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Improving the Business  
Climate in Morocco

*Regulatory Reform and Investment Promotion*

## **Regulatory Quality and Competitiveness in Morocco**

**April 2007**

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## EXECUTIVE SUMMARY

### Overview

As Morocco is taking strides to further the integration of its economy into global markets, to modernize its economy, and to attract foreign direct investment, measures to improve the business climate take on a new sense of urgency. The authorities have demonstrated their commitment to a broad range of structural reforms—through the country's obligations under its membership in the World Trade Organization, the Free Trade Agreement with the United States, Its Association Agreement with the European Union in preparation for the EuroMed zone, and other free trade agreements.

This report seeks to assess where the Moroccan economy stands at the beginning of 2007 as a broad background for efforts underway to improve the country's business climate. It comprises three major sections:

- a brief overview of selected aspects of recent macroeconomic performance;
- an assessment of the ratings of Morocco's business climate in international comparisons; and
- a summary of the work that has been done linking regulatory quality and regulatory reform to economic growth performance and the implications of those linkages for structural reform in Morocco.

### Macroeconomic performance

Recent news from the macroeconomic front is encouraging, although much more needs to be done. In terms of overall macroeconomic aggregates, non-agricultural GDP has been growing at a steady 5 percent per year over the last few years, although growth for total GDP has fluctuated in response to weather patterns which affects the largest sector, agriculture. Inflation is well under control, and there is progress in budget management.

Recent data also suggest that some progress has been made over the last year in tackling the greatest economic and social challenge for the Kingdom—youth unemployment. Morocco has also done reasonably well in terms of gaining a share of foreign direct investment (FDI), and its stock of FDI has been growing relative to the rest of the region and Africa as a whole.

Finally, an overview analysis suggests that Morocco's leading merchandise exports in two major markets, the European Union and the US, are in fact concentrated in expanding markets, whether as a result of a deliberate strategy or market dynamics. However, in most of these markets, Moroccan exporters are either losing market share or are just defending it. For the EU, the gains in market share are in product groups that reflect outsourcing by European companies rather than the product of integrated value chains. In the US, olive oil and footwear are among the products that are gaining market share in expanding markets.

### Trends in regulatory quality

While macroeconomic performance shows the potential of the Moroccan economy, international comparisons in terms of indicators of the prevailing business climate suggest an economy that is barely holding its own or is losing ground. There may have been steps forward, but Morocco's competitors are moving as fast or faster.

According to the World Bank Institute (WBI), a composite measure of regulatory quality (using ratings from around ten different sources) shows a progressive worsening of Morocco's relative position. The trend is the same for other selected indicators—government effectiveness, rule of law, and control of corruption—but it is most pronounced for regulatory quality.

In terms of the World Bank's Doing Business indicators, Morocco's overall rating has slightly improved, from rank 117 to rank 115 (out of 175 countries ranked), but essentially as a result of a single change in one of the subindicators, the minimum capital required to start a business. Most of the other indicators have remained the same, and since other countries are moving forward, Morocco's position has declined slightly in other areas.

Between 2004 and 2005, Morocco experienced the worst slide of all countries in its ranking in the Global Competitiveness Report, published by the World Economic Forum in Davos. It fell from the 43<sup>rd</sup> to the 65<sup>th</sup> percentile in the Global Competitiveness Index. The principal reason for that slide was a perceived worsening in corruption. By 2006, Morocco regained some lost ground, but still not back to the level of 2004; in terms of the Global Competitiveness Index, it was ranked at the 56<sup>th</sup> percentile. Much of the slide is due to harsher judgments by business representatives of the level of corruption, and perceived weaknesses in terms of education and training. Most of the gains in average scores concern the ability of the economy to advance technologically.

### **From red tape to smart regulation**

There is strong, and growing, evidence that reducing red tape and moving to smart regulation produces benefits for the economy and society. Shortcomings in the level of regulatory quality keep an economy from reaching its fullest potential. In a study of the sources of productivity of immigrant labor in the US, fully 55 percent of the differential was explained by the institutional environment, which includes the legal, regulatory and administrative framework.

Regulatory reform is not the same as deregulation. Quite to the contrary, it seeks to build and reinforce market mechanisms, creating market architectures that support rather than hinder the competitive drive of private enterprise. The notion of smart regulation is not limited to developing countries, but it is there where its application can yield the greatest gains.

A major part in this process is the establishment of mechanisms that promote regulatory transparency to gain a better understanding of the impacts of existing and proposed regulations (and laws). The importance of such provisions is clearly acknowledged in both the WTO obligations and free trade agreements. The US FTA, for example, establishes transparency in general and technical regulations as one key commitment. Efforts to meet these commitments are likely to require some form of central support on the part of the government.

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## THE QUEST FOR ECONOMIC TRANSFORMATION

Competitive pressures on the Moroccan economy are increasing. Global trade liberalization under the auspices of the World Trade Organization (WTO) has opened domestic markets. A number of bilateral trade agreements have further lowered barriers to imports, but also have created new opportunities in partner countries. The Free Trade Agreement with the United States (the US FTA) has been in effect for over a year, from January 1, 2006. Morocco's economy is also gearing up in preparation for the Euro-Mediterranean Free Trade Area by 2010.<sup>1</sup> In this rapidly changing environment, Morocco's recent economic performance presents a mixed picture. On the one hand, in terms of macroeconomic aggregates, there are some encouraging signs—moving toward more stable growth patterns, attracting foreign direct investment, and improving the employment situation. On the other hand, Morocco still scores rather poorly in most assessments of its business climate relative to other countries. Weaknesses in the business environment hold back productive investment and retard growth. Addressing these weaknesses will propel the economy to a higher plateau of sustained growth, given the indications of underlying strength. A more supportive business climate will leverage the economy's potential to boost productivity growth, the path to competitiveness and prosperity. Faster growth of income and employment for Morocco lies within reach.

