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Country Development Strategy Statement

FY 1988

MOROCCO

ANNEX B

DETAILED ASSESSMENT:
MOROCCO'S MACROECONOMIC ENVIRONMENT & PROSPECTS

February, 1986

Agency for International Development
Washington, D.C. 20523

UNCLASSIFIED

A N N E X B

DETAILED ASSESSMENT: MOROCCO'S MACROECONOMIC ENVIRONMENT & PROSPECTS

M O R O C C O

COUNTRY DEVELOPMENT STRATEGY STATEMENT

(FYs 1987 - 1991)

FEBRUARY 1986

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Annex B

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Assessment of the Macroeconomic Environment and Prospects

1. Economic Structure and Performance

a. Structural Patterns

Aggregate Trends

Between 1967 and 1984, Morocco's real Gross Domestic Product (GDP) has grown at an average annual rate of 5 percent, or about 2.3 percent per capita. This respectable average reflects primarily a good performance in the late 1960's and mid-1970's; growth has slowed considerably since (cf. Figure 1). Between 1967 and 1977, real GDP grew 6.5 percent per year on the average. Since 1977, the average rate of 2.9 percent barely edged the population growth rate (cf. Table 1). The statistical series for GDP in current dirhams is presented in Table 2. Preliminary data for 1985 paint a favorable picture, with GDP in current prices reaching 124 billion dirhams (about $12.6 million). This level implies a growth of 4.8 percent in real terms, roughly 2 percent per capita. Agriculture accounted for much of that gain, increasing its value added by 14 percent.

Sectoral Structure

Although still heavily dependent on agriculture, Morocco's economy is becoming more diversified. With 42 percent of total employment, agriculture currently contributes about 17 percent of GDP. Agro-industry accounts for an additional 5 percent of GDP, producing 31 percent of the value added in manufacturing. Agriculture's current share represents a decline by half over a thirty-year period; the shares of the industrial and service sectors have increased correspondingly (cf. Figure 2 A,B & C and Table 3). Over the last few years, value added in agriculture has remained nearly constant in real terms. Growth has been entirely due to industry and handicrafts, commerce and other services, and especially public administration.

Between the two Census years, 1971 and 1982, the percentage of total employment in agriculture has declined from over 55 percent to less than 42 percent (cf. Figure 3). The manufacturing sector has registered the biggest absolute gain in the share of total employment, increasing from 11 percent in 1971 to 18 percent in 1982.

The pattern of Morocco's industrial development have been shaped by protectionist policies. Protection against the competition of imports created an incentive structure that made investments in import substitution activities 50 percent more profitable than investments in export industries. Thus, import substitution provided the major impetus for industrial growth, with export activities concentrated in a few sectors. Sheltered from competition, industry remained inefficient and often unable to respond to the needs of the market. A worsening economic environment in the early 1980's, combining a severe drought, dramatic increases in energy prices and a worldwide recession, triggered a crisis that revealed the weaknesses of Morocco's economic structure.

Figure 1

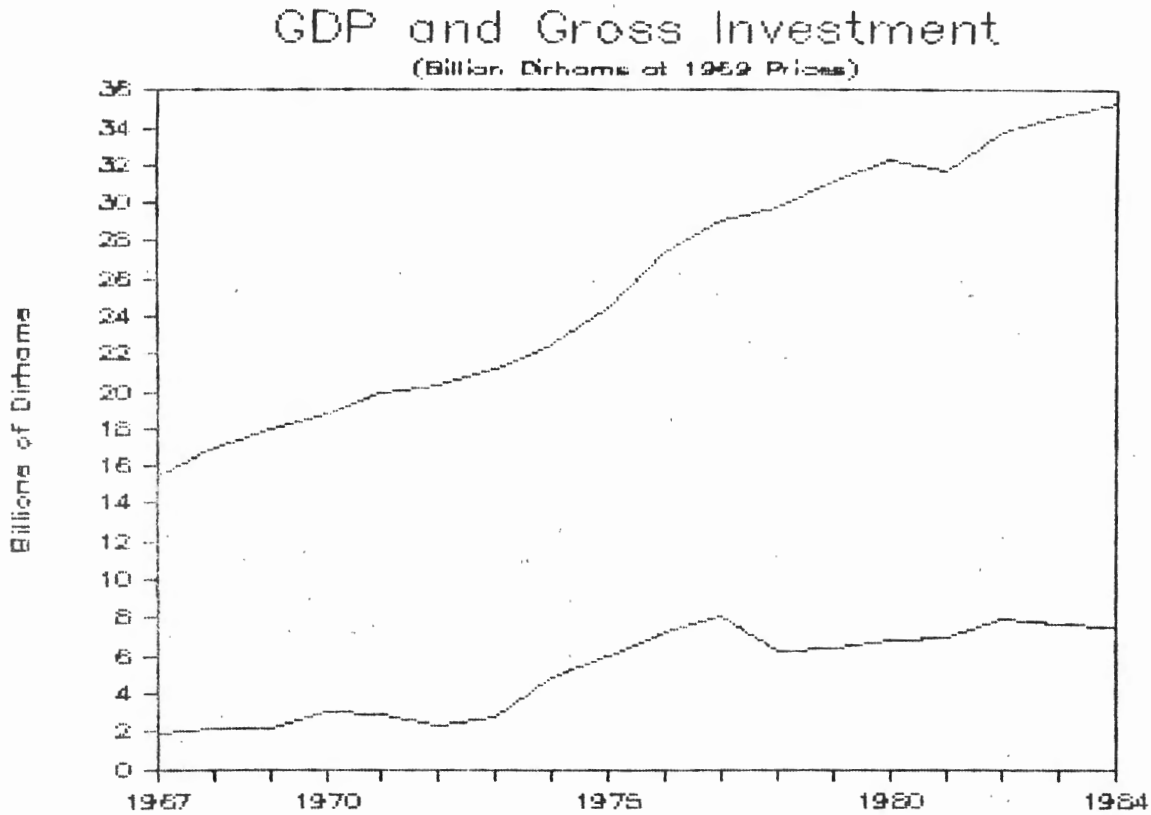
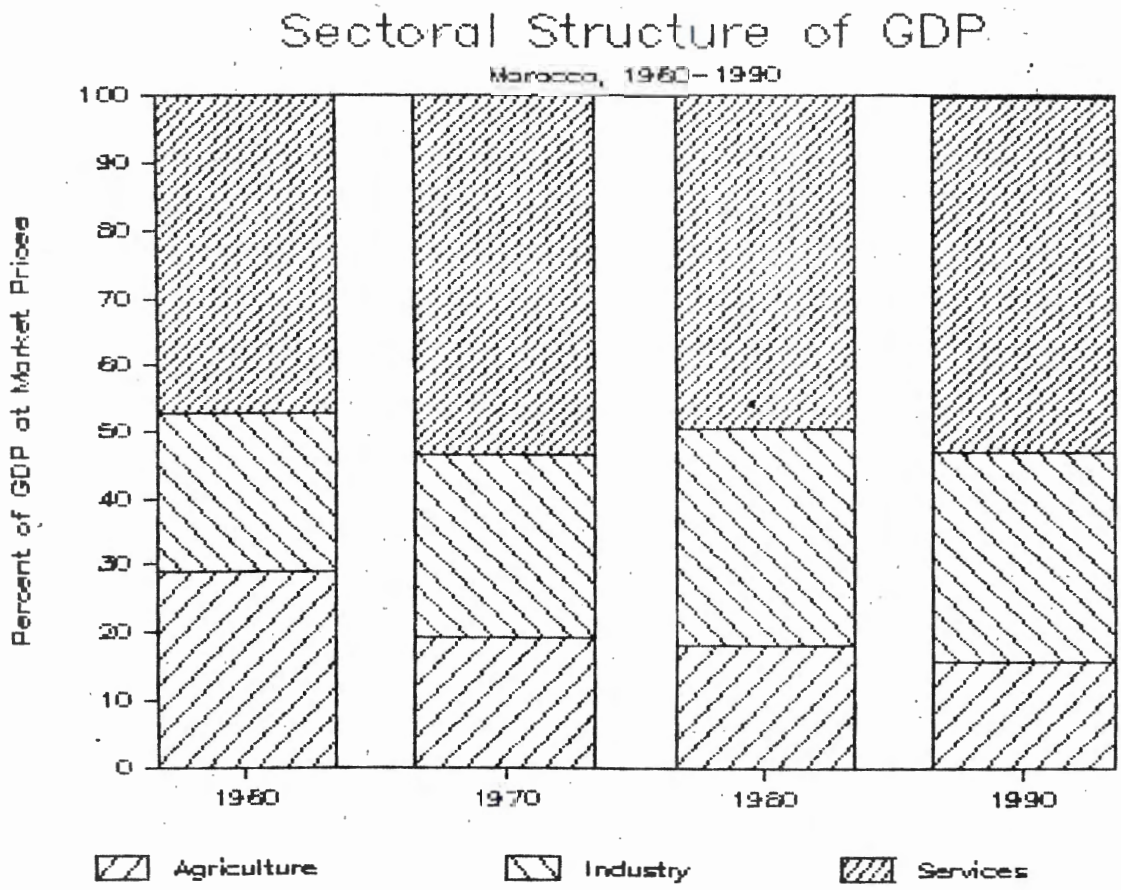


Figure 2 (A)



