccan government must address the pressing needs of boosting economic growth and reducing poverty and unemployment to pave the way for a smooth transition into the global economy.

Agriculture

In agriculture the major policy challenges are promoting sustainable agriculture and reducing vulnerability. These challenges call for:

- Improving the control of water resource use.
- Reversing policies that promote cultivation on climatically vulnerable land.
- Pursuing efficient research and dissemination efforts aimed at transferring appropriate technologies to farmers and reducing vulnerability to adverse weather conditions.
- Adopting a regional approach to development, so as to efficiently exploit the diverse potential of different regions.
- Adopting a new approach to agricultural financing, using mechanisms appropriate to farmers' needs and the climatic conditions.

Industry and services

In industry and the service sector the main challenges include:

- Restructuring local industry to take full advantage of the opportunities emerging from the free trade association with Europe, through improvements in capacity utilization and the adoption of new technologies.
- Developing an appropriate legal and public service delivery system that is sensitive to the needs of the business community, local and foreign.
- Developing new industrial zones and rehabilitating existing ones.
- Improving labour management through effective labour laws.

> *Morocco's export performance has been unsatisfactory in recent years*

Fiscal and monetary policy

Achieving a stable, growing, and competitive economy entails several key fiscal and monetary policy challenges in the medium term:

- Addressing the vulnerability of the fiscal position. The steadily rising wage bill and the overreliance on private sector receipts to maintain revenue are concerns that need to be promptly addressed.
- Establishing a stable real exchange rate regime. This might require adopting a flexible exchange rate system that responds effectively to exogenous shocks.
- Achieving price stability.
- Enhancing the credibility of the Central Bank in the management of the economy.

External sector

Morocco's export performance has been unsatisfactory in recent years, limited by overdependence on the European market, appreciation of the dirham against the currencies of major trading partners, and competition from Asia and Eastern Europe in the market for light manufactures.

The fixed exchange rate regime has been a major constraint on the competitiveness of the export sector. Discrete devaluation may not help. The government needs to think about introducing a floating exchange rate system.

Results of a study by Cherkaoui and Jalali (2001) suggest that real exchange rate depreciation alone cannot achieve sustained export growth. The reason is that once the initial macroeconomic framework is set, including the real exchange rate, the momentum for export growth will slow. Sustained export expansion requires export diversification, product innovation, and quality upgrading. And all these require appropriate industrial and competition policies complemented by strategic alliances, joint ventures, and government-supported research and development programmes.

Human development

Among the main challenges in human development are these:

- Achieving a sustained reduction in poverty and unemployment.

- Reducing disparities in enrolment ratios and achievement levels between rural and urban areas and between males and females.
- Reducing the dropout rate.
- Extending health services to rural areas and to the urban poor.
- Enhancing safety nets for the poor and the unemployed.
- Increasing access to basic infrastructure for the rural poor.

* * *

The pace of economic growth in the past has fallen far short of expectations and of the potential of the country. Both structural and macroeconomic weaknesses are to blame. The overdependence on agriculture, the deteriorating fiscal outlook, and the lack of competitiveness in the export sector may continue to threaten Morocco's ability to achieve the macroeconomic objectives of the 2000–04 economic plan. Unless these constraints are addressed, real GDP growth may not exceed 3.5% a year over the long term.

"The pace of economic growth has fallen far short of expectations and potential"

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