Over the past decade, Morocco has already taken great strides in modernizing its economy and creating a more hospitable business environment. A growing commitment to regulatory reform is shaping policy. In international economic relations, obligations under the country's WTO membership, under the Association Agreement with the EU, free trade agreements with other countries in the region, and especially under the Free Trade Agreement with the US provide evidence for that commitment. But progress has not been fast enough. While investors are well aware of some of the country's competitive advantages, their perceptions of the quality of the country's business climate remain relatively poor.

In its latest edition of its cross-country comparisons of selected features of the business climate, *Doing Business in 2007*, the World Bank ranks Morocco 115<sup>th</sup> out of the 175 countries covered (virtually unchanged from the ratings the year before). In the rankings of the World Economic Forum's *Global Competitiveness Report*, Morocco's position deteriorated sharply 2004 and 2005; in 2005, the country's slippage was the worst of all countries ranked. In terms of the Global Competitiveness Index,<sup>2</sup> Morocco fell from the 43<sup>rd</sup> to the 65<sup>th</sup> percentile;<sup>3</sup> for the Business Competitiveness Index, it slipped from rank 45 to 67 (again in percentiles). By 2006, the country had recovered some lost ground, as reflected in a ranking of 56 for the Global Competitiveness Index, and 54 for the Business Competitiveness Index (all in percentiles). Even with that recovery, Morocco still lags behind some of its regional "competitors," like Tunisia (24<sup>th</sup> percentile on the Global Competitiveness Index in 2006, and 21<sup>st</sup> percentile on the Business Competitiveness Index), Jordan (42<sup>nd</sup> and 38<sup>th</sup>, respectively), or Turkey (47<sup>th</sup> and 42<sup>nd</sup>, respectively). Clearly, much remains to be done to create a modern market economy in Morocco that can compete more effectively in the global marketplace.

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<sup>1</sup> The Association Agreement with the European Union became effective on March 1, 2000; it had been signed over a decade ago (26 February 1996).

<sup>2</sup> The Global Competitiveness Report uses three different indices to rank countries—the Growth Competitiveness Index, which is actually being phased out, the Global Competitiveness Index, and the Business Competitiveness Index. The discussion below provides greater detail on these indices.

<sup>3</sup> The number of countries ranked has been growing from year to year. Moreover, it varies between the Global Competitiveness Index and the Business Competitiveness Index. As a result, the discussion here refers to percentiles; in other words, the total number of countries has been standardized to 100; the total number of countries for the Global Competitiveness Index was 104 in 2004, 117 in 2005, and 125 (2006); for the Business Competitiveness it was 100, 113, and 121, respectively, for these three years.

This report has been prepared as part of the work under the USAID Improving the business climate in Morocco Program. It is intended to sketch some key features of the Moroccan economy, its business environment, and its reform priorities at the beginning of 2007. The report comprises three main parts:

- brief highlights of Morocco's recent macroeconomic performance with respect to growth, exports, investment, and employment;
- a composite assessment of Morocco's position regarding the quality of its business environment in international comparisons, including the World Bank's Doing Business series, the Global Competitiveness Report, and the global governance indicators, including regulatory quality, estimated by the World Bank Institute as part of its (by now) annual publication; and
- a synopsis of findings regarding the link between efforts to upgrade regulatory quality and economic growth and employment generation, and the implications for economic policy in Morocco.

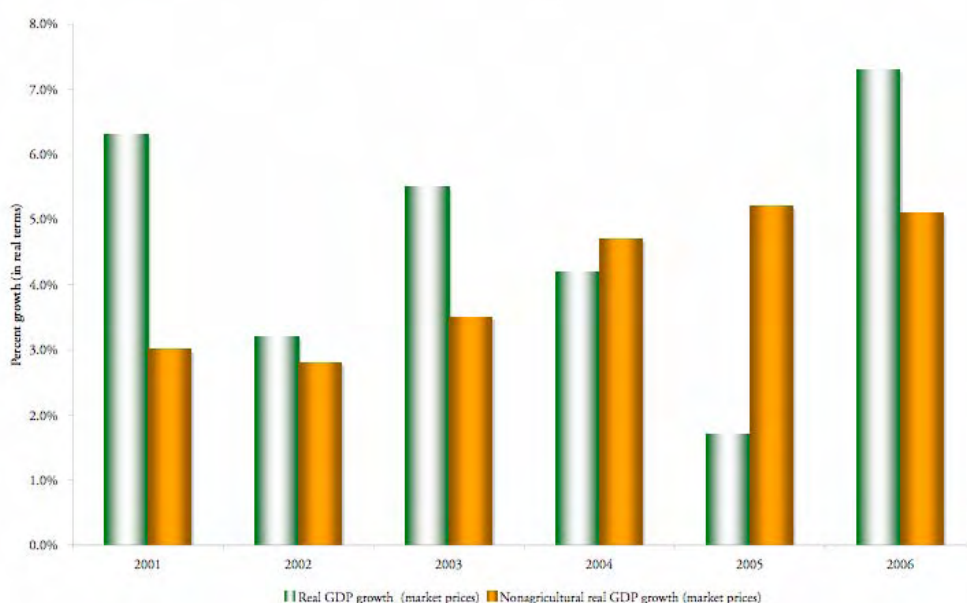
The analysis here is designed to complement and reinforce other recent contributions to the debate over economic policy priorities, such as last year's Country Economic Memorandum prepared by World Bank economists. It provides a guide to initiatives to strengthen the competitive position of the Moroccan economy in the global marketplace. The analysis here also identifies priorities for measures to promote productive investment in the country.