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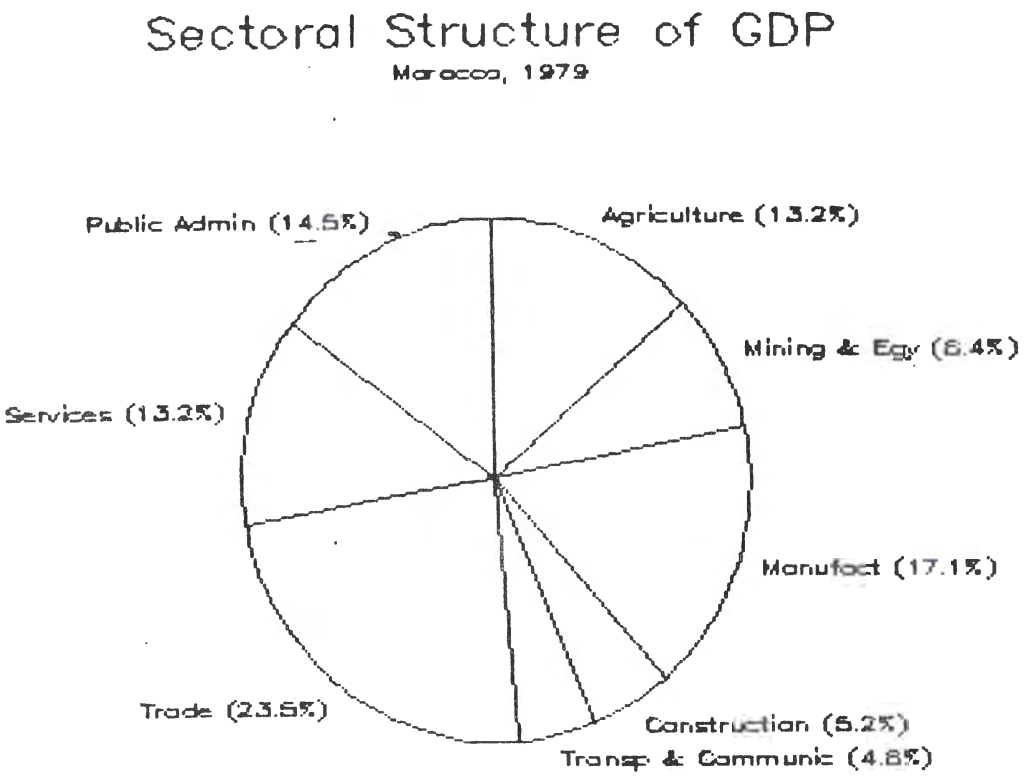

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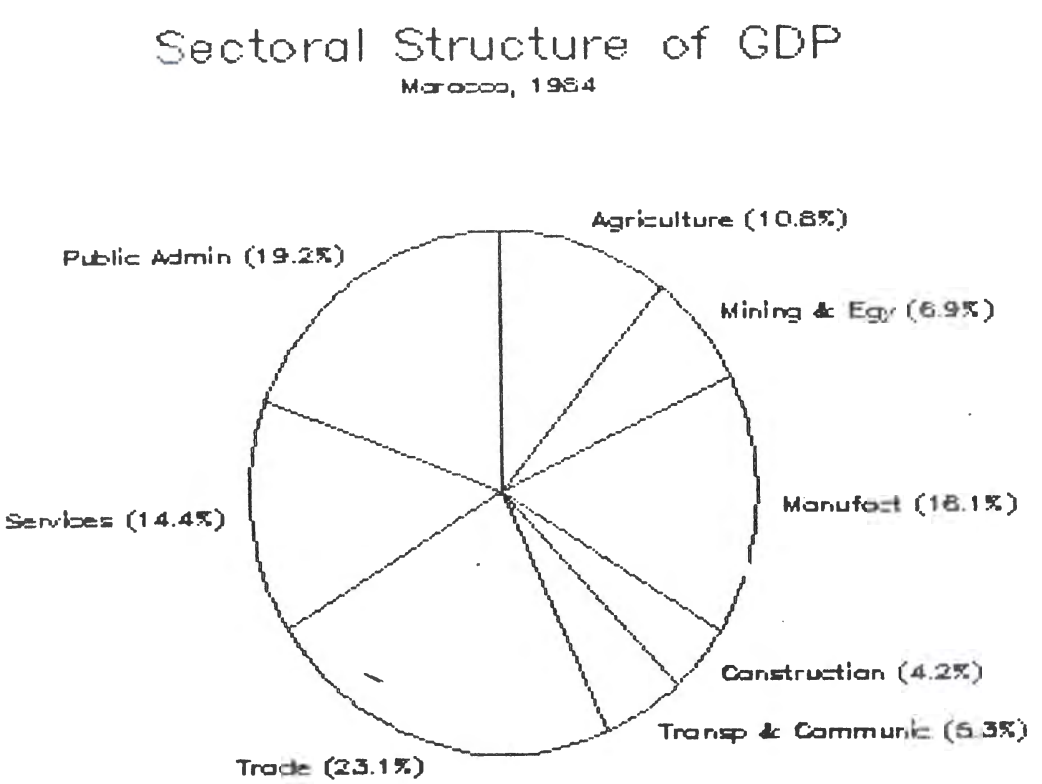


Figure 3 (A)

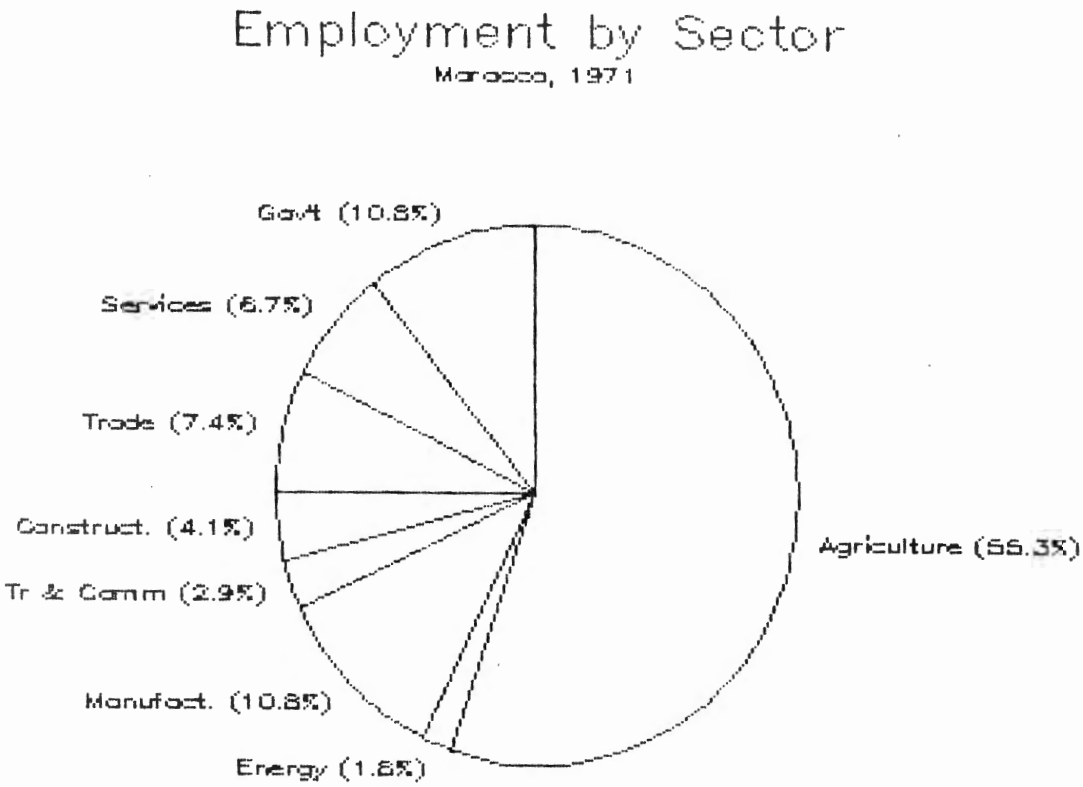


Figure 3 (B)

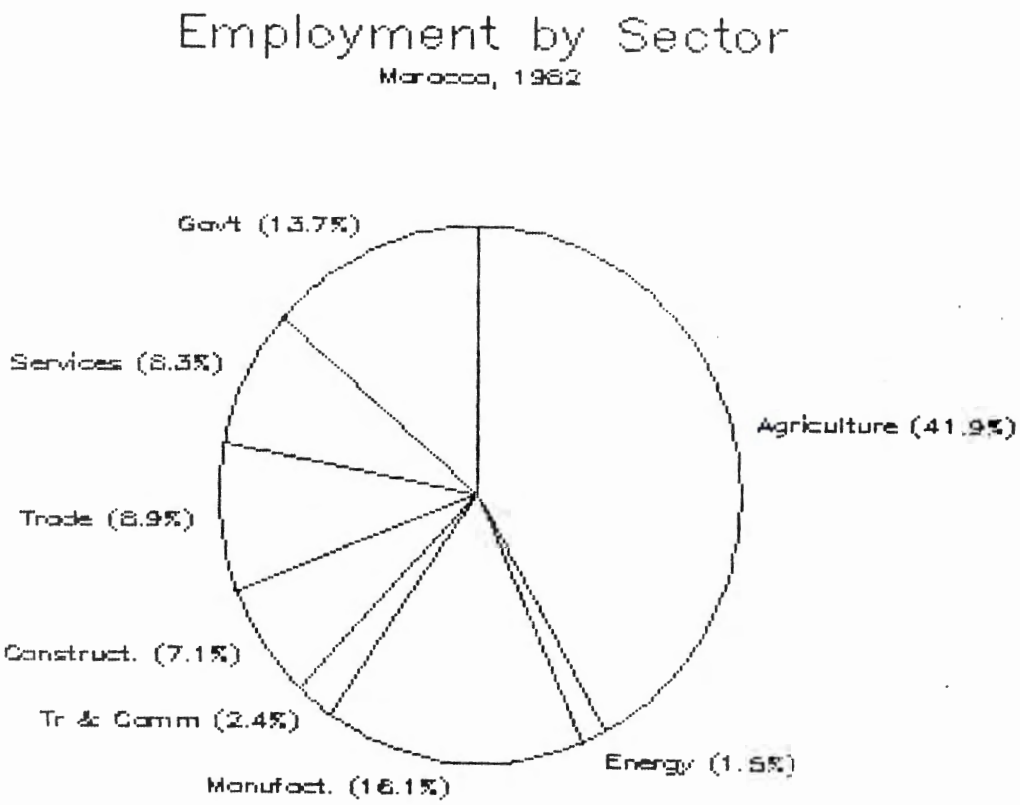


Table 1

GROSS DOMESTIC PRODUCT AND GDP PER CAPITA 1979-1984

(Billions of constant dirhams, 1969 base)

ACTIVITY	1979	1980	1981	1982	1983	1984
Agriculture, Forestry and Fishing	4.1	4.3	3.3	4.0	3.8	3.9
Mining	1.0	.9	.9	.9	.9	1.0
Energy and Utilities	1.6	1.3	1.4	1.5	1.5	1.5
Industry and Handicrafts	5.3	5.5	5.5	5.5	5.7	5.8
Construction and Public Works	1.6	1.5	1.4	1.6	1.5	1.5
Transportation and Communications	1.5	1.6	1.6	1.8	1.8	1.9
Commerce	7.3	7.7	7.6	7.9	7.9	8.3
Hotels, Restaurants, Insurance and Banking, Services	4.1	4.3	4.5	4.6	4.8	5.2
Public Administration	4.5	5.0	5.5	6.1	6.6	6.9
TOTAL GDP	31.0	32.1	31.7	33.9	34.6	36.0
Growth Rate (%/yr.)	4.8	3.6	-1.3	6.9	2.2	3.9
Population (millions)	20.0	20.5	21.1	21.6	22.2	22.8
Per Capita (GDP) (thousands of dirhams)	1.5	1.6	1.5	1.6	1.6	1.6

Source: Ministry of Plan and most recent IBRD population estimate.

Table 2

GROSS DOMESTIC PRODUCT AND GDP PER CAPITA 1979-1984

(Billions of current dirhams)

ACTIVITY	1979	1980	1981	1982	1983	1984
Agriculture, Forestry and Fishing	11.1	12.7	11.4	16.3	16.0	17.8
Mining	2.8	3.4	4.2	4.0	4.0	5.3
Energy and Utilities	2.2	2.4	2.7	3.3	3.4	3.9
Industry and Handicrafts	10.4	12.0	13.4	14.6	16.0	18.0
Construction and Public Works	4.9	4.9	5.4	6.6	6.8	7.5
Transportation and Communications	2.6	3.1	3.4	4.0	4.5	5.7
Commerce	12.2	13.4	15.0	17.2	17.7	19.8
Hotels, Restaurants, Insurance and Banking, Services	8.5	9.7	11.2	12.7	13.7	15.9
Public Administration	7.3	8.6	10.0	11.5	12.5	13.2
TOTAL GDP	62.0	70.2	76.7	90.1	94.6	107.0
Growth rate (%/yr.)	12.5	13.1	9.0	17.5	5.0	13.1
Population (millions)	20.0	20.5	21.1	21.6	22.2	22.8
Per Capita GDP (thousands of dirhams)	3.1	3.4	3.6	4.2	4.3	4.7

Source: Ministry of Plan and most recent IBRD population estimate.

Table 3

SHARE OF GDP AT MARKET PRICES

(Percentage)

	1960	1970	1980	1990
Agriculture	29.1	19.2	18.1	15.7
Industry	23.5	27.2	32.3	31.3
Services	47.4	53.6	49.6	53.0

Investment Trends and Policies

Gross investment as a percentage of GDP soared in the mid-1970's (cf. Figure 4). Buoyed by high prices and strong demand in the world market for phosphates in 1974, Morocco embarked upon an investment spree, led by the public sector which often opted for projects with low rates of return or long-term payoffs. This strategy accounts in part for current difficulties. The investment rate has since dropped, but not back to the levels of the late 1960's and early 1970's.

Since 1983, the GOM has sharply curtailed public investment, in compliance with agreements under successive IMF Stand-by Arrangements. Private sector investment had remained steady at about 12 percent of GDP, but increased to 16 percent in 1984 in response to new incentives (cf. Table 4).

The efficiency of investment, which was badly eroded by poor public investment selection, is projected to improve significantly during the rest of the decade. It will still fall short of the levels of the late 1960's and early 1970's when the incremental capital-output ratio (ICOR), was closer to what is generally considered adequate (roughly 3). The expected improvement in the overall productivity of investments should result from a continuing shift to private sector investments, and better project selection in public investments.

To improve public investment choices, the GOM has launched several initiatives to honor a pledge it made at the Consultative Group Meeting in January 1985 to develop its capabilities in economic analysis and investment appraisal. The most prominent of these is the National Training Program in Project Appraisal and Management (PNAP) which will complement the training of analysts in various GOM agencies by the promulgation of project appraisal standards and the provision of technical assistance to GOM Ministries requesting it.

As illustrated in Figure 5, gross national savings have been inadequate to finance Morocco's level of investment. The financial sector has been unable to mobilize additional savings, largely because government regulation provided neither the means nor the incentives to pursue household savings more aggressively. The positive response of Moroccan workers abroad to specific incentives, and the oversubscription of the first government bonds issued to the public since 1976 suggest untapped opportunities for mobilizing household savings.

Foreign investment in Morocco had been extensive, reflecting in part the country's colonial past. Following the sweeping Moroccanization of the early 1970's, the share of total equity held by foreign investors dropped, but has remained significant. In manufacturing, this share was estimated at 18 percent (1978). The current economic policy reform in fact also seeks to dismantle barriers to foreign direct investment. Concentration of domestic ownership is high. As in other developing countries, relatively few family groups account for a major share of total equity held by Moroccan investorsñ according to some estimates, family holdings may account for as much as 48 percent of equity in manufacturing.