## PART I: SELECTED ASPECTS OF RECENT MACROECONOMIC PERFORMANCE

### Macroeconomic balances<sup>4</sup>

On the macroeconomic front, Morocco is showing some encouraging signs. Macroeconomic indicators are pointing to a recovery in 2006, following a slowdown in 2005 which was largely due to unfavorable weather conditions (which affect agriculture, still the dominant sector). Figure 1 provides an overview of recent growth patterns in terms of real GDP at market prices. The growth performance in terms of total GDP—the white columns in Figure 1—has been subject to fluctuations caused by the continuing dependence of the economy on agriculture and therefore the weather. Non-agricultural GDP has been growing at a more stable rate over the period 2001-2006. Its growth rate has hovered around 5 percent per year for the last three years. Tourism receipts, workers' remittances and a recovery in textile exports account for an external current account surplus, the sixth in a row, in spite of rising energy imports. Gross external reserves are estimated to stand at around USD18.8 billion.

**Figure 1: Growth rates for real GDP 2001-2006**



Note: 2005 figures are preliminary; growth rates for 2006 are projected.

The budget deficit for 2006 is expected to amount to 4.1 percent of GDP, a decline from the 2005 level of 5.9 percent. For the next few years, the government is targeting a budget deficit of 3 percent of GDP. Moreover, the authorities also aim to bring down the ratio of the public debt to GDP from the estimated level of 66.8 percent projected for 2006 to 60 percent. Much of the deficit is due to continued subsidies for petroleum products (1.6 percent of GDP) and food (0.8 percent). The successful campaign for voluntary early retirement of civil servants in 2005 has curtailed the growth of the wage bill for the public sector.

Since 2001, inflation has remained moderate. Changes in the Consumer Price Index have ranged from 0.6 percent (2001) to 2.8 percent (2002), with annual rates hovering in that range since then. The projected inflation rate for 2006 is 2.5 percent. Morocco's recent macroeconomic

<sup>4</sup>This section draws on data presented in the memorandum regarding the IMF Article IV Consultation with Morocco, October 2006



performance suggests greater potential for accelerating growth, in particular of the non-agricultural GDP. And higher sustainable growth rates are essential. While 5 percent growth for the non-agricultural GDP is respectable, it remains insufficient for creating new jobs at a rate to absorb the growing number of job seekers.

### Recent export performance

One of the key indicators of an economy's competitiveness is its performance in export markets. The World Economic Forum's *Global Competitiveness Report* classifies Morocco as a factor-driven economy. The economy's export performance is consistent with this classification, but there are also signs of a shift to knowledge-driven exports. To get some notion of recent export performance patterns, the analysis here focuses on two major markets, the EU and, secondarily, the US. Obviously, the European Union (EU 25) is the natural export market for Morocco, in terms of size, proximity and relative importance. Over the period 2000-2005, Morocco exported approximately USD8.7 billion annually to the EU 25, corresponding to 6.7 ‰ (pro mille) of the EU's total imports.<sup>5</sup> In contrast, total exports to the US averaged USD523 million per year, corresponding to 0.3 ‰ of total US imports. Moreover, Morocco's total exports to the EU have been growing at 14.6 percent per year, while exports to the US have virtually stagnated, with a 0.1 percent annual growth rate per year over the period 2000-2005. Since imports to the EU 25 from all countries increased by 9.9 percent per year over that period, Morocco has been gaining a greater share of the total EU import market. For the US, however, where total imports have been growing at a rate of 6.6 percent, Morocco has been losing total market share at a significant rate.

What are the products that drive performance in terms of merchandise exports? A useful tool for addressing that question is the Boston matrix, which links the dynamics of market growth and market capture on its two axes.<sup>6</sup> Export markets are defined in terms of the product definitions of the Harmonized System (HS)-from the 2-digit chapters down to the exceedingly fine 10-digit categories-used for tracking merchandise flows among countries. The Boston matrix shows market growth in the importing economy (the EU or the US) on the x-axis, and the growth rate of market share for the exporting country, Morocco, on the y-axis. Market growth is defined by the average annual rate of change of total imports in the respective HS category over a selected time period, and market share is simply the ratio of imports from the exporting country to total imports in the particular product category. For each HS product category, the dynamics of export performance can be described by a combination of total market growth and growth in market share. The volume of exports in that category can then be represented by the size of the data point-a bubble-for that particular combination.

The Boston matrix defines in effect four quadrants. In the upper right-hand corner, we find the "rising stars," defined by a growing market and a growing market share. In the lower right-hand corner are the "missed opportunities" or "shooting stars" where the market is growing, but market share of the exporting country is declining. On the left-hand side, the upper quadrant refers to the "declining stars," where the market is contracting, but the country's market share is growing.<sup>7</sup> Finally, in the lower left-hand quadrant, the markets are the "dark stars," where both market size and share are on the decline.

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<sup>5</sup> The analysis here uses data from the *Global Trade Atlas*, a proprietary database of international trade that adjusts continuously for changes in the exchange rate and provides a number of other quality control services. The database is generally considered to be the most reliable collection of international trade information.