Figure 4

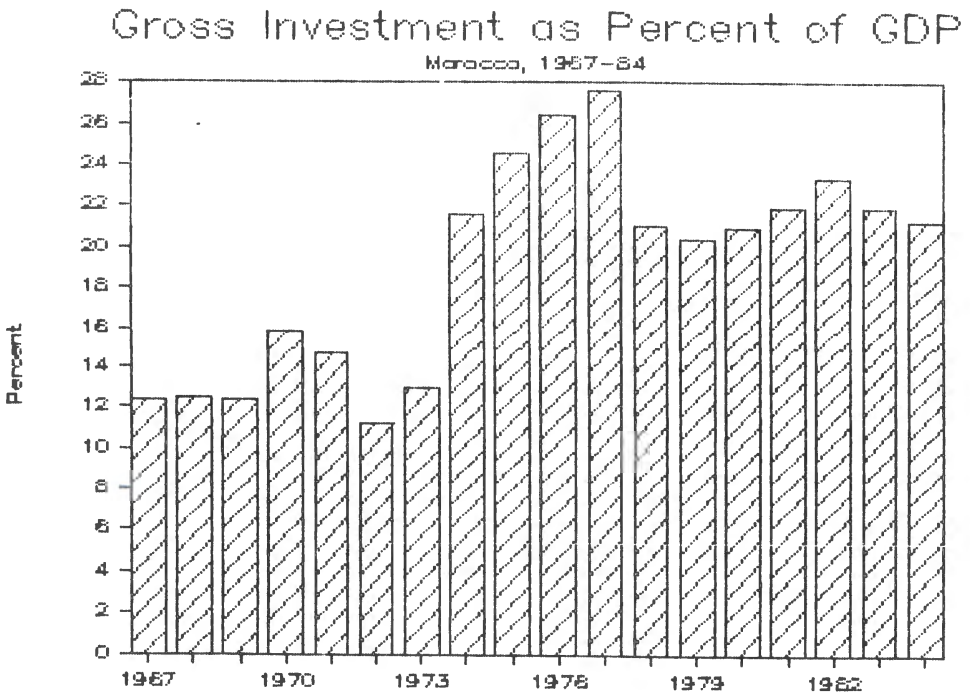


Figure 5

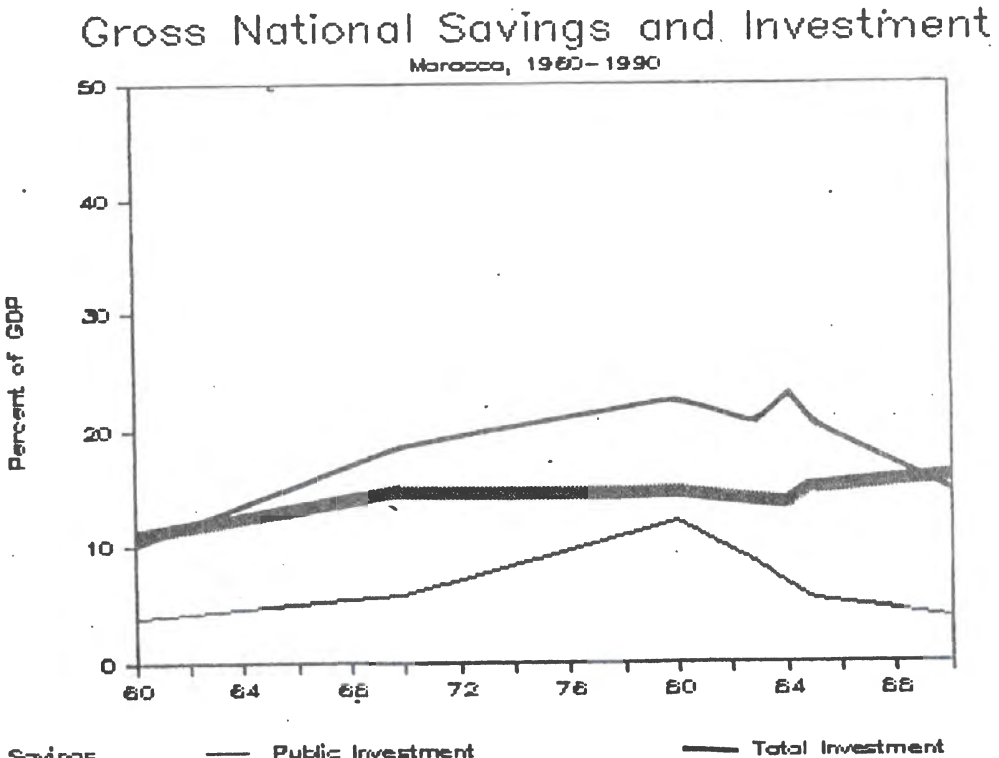


Table 4

Savings and Investment as Percent of GDP

	1960	1970	1980	1983	1984	1985*	1990
Gross National Savings	11.0	14.8	14.6	14.0	13.8	15.0	15.9
Gross Investment	10.3	18.5	22.6	20.6	23.0	20.3	14.7
of which:							
(Public Capital Expenditure)	(3.8)	(5.7)	(12.2)	(8.4)	(6.8)	(5.4)	----
(Private Investment)	(6.5)	(12.8)	(10.4)	(12.2)	(16.2)	(14.9)	----
ICOR (5-yr. average up to year)	----	3.1	4.1	-----	-----	8.3	5.7

Source: IBRD Report to the Consultative Group for all years except 1985
*Provisional GOM estimates for 1985.

Fiscal Performance

Under successive IMF Stand-by Arrangements, the GOM has reduced its budget deficit to more manageable levels, by slashing the investment budget and restraining the growth of the operating budget. In 1984, it met the IMF program target of reducing the deficit to 6.8 percent of GDP after debt relief, compared to 12.3 percent in 1982, in spite of tax revenues falling far short of projections. This reduction was accomplished only at the cost of severe cuts in the investment budget. The GOM exceeded its investment budget by a fair margin in the first part of 1985, triggering delays in a new Stand-by Arrangement and necessitating some budget "heroics" in July of 1985. According to preliminary information, the GOM exceeded the 1985 IMF program target of 6.5 percent, but this performance still represents a significant improvement over prior years.

At first glance, the budget for 1986 (cf. Table 5) appears to reverse the progress made with a leap in the investment budget to 20.5 billion dirhams (about $2 billion), some 67 percent higher than budgeted investment in 1985, or about three times the level finally agreed on with the IMF for 1985. However, the 1986 capital budget has been formulated in part according to political criteria; it is designed to conceal the full impacts of the austerity program. A large portion of this budget is contingent upon the availability of concessional financing to complement GOM contributions. To undertake all investment projects in the budget would require some 19.8 billion dirhams of concessional financing (cf. Table 6). Assistance levels are expected to fall far short of that figure. Since the GOM will not borrow on domestic capital markets beyond the amounts programmed with the IMF, most of the budgeted investments will not be implemented this year. The Ministry of Finance expects actual investment expenditure in 1986 to be on the order of 8 to 9 billion dirhams, almost all of which will be financed on concessional terms by the donor community.

The government sought to complement its efforts to bring the budget deficit under control by a reform of the tax structure, designed to make it simpler and to remove any inherent distortions. In its 1985 fall session, the Moroccan parliament voted to replace a complex sales tax by a value-added tax, and to simplify the income tax system. The designers of the new tax system expect at best marginal increases in revenues, although Morocco's current relative tax burden seems to be lower than in other countries in its income category.

Policy Planning

In principle, the GOM has been guided by a series of successive multi-year plans -- 1973-77, 1978-80, and the last one 1981-85. These plans focus primarily on the public investment program, typically with inadequate consideration of macroeconomic policies and their implications. More often than not, these plans were revised substantially or virtually abandoned during implementation. Even so, they remain important elements of the process of formulating the GOM's investment policies. They map out the activities of the various technical Ministries in charge of specific sectors, and provide a framework for the investment portion of the annual budget, the Loi de Finances.

Table 5

CENTRAL GOVERNMENT BUDGET
(Actual Receipts and Expenditures in billions of dirhams)

	1981	1982	1983	1984	1985*	1986**
General Revenues	17.8	20.5	21.1	23.5	27.8	29.2
Less: Operating Budget	15.8	17.2	18.0	19.0	20.8	22.1
Less: Public Debt	4.5	4.6	3.5	4.4	10.8	19.4
Operating Budget Surplus or Deficit	-2.5	-1.3	-0.4	+0.1	-3.8	-12.3
Less: Investment Budget	9.6	12.5	7.6	7.3	6.7	20.5
General Budget Surplus or Deficit	-12.1	-13.8	-8.0	-7.2	-10.5	-32.8

* Estimated actual expenditures and revenues for 1985.
** Planned expenditures and revenues of the 1986 budget before debt relief.

Source: Ministry of Finance - Treasury Operations Divisions

Table 6

FINANCING THE GENERAL BUDGET DEFICIT
(billions of dirhams)

	1981	1982	1983	1984	1985*	1986**
Annexed Budget and Special Treasury Accounts (net)	-.7	1.3	----	----	----	-1.5
Reserved Funds/Arrears	-.1	2.0	-2.3	-0.3	-3.0	N/A
Loans						
-Domestic	1.9	1.9	3.3	0.9	2.2	1.6
-Foreign	8.5	7.6	2.4	5.2	6.9	19.8
Grants	----	----	1.0	0.1	3.0	-----
Exceptional Revenues	----	----	0.2	----		
Recourse to IMF Facilities	.8	2.9	.8	1.4	-----	-----
Advances from the Bank of Morocco	1.6	-1.3	2.6	-0.1	-----	N/A
Special Bond Issue	----	----	-----	------	1.4	N/A
Postal Checking and Treasury Deposits	.1	-.6	N/A	N/A	N/A	N/A
TOTAL	12.1	13.8	8.0	7.2	10.5	19.9
Additional Financing Required	----	----	-----	----	-----	12.9

* Estimated actual expenditures and revenues for 1985.
** Planned expenditures and revenues of the 1986 budget before debt relief.

Source: Ministry of Finance - Treasury Operations Divisions

Past plans have suffered from both overambition and indiscriminate acceptance of proposed investment projects. Moreover, investment projects were authorized as part of the annual budget cycle without regard for the availability of financing. As a result, the GOM had been carrying a huge "overhang" of authorized projects for which financing was yet to be found. Efforts to cull worthwhile projects from this overhang to come up with a manageable list encountered many problems. To resolve this issue, the GOM adopted a form of "zero-based budgeting:" for the first time ever, it canceled all outstanding project authorizations, reviewed the entire public investment program with the assistance of the World Bank and drew up an investment budget for 1986 retaining only those projects which passed muster. The 1986 budget also serves as a transition between two Plans, following the completion of the 1981-85 Plan and in anticipation of the next.

Monetary and Financial Policies

The money supply and credit growth are tightly controlled and administered by the Central Bank. Even so, inflation has been increasing in recent years as a result of the decontrol of prices, reaching 12 percent in 1984 and 1985.

Monetary controls work through allocations of credit expansion to the private banks (who are penalized if they exceed the ceilings) and by monitoring the growth of credit to the Treasury. Regulation and protection have made it unnecessary for banks to market their services more aggressively to savers and borrowers alike. Banks have favored state-owned enterprises and large private enterprises as borrowers, which have captured the lion's share of commercial bank lending. Credit availability to small and medium enterprises has been limited. This system has resulted in a mediocre record in mobilizing household savings, has required a rationing of credit, and has assured less than efficient use of financial resources.

The GOM has begun to take the steps necessary for improved performance, which include a partial deregulation of interest rates for depositors and borrowers -- the government now sets ceiling and floor rates instead of fixing the rates outright -- as well as a partial removal of administrative controls on the allocation of credit. The government also no longer borrows at preferential rates. These reforms may not be sufficient. For example, current spreads on interest rates offer no room for real price competition among financial intermediaries.

Initiatives to mobilize additional resources through public issues of government bonds have been surprisingly successful. Two issues offering very attractive terms in 1984 and in 1985 -- the first since 1976 -- were substantially oversubscribed.

Housing and agriculture play particularly important roles in the restructuring of the financial sector. Private investments in housing remain one of the most effective forms of saving. Such investments are encouraged through subsidized interest rates for housing loans and special tax treatment. With respect to agriculture, the GOM has been seeking ways to improve the performance of financial intermediaries serving small and medium-size farms.

Public Enterprises

The GOM owns a good portion of Morocco's industry. In 1978, the state owned some 47 percent of the equity in the manufacturing sector. This percentage reached 90 percent in energy, 53 percent in the mining sector, and 32 percent in construction (cf. Table 7). These percentages are beginning to decline, but more recent data are not yet available. With the notable exception of phosphate products, enterprises in the export sectors (agro-industry, textiles, clothing and leather goods, and electrical and mechanical industries) are predominantly privately owned.

As a group, public enterprises have represented a drain on the Treasury. In four of the five years 1977-1981, public enterprises (excluding the profitable phosphate operations) required more than 2 billion dirhams (about $204 million) in annual subsidies to stay afloat. Given this dismal performance, the GOM has launched efforts to improve the performance of public enterprises and to turn management and eventually ownership for selected operations over to the private sector.

The diagnosis is clear: public enterprises have little or no incentive to pursue efficiency. Price controls often make it impossible to earn sufficient revenues to finance modernization investments. Worse, major clients of public enterprises (particularly the administration and other public enterprises) have been slow in paying their bills, running up sizeable arrears. For example, the national electricity utility in 1982 was owed some 550 million dirhams ($56 million) by other government entities (net of its own debts). Disentangling this "morass of claims and counterclaims" has proved to be difficult, requiring major revisions of accounting practices among public enterprises. These problems exacerbate the fundamental issue of poor management. Managers of state-owned enterprises go virtually unrewarded for good performance, and typically do not have to answer for poor results. In addition, information and control structures within the public enterprises are often so rudimentary that effective management becomes all but impossible.

A "Comité de Vigilance" has been established in the Ministry of Public Works (Equipement) to direct public enterprise reform. This committee has promulgated management guidelines rules aimed at cost containment. It is also working with the World Bank to develop ways to reduce the mutual arrears and establish better management and information system. Furthermore, and of great interest to USAID, the GOM is experimenting with options for increasing the role of the private sector, notwithstanding considerable domestic opposition. It has virtually eliminated the state monopoly on the export marketing of agricultural produce, licensed private operators to provide public transit services in urban areas (including Casablanca), and has contracted with private companies operate to state-owned hotels and tourism complexes. Options to sell off public enterprises have been discussed in public. However, few state-owned enterprises show the kind of financial performance that would arouse the interest of private investors. Morocco also lacks the financial markets capable of handling divestiture effectively. Consequently, much of the attention has focused on steps needed to create the conditions for privatization.

Table 7

Assets, Equity and Public Enterprise Participation in Morocco's Manufacturing Industries, 1978[a]
(millions of dirhams)

	Assets		Equity		Public Enterprise Participation in
	(Value)	(Percent)	(Value)	(Percent)	Equity (percent)
Flour, sugar and baked goods	1,362	14.0	635	13.4	67.0[b]
Canned vegetables and fish	928	9.5	452	9.6	15.5
Beverages	389	4.0	73	1.5	23.3
Tobacco	135	1.4	11	0.2	100.0
Textiles	2,269	23.2	654	13.8	20.9
Clothing	106	1.1	60	1.3	0.0
Leather and Footwear	100	1.0	81	1.7	--
Wood and Furniture	220	2.3	94	2.0	--
Paper and Printing	789	8.1	260	5.5	98.2
Rubber and Plastics	488	5.0	779	16.5	3.2[c]
Chemicals	509	5.2	412	8.7	90.0[d]
Oil refining	546	5.6	455	9.6	100.0
Processed quarry products	813	8.3	244	5.2	89.7[e]
Metallurgy	46	0.5	24	0.5	42.0
Metalworking	485	5.0	202	4.3	77.7
Machinery	159	1.6	48	1.0	35.4
Electrical Products	138	1.4	94	2.0	--
Transportation Equipment	272	2.8	141	3.0	27.0
Other Industries	8	0.0	4	0.0	--
TOTAL	9,762	100.0	4,723	100.0	46.6

a/ Firms employing ten persons or more.

b/ Equals to about DH 450 million in the sugar industry.

c/ In the rubber industry.

d/ Consists largely of the production of chlorine, caustic soda, polyvinyl chloride PVC phosphoric acid and fertilizers.

e/ In the cement industry.

Source: IBRD, Report No. 4893-MOR, Morocco Industrial Incentives and Export Promotion.

b. Income and Employment

Unemployment and Underemployment

Quantitative measures for unemployment and underemployment remain somewhat suspect because of definitional and data gathering problems. Data for 1982 indicate an overall unemployment rate of 10.7 percent, which applied equally to the male and female labor force. 1/ Estimates for 1985 put the unemployment rate at about 11.5 percent.

The 1982 data also show a more serious problem for labor force entrants. Some 44 percent of all first-time job seekers was unemployed. In fact, the percentage of secondary and post-secondary school graduates who found a job within the first six months dropped from 43 percent in 1977 to 25 percent in 1982. About a quarter of the young adults in the labor force (age 15-24) was unemployed. Population projections prepared by the Ministry of Plan suggest that about a quarter million (252,000) new job seekers will join the labor force each year over the next five years.

A definition of underemployment as work for less than two-thirds of the workyear puts some 18 percent of the employed population (11.6 percent of the male and 34.1 percent of the female workers) into the underemployed category. Thus, about one-third of the population in the labor force is either unemployed or underemployed. This percentage appears to have been increasing slowly but steadily over the last decade or so.

Job Creation

The manufacturing sector has led in terms of job creation by more than doubling the number of jobs between 1971 and 1982 (Figure 6). It is likely to continue to play this role as the principal engine of employment growth. In 1978, the investment required per job in manufacturing amounted to 40,660 dirhams (estimated capital-labor ratio: real assets per worker times rates of capacity utilization), which would correspond to roughly 62,700 dirhams in 1983 prices. Figure 7 illustrates the wide variation across subsectors.

At this cost per job, the annual net investment required to provide jobs for the projected annual net increase in job seekers would be in the neighborhood of 16-17 billion dirhams. Gross investment in 1983 amounted to 20.7 billion dirhams. Since available data preclude a breakdown of this figure into new and replacement investment, one cannot judge whether the economy could generate the investment required to create the jobs needed.

1/ According to the 1982 Census, total labor force participation rates for the male population age 10 and older were for men 63.5 percent in urban and 73.9 percent in rural areas; the percentages for the female population age 10 and older 19.7 and 13.7 percent, respectively. If one takes the age groups 10 and older loosely as the labor force age groups, the overall labor force participation rate would be about 42 percent. However, explaining the urban/rural differences for men and women presents some problems. These problems suggest that official statistics are using some non-standard criteria to determine labor force participation.of the figure for all of manufacturing.

Figure 6

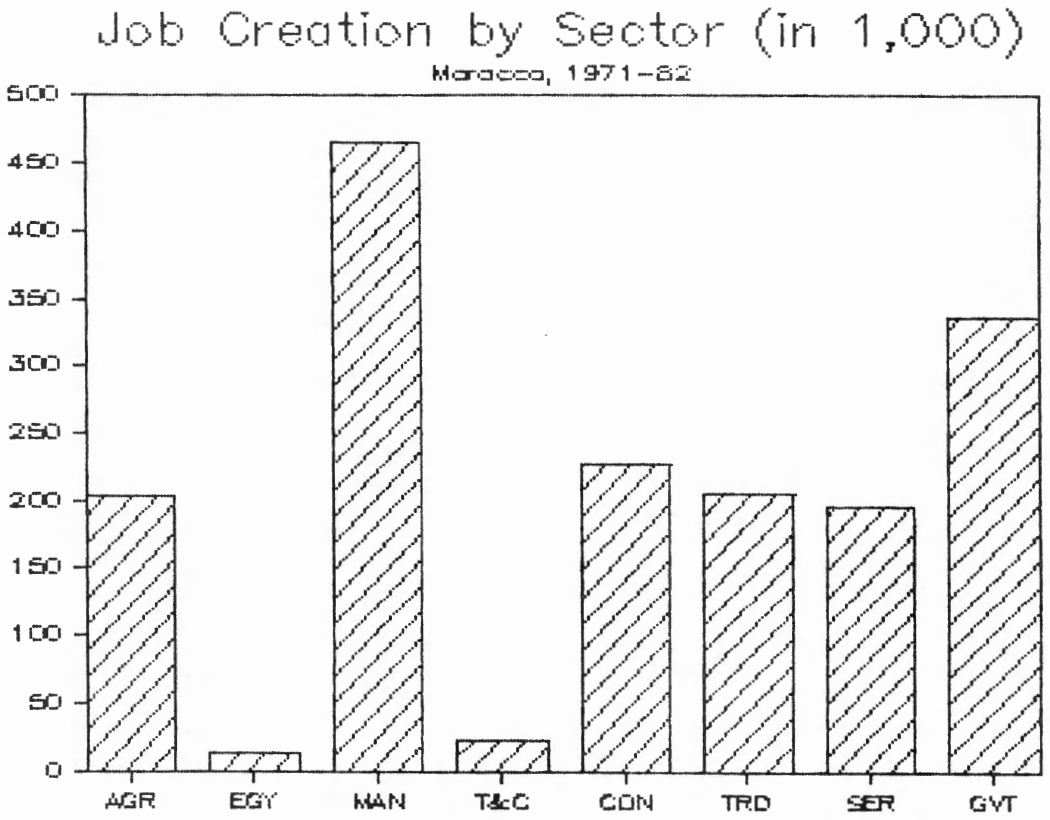
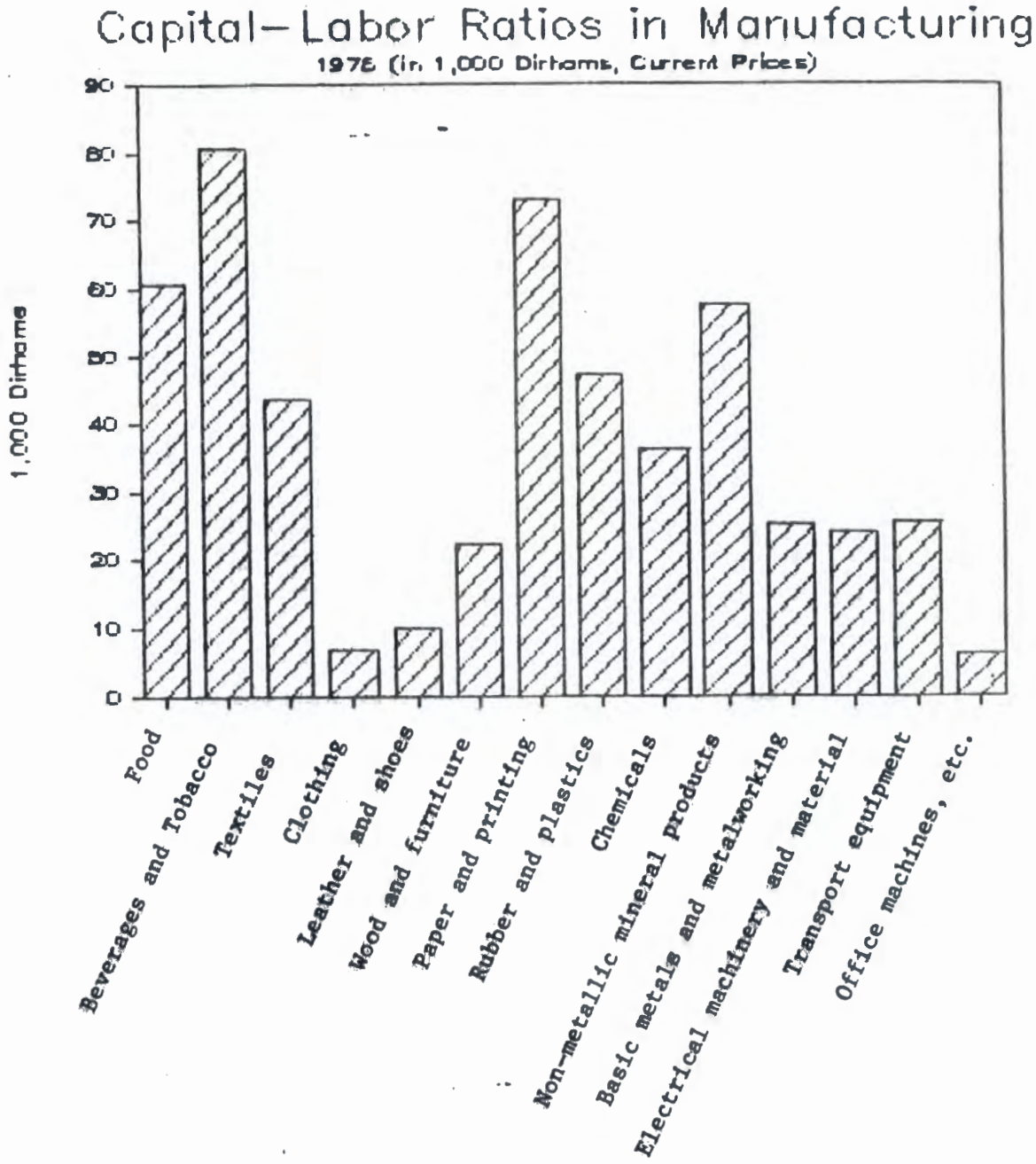