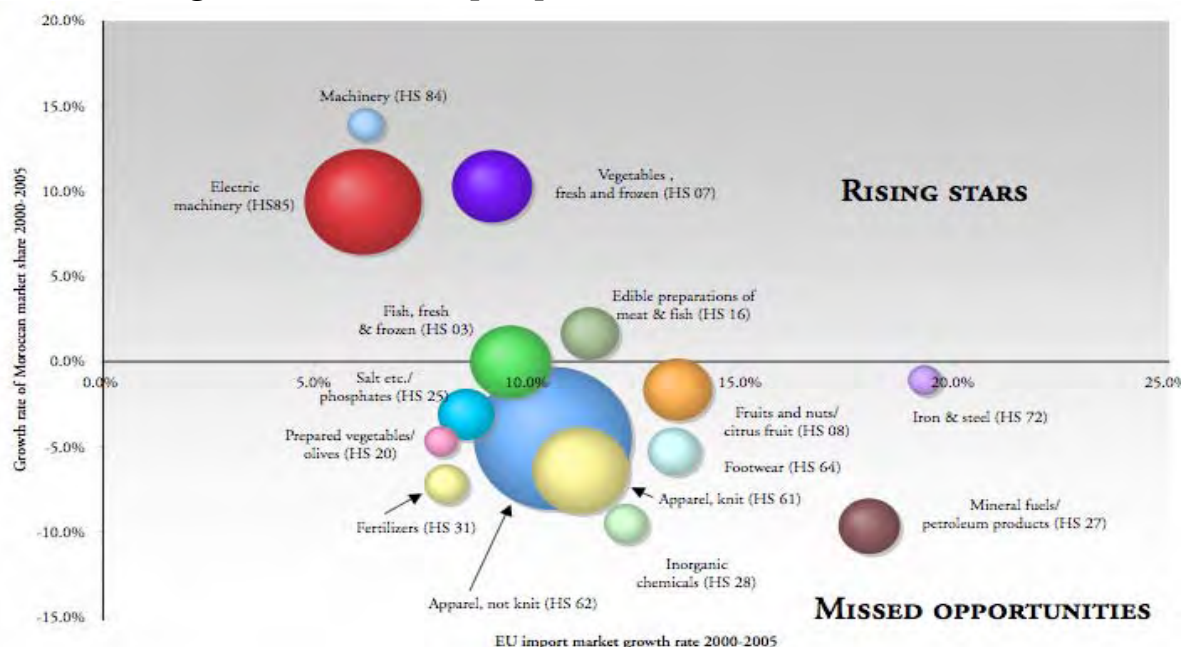
<sup>6</sup> The tool was originally introduced as a strategic assessment tool by the Boston Consulting Group, thence the name. For business strategy, its use focuses on the markets for a firm's products or services, and the interpretation resembles that for trade analysis.

<sup>7</sup> In the business strategy literature, these product markets—stagnant or declining markets with a stable or growing market share, are seen as "cash cows:" since the market size is contracting, it does not make sense for competitors to enter, and the position of

To maintain consistency, fill data gaps, avoid the problems of reconciliation<sup>8</sup> and use up-to-date information, it is common to rely on the statistics of the importing country, in this case the EU 25 and the US. Their trade partners are covered through the use of “mirror” data. The analysis here is designed as a summary overview, and therefore focuses on the broadest categories, defined in terms of 2-digit HS chapters.<sup>9</sup>

Using Boston matrix exposition, Morocco’s export performance in the two selected export markets can be characterized as shown in Figure 2 and Figure 3. These figures should be interpreted with care. The sizes of the bubbles, which are proportional to 2005 exports, are *not* visually comparable between these two figures. For example, the volume of exports for electric machinery (HS 85) is roughly the same for both export markets, USD117 million for the EU and USD108 million for the US, but the sizes of the bubbles shown graphically are quite different in the two figures.<sup>10</sup> Both graphs, however, show one common feature: Morocco’s leading products are concentrated in markets that are growing, both for the EU 25 and the US. At the 2-digit HS level, at least, there are no declining or dark stars among the leading Moroccan exports into these two markets.

**Figure 2: Morocco’s export performance in the EU 25, 2000-2005**



Source: Global Trade Atlas, author’s calculations.

the firm is (relatively) safe without additional investments to defend its position. In international trade, it may make a lot of sense for an exporter to target a declining market.

<sup>8</sup> As a rule, exports recorded in one country are not the same as imports recorded by the receiving country, and not just because of fob and cif differences. Country A may record a shipment by final destination, country B, but ship it through country C. Country B may then record it as an import from country C. These differences make it quite difficult to reconcile trade statistics between two countries.

<sup>9</sup> For a more strategic analysis, it is critical to look at a finer market segmentation of at least 4-digit HS categories, together with an assessment of how competitor countries are doing in these markets. It is entirely possible that the behavior of submarkets differs significantly from the aggregate market performance.

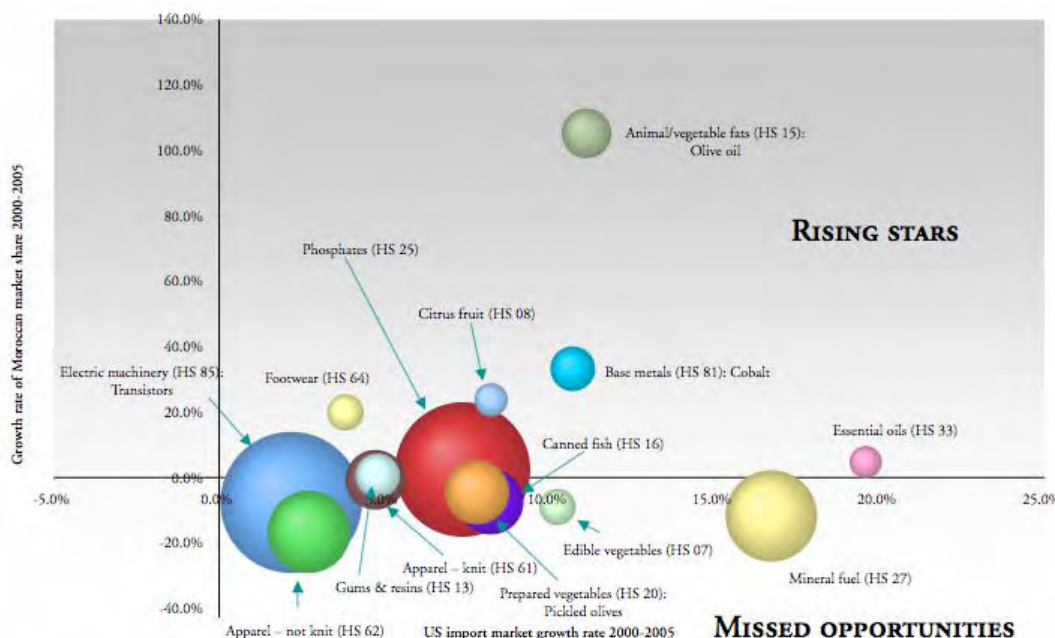
<sup>10</sup> To keep things manageable, the analysis here used imports above a certain cutoff point. The cutoff for inclusion in the graphs was USD5 million for the US, and almost 20 times that, USD95 million, for the EU 25.