Job Creation by Sector (in 1,000)
Morocco, 1971-82
500
450
400
350
300
250
200
150
100
50
0
AGR
EGY
MAN
T&C
CON
TRD
SER
GVT

Figure 7


Capital-Labor Ratios in Manufacturing
1976 (in 1,000 Dirhams, Current Prices)
1,000 Dirhams
0
10
20
30
40
50
60
70
80
90
Food
Beverages and Tobacco
Textiles
Clothing
Leather and shoes
Wood and furniture
Paper and printing
Rubber and plastics
Chemicals
Non-metallic mineral products
Basic metals and metalworking
Electrical machinery and material
Transport equipment
Office machines, etc.

However, under the assumption of "reasonable" incremental capital-output ratios, annual growth rates of GDP would have to exceed 5 percent in real terms to absorb new entrants into the labor force -- perhaps not impossible, but definitely on the optimistic end of projections.

Studies by the Ministry of Plan project employment growth as a function of sectoral growth in value added and changes in productivity. These projections suggest that over the five years the economy will generate jobs at an annual rate of some 161,000, less than two-thirds of the net additions to the labor force.

The aggregate figures gloss over opportunities for maximizing the job creation performance of the economy. For example, two manufacturing subsectors showing considerable promise for exporting, clothing and leather & footwear, had capital-labor ratios in 1978 of 17 and 24 percent. Targeting investment to the export industries could therefore improve the job creation record of manufacturing.

Income

Morocco's real per capita income has not only stagnated but actually declined during the first part of the 1980's. A population growing at some 2.6 percent per year has outpaced the economy. In international comparisons, the gradual adjustment of the exchange rate for the dirham has resulted in a noticeable decline of per capita income expressed in US dollars. According to the official estimates of the World Bank, Morocco's per capita income fell in 1983 to $760, making the country eligible for the softest category of loan terms short of IDA eligibility. The downward trend in per capita income measured in dollars has continued. This trend may slow down as adjustments in the exchange rate level off, but the near future holds little hope for significant gains in real per capita income.

This conjecture is supported by some disturbing evidence from the manufacturing sector, where labor productivity fell by 1.4 percent per year between 1976 and 1980, in spite of the relatively good performance of the Moroccan economy in the latter part of the 1970's. Given the strong correlation between labor productivity and wage rates (cf. Figure 8), real earnings in the most dynamic sector of the economy may stagnate, unless productivity growth can resume. More capital per worker does not necessarily mean higher productivity, as illustrated in Figure 9. Focusing investment on labor-intensive industries therefore would not lower average wages.

c. Balance of Payments

Trade Performance

Morocco has made slow progress in reducing both its trade and balance of payments gaps in spite of adherence to austerity programs and adjustments to the trade regime. Figure 10 illustrates recent developments in imports and exports and the resulting balance of trade. Import controls in 1983 account for a slight improvement. Lifting them toward the end of the year contributed to the sharp upturn in imports in 1984.

Figure 8

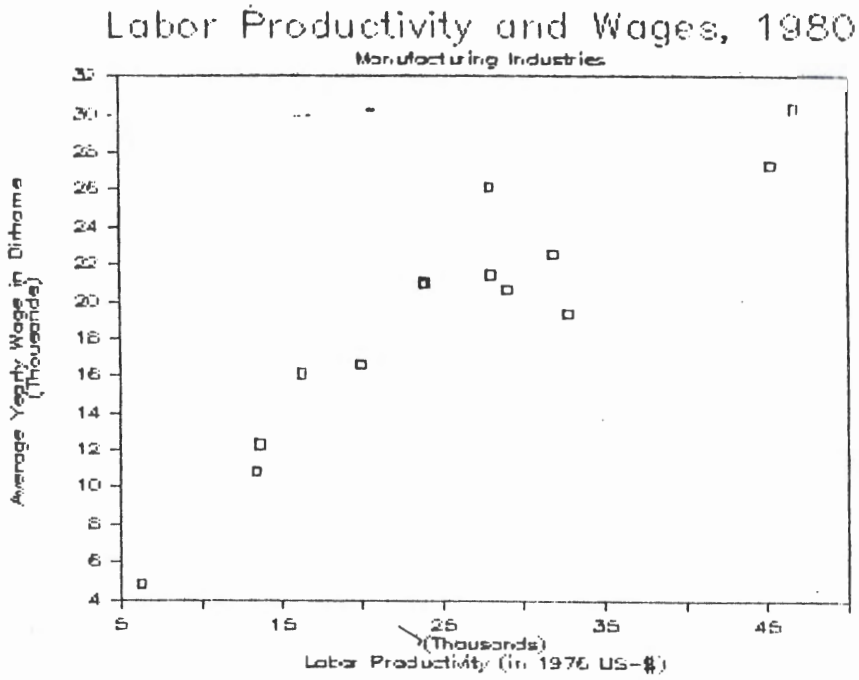


Figure 9

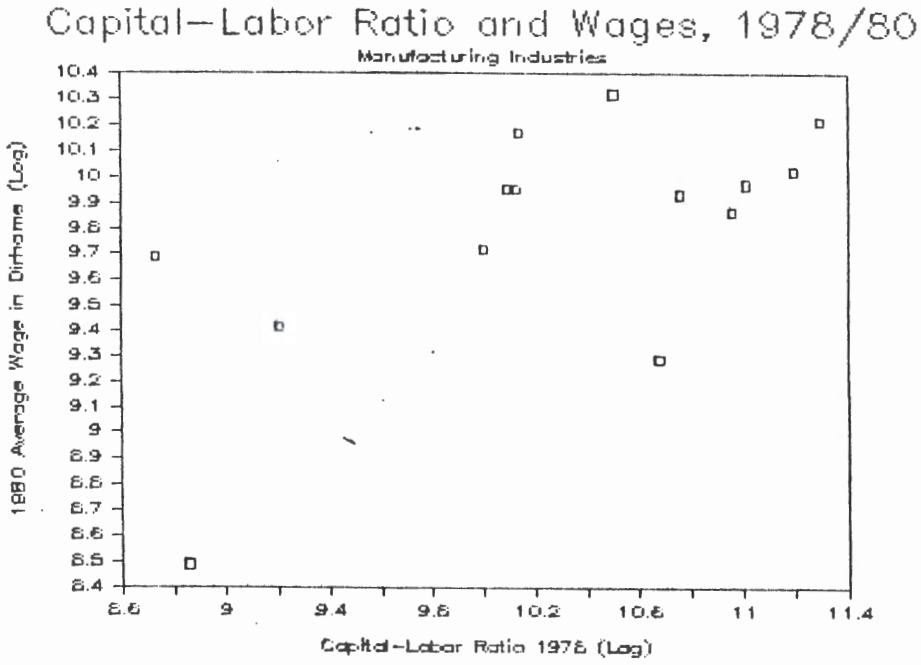
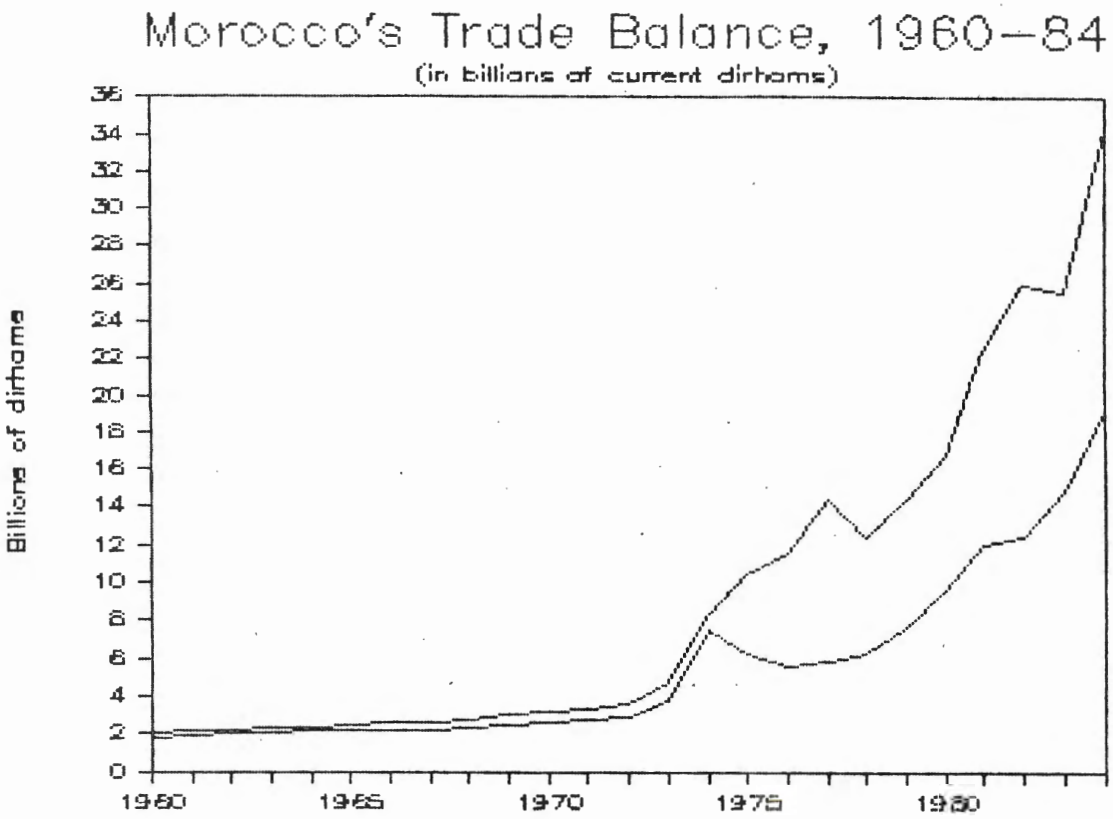


Figure 10


Morocco's Trade Balance, 1960–84
(in billions of current dirhams)
Billions of dirhams
36
34
32
30
28
26
24
22
20
18
16
14
12
10
8
6
4
2
0
1960
1965
1970
1975
1980

Expectations for higher export growth in 1985 were dashed, as world markets for phosphoric acid softened. USAID/Rabat estimates exports for 1985 will not exceed 21.3 billion dirhams, 800 million dirhams short of the revised IMF target, for zero growth in real terms. The apparently poor export performance overall masks the excellent growth of manufactured exports. This category grew by more than 25 percent in dirhams, largely compensating for the unforeseen decline in earnings from phosphate derivatives.

At the same time, import growth slowed to 6.6 percent in dirhams, a decline of 5.5 percent in terms of SDRs, an impressive result in the face of the continued liberalization of imports. The maximum import duty has been reduced to 60 percent, and is scheduled to move to 45 percent (1986) and finally 25 percent (1988). Import licensing requirements have also been substantially lightened. Finally, restrictions on imports of most goods have been lifted; only a few items remain prohibited. Imports of consumer goods have responded to these changes; in 1984 they increased less than had been feared (18 percent), but seem to have accelerated in 1985 (33 percent between September 1985 and September 1984). The good performance overall was largely due to a leveling off of food and energy imports. Even so, the projected 1985 trade deficit represents no improvement over 1984 in absolute terms. It heralds an improvement in relative terms, though, with exports reaching 58 percent of imports, the highest ratio since 1977.

The increases in manufactured exports may represent initial successes of the trade policy reform. Structural adjustment efforts under the World Bank's Industrial and Trade Policy Adjustment Loans (ITPA I: $150 million, 1984; ITPA II: $200 million, 1985) have focused on reorienting the economy toward export markets. For example, the GOM has made progress in cutting back on the paperwork for exporters, including that needed for the temporary import of items scheduled for processing and re-export. It is also in the process of making it easier to obtain financing for export activities, providing additional support in the form of export credit insurance, and assuring preferential treatment of exporters in other areas. While it is too early for many of these measures to have taken hold, the initial results appear encouraging.

External Debt and Rescheduling

Morocco's external debt has grown to 108% of GDP in 1985, or approximately $13.25 billion; it is projected to grow to $14 billion by 1989 before it begins to decline. Reduction in the budget deficit and a small improvement in the current account deficit resulted in a reduction in foreign borrowing required. However, Morocco has been unable to service its debt and has obtained some relief through the rescheduling of debts to public creditors at the Paris Club. This latest debt rescheduling in September 1985 potentially reduced debt servicing from $5.6 billion to about $3.6 billion for the two years 1985 and 1986. The Paris Club agreement is valid through February 1987 which is also the period of the IMF Stand-By Arrangement. The terms obtained by Morocco from the Paris Club set the standards by which other public creditors reschedule their debts on a bilateral basis with Morocco, hence the significance of the 1985 agreement at Paris.

The external debt owed to private creditors is approximately equal in size to the public external debt. Morocco obtained a debt rescheduling agreement with this so-called London Club this past summer to cover the two years 1983 and 1984. Repayments on debt to private creditors for 1985 and 1986 are being treated as if they have been rescheduled while a new agreement to cover the current period is negotiated. This de facto rescheduling is satisfactory neither to Morocco nor to private international creditors. However, there are basic legal disagreements between the two parties over what constitutes adequate commitment or guaranty of repayment which continue to complicate negotiations over rescheduling arrangements. Nonetheless, the private international creditors have not attempted to withdraw their capital from Morocco and have, with a few minor exceptions, maintained their exposure levels from year to year. This prevents Morocco's debt situation from being aggravated, but it does not contribute to the long-term restoration of private capital flows which Morocco will require to restore economic growth.

2. Problems and Prospects of Economic Adjustment and Growth

Morocco's per capita income is projected to remain nearly constant for the remainder of this decade. This will undoubtedly create social tensions since Moroccans can readily compare their situation to neighboring Spain and Portugal and other European countries. The key to political stability may be found in the employment picture. The growth of labor-intensive exporting industries will have to be sufficiently rapid to make up for the loss of jobs in inefficient industries which cannot meet external competition as tariff barriers fall. The net result in terms of employment cannot be assessed on the basis of existing data. Whatever the outcome, it is clear from the USAID projections in Table 8(A) that Morocco will continue to require significant donor support and annual or bi-annual debt rescheduling for at least another five years as the austerity programs and restructuring take effect.

a. Internal Adjustment

Fiscal Soundness

Morocco is clearly committed to a steady reduction in its budget deficit. However, this commitment may founder on the rock of inability to set priorities in the public investment budget. The public anouncement of a 20.5 billion dirham investment budget in 1986 reflects the difficulty the GOM is experiencing in keeping this portion of the budget under control. The key to deficit reduction in future budgets will be the efficacy in which the new plan is elaborated and linked to the budgeting process.

The other significant problem facing the GOM is the reduction of arrears to its suppliers. These were estimated at 10.26 billion dirhams at end-1984. It is planned to reduce these to zero over the next three years under the World Bank's project for public enterprise rehabilitation.

Role of the Public Sector

The restriction of public investment, the continued growth of the private sector through investment in new areas and the GOM's plans to reform and privatize state owned enterprises will all contribute to an increasingly greater share of economic activities in the private sector. It is not yet

and the direction of change is well established. For example, the private sector will be free to compete against the Office for Marketing and Export (OCE) in fresh fruit and vegetables starting in 1986-87. Previously the GOM had removed OCE's monopoly on processed food exporting. Some major industries will not be privatized, e.g., the national airline, train transport, the Phosphate company (OCP), and the oil refinery. But companies in other sectors are candidates for privatization, provided that market forces do not make them too unattractive to potential private owners.

b. External Balance

Trade

One key to Moroccan recovery is reduction of the trade deficit. The most promising avenue is export promotion, with some scope for the compression of imports. Table 9 shows the most recent IMF projections of exports, imports and external financial flows. These indicate a significant reduction of the trade imbalance to slightly over $400 million and a positive current account balance by 1988. These projections are too optimistic in our judgement. They generally depend upon growth in world trade which may not materialize this decade. They also depend upon strength in commodity markets which is now in doubt. On the other hand, declines in the price of oil and wheat combined with better management of energy use and increased production of wheat domestically may result in import savings which were not foreseen in current projections. Alternate USAID projections are presented in Table 8. These are based upon solid, but slightly slower growth in exports, but also favorable developments in the crude oil and cereals markets. The net result is a longer period of adjustment, a greater need for external financing, slightly higher debt-service ratios, and continuing stagnation in per capita income growth likely well into the 1990's. Table 10 shows both the USAID and IMF trade projections so that the differing assumptions and results of the two projections may be readily compared.

We make this case on the basis of longer-term trends in exports, the cautious pace at which the Moroccan bureaucracy has implemented changes, the administrative encumbrances which continue to hinder day-to-day operations of the private sector and resistance to further change which appears to be developing in the most affected industrial sectors. While liberalization continues to make inroads into the economy, there is still an over-reliance on administrative control over activities which discourages private initiative. This system and mind-set are not easily restructured and redirected and will not be legislated out of existence. Progress will continue, but we believe it will be slower than projected by the IBRD and the IMF.