For the EU 25, Morocco’s rising stars include electric machinery (HS 85) and other machinery (HS 84), to a large extent the result of outsourcing of parts production. Vegetables and fish (both fresh/frozen and canned) also can be regarded as rising stars.

Yet in terms of the other leading exports to the EU 25, Morocco is losing market share in growing markets. That includes both apparel categories (HS 61, knit, and HS 62, not knit), but also phosphates (HS 25), fertilizers (HS 31), inorganic chemicals (HS 24), fruits and nuts (HS 08, mostly for citrus fruit), prepared vegetables (HS 20, mostly preserved olives), and footwear (HS 64).<sup>11</sup> These missed opportunities, that is, the failure to take advantage of a growing market may call for specific efforts to expand, especially in the less traditional markets. A strategic analysis, with a finer breakdown of export markets, for at least 6-digit HS product categories, and a careful assessment of key competitors would be essential in identifying the reasons for any loss in market share and devising appropriate responses.

For the US, the major “rising star” is olive oil, where the import market has been growing at over 10 percent per year during the period 2000-2005, and Morocco’s market share has been exploding at a rate of close to 150 percent per year. The biggest export to the US, however, is made up of electric machinery (HS 85), mostly transistors produced by a major investment (ST Microelectronics). The transistor exports outstrip even the exports of phosphates, but they appear to be unable to maintain market share in a growing market. Exports of phosphates essentially hold their own, that is, there have been no changes in market share over the last six years. Other rising stars include footwear (HS 64), base metals (HS 81, primarily cobalt), citrus fruit (HS 08), and essential oils (HS 33). The latter, although at a modest USD5.6 million in 2005, targets a US import market that is growing at close to 20 percent per year. Knit apparel (HS 61) and gums and resins (HS 13, which includes mucilages and agar-agar) have also been holding their market share in a growing market.

**Figure 3: Morocco's export performance in the US, 2000-2005**



<sup>11</sup> The chart excludes “aircraft,” which was a major item in 2005 because of individual transactions. Similar reservations also apply to the interpretation of iron & steel (HS 72) and mineral fuels (HS 27)

Among the missed opportunities are apparel (not knit, HS 62). Moroccan exporters have also been losing market share in growing markets in processed vegetables (HS 20, essentially preserved olives), canned fish (HS 16) and other vegetables (HS 07). Finally, that category also includes mineral fuel (HS 27), which, as always, constitutes a separate issue; Morocco is a provider there because of delivery of refined products, which have little to do with competitiveness, but are primarily the result of the global organization of petroleum markets.

Taking these findings at face value, that is, assuming that submarkets (finer HS distinctions) are also growing and that Morocco's market shares behave in a similar manner to that in the aggregate markets,<sup>12</sup> the strategy of Moroccan exporters appears to be sound. These outcomes may be the result of deliberate targeting or may be a consequence of market dynamics. In any case, focusing on expanding markets, rather than trying to compete in stagnant or shrinking markets which are usually well covered by established players,<sup>13</sup> is certainly appropriate. However, in both the European Union and the United States, Moroccan exporters are losing market share in some expanding markets, that is, they are not taking full advantage of market opportunities. In the EU market, most market share gains appear to have been the result of outsourcing of parts production without many backward linkages into the rest of the economy. These patterns tend to reflect more the initiative of European investors, rather than intrinsic gains of the Moroccan economy.

Rising exports (and an expanding market share) for fresh and frozen vegetable exports are much more likely to drive the transformation of the economy, because of their economic linkages, primarily with respect to upstream activities. From a strategic point of view, a similar reasoning would focus on efforts to gain market share for fruits, prepared vegetables, fishery products or footwear. Such a strategy emphasizes backward linkages. Efforts to address the apparent loss of market share in apparel, which tends to be produced under outsourcing arrangements, are unlikely to have the same "pull" effect for other parts of the economy.

In the US market, olive oil and footwear offer clear opportunities, and both are targeted by current USAID assistance programs. In terms of special efforts to maintain or expand market share, Moroccan exporters again may need to focus on products with stronger linkages to the rest of the economy, including essential oils and (prepared and "edible") vegetables.

In both the EU and the US markets, the available evidence supports the principal argument of this report: despite signs of strength, competitiveness needs to be strengthened in key areas in order to reach the economy's full potential. In the case of exports, this means working to expand market share in growing markets.

## **Facing the employment challenge**

The level and pattern of unemployment among young people, in particular for better educated youth, poses Morocco's greatest development challenge—socially, politically and economically. Generally, the youth unemployment crisis looms largest in the countries of the Middle East and North Africa (MENA). In international comparisons, youth unemployment is highest in the MENA region, especially for female youth. As shown in Figure 4, which uses data from a report by the International Labour Office (ILO) for 2003. The red (dark) bars refer to unemployment

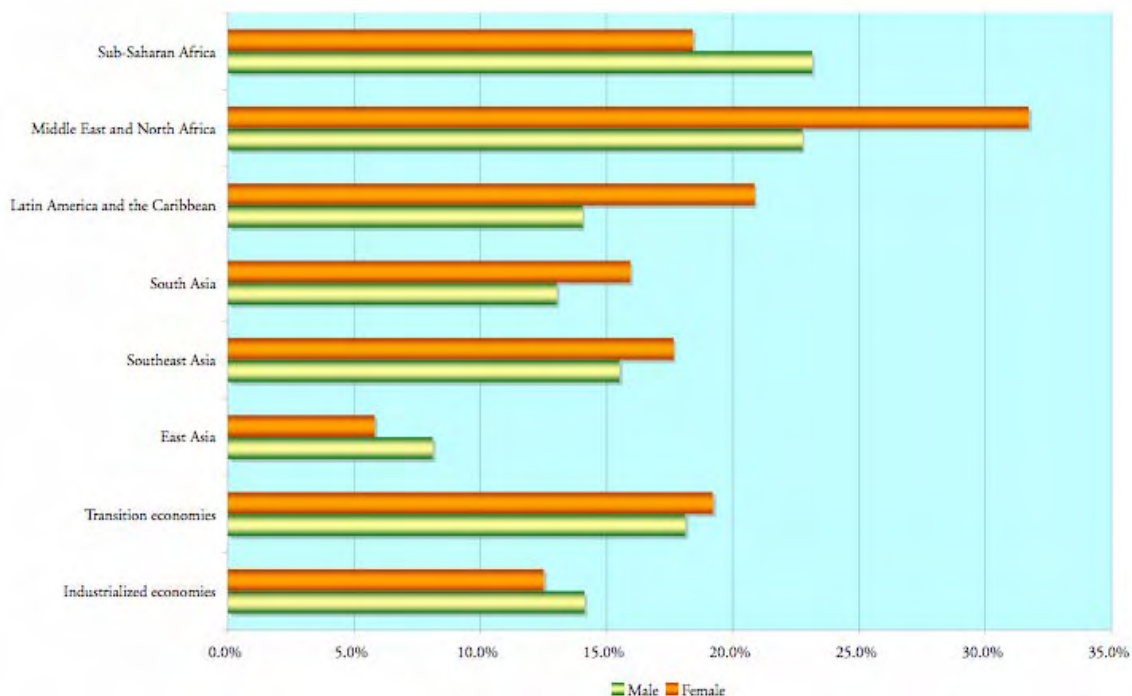
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<sup>12</sup> Additional analysis with finer submarket breakdowns (at the HS 6 level and above) suggests that relevant submarkets are in fact also growing.

<sup>13</sup> There are indications that the exports of the world's most competitive economies, as measured by, say, the Global Competitiveness Report, tend to be concentrated in stagnant or declining markets worldwide. From a strategy perspective, these are in fact the "cash cows" of the original Boston matrix. Whether protection from new entrants leads to complacency or fuels innovation in other markets has not been explored empirically, at least not to my knowledge.

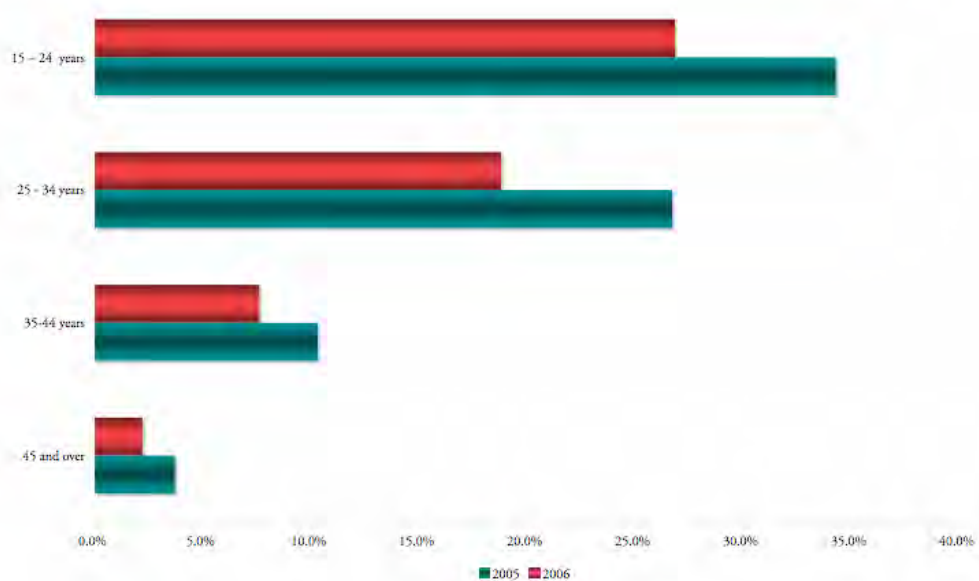
rates among female youth, and the yellow (light) ones to male youth. For the Middle East and North Africa, unemployment among young women registered at well over 30 percent, while that for men was roughly 25 percent, approximately the same as for sub-Saharan Africa.

**Figure 4: The global challenge of youth unemployment**



Source: ILO, Global employment trends for youth, 2004.

The magnitude of this regional crisis becomes even more pronounced when differences in labor force participation rates for young people are taken into account, that is, the percentage of people in a given age group who are actively looking for a job.. The MENA region has one of the lowest participation rates for young people. If the difference between the actual labor force participation rate for the region and the average participation rate across all countries is treated as “discouraged workers” who have given up looking for a job, the effective youth unemployment rate balloons to over 45 percent for the region.

**Figure 5: Urban unemployment rates in Morocco by age group, 2005 and 2006**

Source: Haut Commissariat au Plan, *Enquête nationale sur l'emploi*, 2006 ; the reported unemployment rates refer to the second quarter.