Whether one is relatively optimistic or pessimistic about the prospects for trade growth, the projections in the IMF table show that the debt service will require nearly half of the foreign exchange earnings from the export of goods, non-factor services, and transfers. To maintain financial equilibruim, the GOM will have to borrow over a billion dollars a year even under the most optimistic scenario.

Under our projections in Table 8, the phosphate market is projected to remain weak for several years and further structural adjustment will continue at a slower rate than foreseen by the IBRD and IMF. Morocco's situation will improve slowly, with financial gaps remaining no lower than $500 million or, in the event that external financing cannot be found, investment and economic growth falling sharply.

Table 8

Balance of Payments
USAID Projections
(1985 - 1990)

Assumptions
(annual percentage increase)

	1986	1987	1988	1989	1990
Prices					
Total export prices	2.0	4.0	4.0	4.0	4.0
Total import prices	0.0	4.0	4.0	4.0	4.0
Volumes					
Total exports	3.0	3.0	3.0	3.0	3.0
Total imports(f.o.b.)	0.0	0.0	0.0	2.0	3.0
Values					
exports	5.0	7.0	7.0	7.0	7.0
imports (f.o.b.)	0.0	4.0	4.0	6.0	7.0

USAID Projections
(millions of dollars)

	1985	1986	1987	1988	1989	1990
Exports	2,117	2,223	2,378	2,545	2,723	2,914
Imports	3,363	3,363	3,498	3,637	3,856	4,126
Trade balance	-1,246	-1,140	-1,120	-1,092	-1,133	-1,212
Services balance	-793	-763	-712	-609	-535	-510
Transfers account	1,010	1,068	1,128	1,197	1,268	1,344
Current account	-1,029	-835	-704	-504	-400	-378
Nonmonetary capital account	-76	-1,297	-799	7	-127	-265
Overall Balance	-1,105	-2,132	-1,503	-497	-526	-643
Possible Debt Relief	1,059	1,700	1,200	------	------	------
Remaining Gap	46	432	303	497	526	643
Debt-service Ratio (%)	63.9	80.4	64.2	51.2	51.2	53.3

Table 9

Morocco: Medium-Term Balance of Payments Projections, 1984-1990 1/
(In millions of SDRs)

	1984	1985	1986	1987	1988	1989	1990
Higher export growth from 1987							
Trade balance	-1,373	-1,087	-849	-619	-413	-379	-356
Exports, f.o.b.	2,108	2,187	2,350	2,587	2,846	3,134	3,452
Percent change	8.0	3.7	7.4	10.1	10.0	10.1	10.1
Imports, f.o.b.	-3,482	-3,274	-3,199	-3,206	-3,259	-3,513	-3,807
Percent change	12.8	-6.0	-2.3	0.2	1.8	7.8	8.4
Services balance	-829	-793	-763	-712	-609	-535	-510
Transfers account	907	1,010	1,068	1,128	1,197	1,268	1,344
Goods, Nonfactor Services and Transfers	3,112	3,442	3,706	4,065	4,467	4,888	5,350
Current account (before debt relief) 2/	-1,295	-870	-544	-203	175	354	478
Nonmonetary capital account	-260	-76	-1,297	-799	7	-127	-265
Private (including errors and omissions)	75	-10	25	25	55	55	55
Official grants	15	297	------	------	------	------	------
Public short-term (net)	-65	80	------	------	------	------	------
Public medium-and long-term loans	-285	-443	-1,322	-824	-49	-190	-344
Disbursements	999	1,000	820	820	1,260	1,260	1,390
Amortization	-1,284	-1,443	-2,142	-1,644	-1,309	-1,450	-1,724
Debt relief	1,333	------	------	------	------	------	------
Overall balance	-222	-946	-1,841	-1,002	182	228	213
Net foreign assets of the banking system	119	-10	-258	-344	-182	-228	-214
Financing gap	103	956	2,145	1,346	------	------	------
Possible debt relief 3/	------	1,059	1,700	1,200	------	------	------
Other	103	-103	445	146	------	------	------

Table 9 (contd.)

Morocco: Medium-Term Balance of Payments Projections, 1984-1990
(In millions of SDRs)

	1984	1985	1986	1987	1988	1989	1990
Memorandum items:							
Current account before debt relief/GDP	-11.1	-7.1	-4.2	-1.5	1.2	2.3	2.9
End-year reserves (SDR million)	50	148	318	453	466	478	487
End-year reserves (months imports, c.i.f.)	0.2	0.5	1.1	1.5	1.6	1.5	1.4
Debt service	1,802	2,168	2,876	2,476	2,135	2,292	2,563
Debt service ratio (in percent of exports of goods, nonfactor services, and transfers)							
before debt relief	57.9	63.0	77.6	60.9	47.8	46.9	47.9
after debt relief	23.5	37.5	39.6	36.3	47.8	46.9	47.9
$/SDR	1.03	.99	1.00	1.00	1.00	1.00	1.00

Sources: Data provided by the Moroccan authorities; and staff estimates, International Monetary Fund

1/ On the basis of continued adjustment policies through 1988.
2/ Includes Interest payments on exceptional financing, including debt relief.
3/ From the Paris Club, other official creditors and commercial banks. Illustrative amounts assume terms broadly similar to those obtained in 1984.

Table 10
Balance of Payments Projections (1985 - 1990)

Assumptions
(annual percentage change)

	1985	1986	1987	1988	1989	1990
IMF Projection						
Exports	-	7.4	10.1	10.0	10.1	10.1
Imports	-	-2.3	0.2	1.8	7.8	8.4
USAID Projection						
Exports	-	5.0	7.0	7.0	7.0	7.0
Imports	-	0.0	4.0	4.0	6.0	7.0

IMF Projection
(millions of dollars)

Trade balance	-1,076	-849	-619	-413	-379	-356
Exports, f.o.b.	2,165	2,350	2,587	2,846	3,134	3,452
Imports, f.o.b.	-3,241	-3,199	-3,206	-3,259	-3,513	-3,807
Services balance	-785	-763	-712	-609	-535	-510
Transfers account	1,000	1,068	1,128	1,197	1,268	1,344
Current account (before debt relief)	-861	-544	-203	175	354	478
Nonmonetary capital account	-75	-1,297	-799	7	-127	-265
Overall balance	-936	-1,841	-1,002	182	228	213
Debt service ratio before debt relief	63.0	77.6	60.9	47.8	46.9	47.9

USAID Projection
(millions of dollars)

Trade balance	-1,246	-1,140	-1,120	-1,092	-1,133	-1,212
Exports, f.o.b.	2,117	2,223	2,378	2,545	2,723	2,914
Imports, f.o.b.	3,363	3,363	3,498	3,637	3,856	4,126
Services balance	-793	-763	-712	-609	-535	-510
Transfers account	1,010	1,068	1,128	1,197	1,268	1,344
Current account(before debt relief)	-1,029	-835	-704	-504	-400	-378
Nonmonetary capital account	-76	-1,297	-799	7	-127	-265
Overall Balance	-1,105	-2,132	-1,503	-497	-526	-643
Debt service Ratio before debt relief	63.9	80.4	64.2	51.2	51.2	53.3

Furthermore, in USAID projections, no adjustments were made in the IMF's 5.7 to 6.0 % annual growth projections for transfers or the 14 to 21 % annual growth in non-factor services, both of which could also prove to be less favorable.

USAID concludes, therefore, that it is highly likely Morocco will be facing the need for additional debt rescheduling beyond 1988 or additional economic assistance or both for the rest of the decade. In spite of everyone's best efforts, the chances of achieving external equilibrium in 1988 do not seem any better to USAID than the chances of a prolonged economic recession lasting until the 1990's. Improving the chances for success requires much better economic policy, faster restructuring and privatization, better management of the public sector and, above all, reliance on market forces to provide an appropriate incentive structure.

External Debt

The external debt is projected to increase to almost $14 billion by 1989 and thereafter to decline. At $13.25 billion, it is currently 108% of GDP. This projection depends to some extent upon better trade performance than USAID now projects. However, assuming that Morocco will be able to obtain the additional debt relief required by the slightly bleaker USAID projections, the overall debt profile will be pushed off a little farther into the future, mortgaging somewhat more of future export earnings to debt repayment.

The external debt is a drag upon economic growth, not only because it has discouraged additional lending, but also because it has affected the investment climate. Doubts about actual convertibility of dirham profits into other currencies, although guaranteed on paper, add to any doubts potential investors may have about the return on investment in Morocco. This has discouraged long-term direct foreign investment and shifted investment toward short payoff periods and business deals to use existing capacity rather than looking seriously at long-term investment in plants and facilities.
One possible contributor to the reduction of short-term capital scarcity would be the Baker Plan. As a small, but highly significant debtor country in comparatively worse straits than many of the larger debtors, Morocco figures prominently among countries which could qualify for treatment under the Baker Plan. Increased commercial bank lending to Morocco coupled with a larger IBRD Structural Adjustment package could accelerate the process of change in the economy and restore growth to levels which ease social tensions constraining the program of adjustment. As Table 9 shows, resources totalling close to $500 million (SDR 445 million) will be required in 1986 in addition to the debt relief already obtained through the Paris and London Club processes.

Given the difficulties in obtaining additional bilateral resources in a period of fiscal stringency in the developed countries, the option of a Baker Plan for Morocco should be one of the priority discussion items for the next Consultative Group meetings. Even before then, the possibility of mounting such an effort is under consideration at the World Bank and elsewhere. The difficulties in bringing about a Plan commensurate with the resources required and involving the World Bank, which already has a large program in Morocco, and the commercial banks, which have not increased their lending to Morocco for several years now, should not be underestimated. On the other hand, a well-conceived program could restore the confidence of the international financial community and could very well help Morocco get a little bit farther down the road and help it make the liberalization program a durable success.