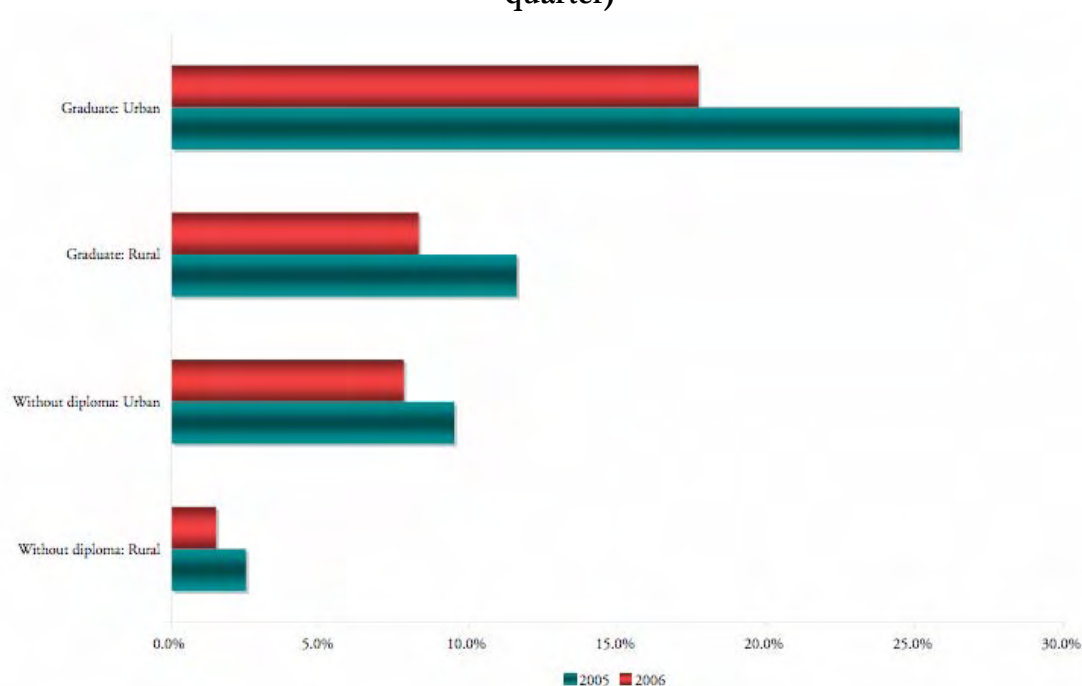
Recent data for Morocco suggest, however, that while the problem remains critical, some progress in tackling the youth unemployment problem seems to have been achieved. According to data gathered and published by the Haut Commissariat au Plan, the total unemployment rate for all ages has declined by over 30 percent (or by 2.4 percentage points), from 11.1 percent in the second quarter of 2005 to 7.7 percent for the second quarter 2006. The decline has been particularly pronounced in urban areas, where it fell from 18.4 percent (2005) to 13.0 percent (2006). Still, unemployment among the young remains a severe problem, especially in urban areas, as illustrated in Figure 5. The unemployment rate for the 15-24 age group has declined from about 35 percent (green bars) to 27 percent (red bars)—which still means that one out of every four young people is unsuccessfully looking for a job.<sup>14</sup> It is difficult to assess whether these changes are sustainable, since two points cannot establish a trend. Further tracking of unemployment figures will be needed.

The youth unemployment quandary hits young people with a higher educational status particularly hard. Figure 6 illustrates this pattern for graduates (“*ayant un diplôme*”) versus lower educational achievements (“*sans diplôme*”), across all age groups. In 2006, unemployment among the better-educated group was more than double that for workers with lower qualifications in the urban areas, and double that for the *diplômés* in rural areas.<sup>15</sup> On a positive note, the available data suggest that unemployment for the group of urban graduates has declined more than for any other group between 2005 and 2006. (The *Haut Commissariat* data do not provide a breakdown by age and education level.)

<sup>14</sup> There has also been a slight decline in the labor force participation rate, but it does not affect the reported change in unemployment rates very much.

<sup>15</sup> Unemployment rates for rural areas are somewhat difficult to interpret, since only half of the employed there actually receive salaries.

**Figure 6: Unemployment rate by educational achievement, 2005 and 2006 (second quarter)**



Source: Haut Commissariat au Plan, Enquête nationale sur l'emploi, 2006

Why is youth unemployment in Morocco (as in other MENA countries) so high? Empirical evidence is thin. Normally, one would expect that scarce skills command a premium. While Morocco is spending now more than 6 percent of its GDP on education, only around 9 percent of Moroccan workers have completed secondary education—which would suggest that they be sought after. Yet studies of the economic returns on education in Morocco show low rates, lower than in comparison countries. Ultimately, investment in human capital is expected drive faster growth, yet returns to education in turn are dependent on growth.<sup>16</sup> As long as these returns remain low in the country itself, graduates may look elsewhere for work. And the resulting brain drain is definitely perceived as a major issue by business (see the discussion below). The fact that it happens, however, would seem to refute the argument that the quality of education itself is to blame.

Even if the quality of education is competitive, its content may not meet the current needs of the Moroccan economy. There is some anecdotal evidence that competition for a small pool of graduates from engineering schools is fierce. However, statistical evidence for any education-skill mismatch is not available. Other factors may play a role, in particular rigidities in the labor market, identified in *Doing Business in 2007* (as well as in earlier years) as the weakest point in Morocco's business climate. In any case, the World Bank's Country Economic Memorandum therefore concludes that "...the *demand* for highly skilled labor is simply not there," and the rigid labor market raises the risk for employers particularly for young people with a longer career ahead of them. In fact, surveys suggest that employers look for alternative solutions to meet their staffing needs when business expands, rather than adding regular employees to their payroll.

<sup>16</sup> Investments in higher education have been credited with creating higher growth prospects in the BRIC (Brazil, Russia, India and China) countries.

The Moroccan authorities have launched a number of programs that target in particular young unemployed adults with better education, such as the Mokawalati program which seeks to encourage the creation of small enterprises (*très petites entreprises*—TPE). One of the features of this program is an emphasis on decentralization: a regional commission reviews and approves (or rejects) applications to the program. A survey conducted under the Improving the business climate in Morocco Program in cooperation with the World Economic Forum targeting selected regions in Morocco found that the degree of decentralization perceived by business executives is associated with greater investor satisfaction with other elements of competitiveness, even if objective measures fail to suggest much decentralization in economic policy making. Morocco's Regional Investment Centers (CRI) are heavily involved in the enterprise creation effort, and provide key services, including the development of project banks, to the target group of (largely urban) educated youth without jobs. The focus on enterprise creation drove the recent decision to lower the minimum capital for launching an enterprise—a step that has caused a major improvement in the World Bank's Doing Business ranking for "Starting a business," as discussed in Part II.

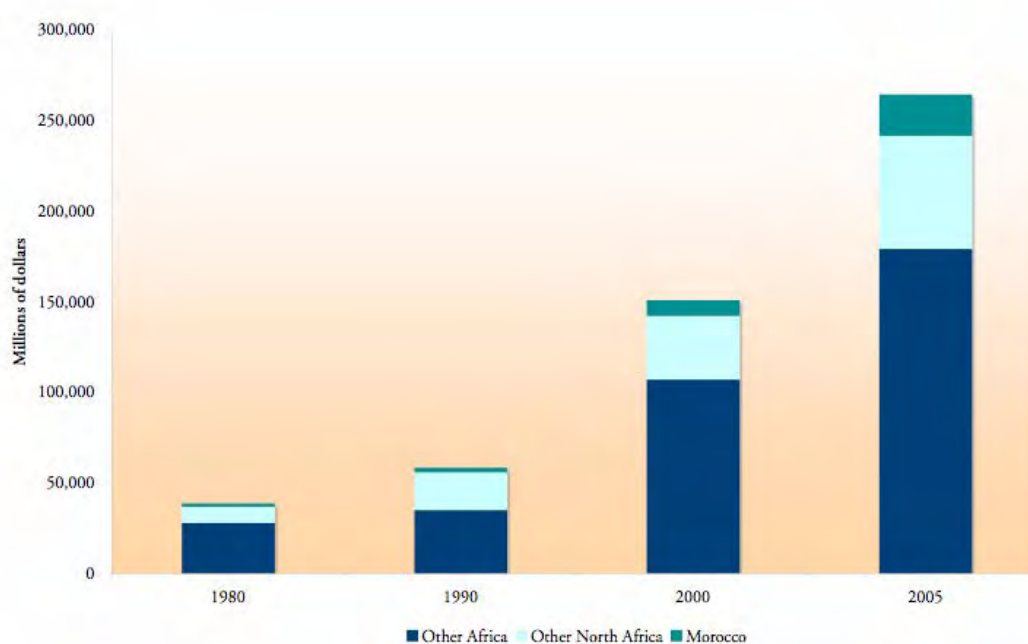
## Foreign direct investment

### Recent patterns

The latest World Investment Report 2006 provides a comprehensive perspective on foreign direct investment (FDI) and its implications for the recipient countries. In many instances, foreign investment flows from year to year tend to fluctuate widely. Often, they reflect individual transactions, such as those linked to privatizations. For example, between 2003 and 2005, Morocco's share in total FDI flows into North Africa went from 45 percent (2003) to 18 percent (2004) and then back up to 23 percent (2005).

To obtain a better idea of the relevant trends, it is therefore preferable to look at trends in the FDI stock in the economy. Figure 7 provides an overview of recent trends for the African continent. Between 2000 and 2005, the total FDI stock for all of Africa increased by 75 percent. For Morocco, it rose by a much higher margin, 162 percent above the level for 2000. Since 1990, Morocco's total share in inward FDI stocks for African countries doubled, from 4.3 to 8.6 percent.

**Figure 7: Trends in FDI stocks for Africa, North Africa and Morocco**



Source: UNCTAD, World Investment Report 2006.



In 2005, the major drivers for FDI flows to Morocco were telecommunications (which included the acquisition of 16 percent of Maroc Telecom by Vivendi), followed by tourism (stimulated by the Plan Azur), residential developments, industrial activities (in particular automotive and aeronautical parts), and insurance. These inflows accounted for 22 percent of gross fixed capital formation in 2005, a rate similar to that in 2003, following a slump to 9 percent in 2004.

The performance of the economy in attracting (and retaining) foreign direct investment has been encouraging, with privatizations accounting for a large part of that investment. Arguably, Morocco's FDI stocks have grown for reasons other than a hospitable business environment, driven more by its location and proximity to Europe.

Largely because of weaknesses in the business climate, overall returns on investment are reported to be low. Moreover, while FDI can be an important source of technology transfer (as discussed below), the patterns of FDI suggest relatively little spillover effects. To leverage FDI more effectively for growth will require more intense efforts to improve the business climate across the country to facilitate and promote the evolution of value chains that leverage FDI, as well as domestic investment, for broad-based growth. Recent international comparisons suggest that Morocco is not advancing as fast and as effectively as possible in the pertinent structural reforms.

## PART II: HOW MOROCCO FARES IN BUSINESS CLIMATE COMPARISONS

### A plethora of ratings

Over the past few years, many organizations and institutions have sought to compare the business climate across countries and regions, either in some comprehensive manner, using a range of indicators, or for selected aspects. For example, these efforts include a ranking of a country's creditworthiness by a group of analysts, such as the country creditworthiness ratings offered semiannually by Institutional Investor, appraisals of the country's openness to trade (The Heritage Foundation), or comparisons in terms of indicators of corruption (Transparency International).

Three of the attempts to compare the business climate across countries are widely considered as the most comprehensive and respected:

- The global governance indicators estimated by a team at the World Bank Institute under the leadership of Daniel Kaufmann; five of the six indicators published annually<sup>17</sup> are among the 16 criteria for eligibility for funding under the Millennium Challenge Account (MCA);
- The annual Doing Business series prepared by a World Bank/IFC team which covered some 175 countries in its latest edition, *Doing Business in 2007*; and
- The Global Competitiveness Report published annually by the World Economic Forum which is seeking to ascertain the views of business leaders regarding factors influencing competitiveness, and combining these answers with "hard data" to rank countries, covering 125 countries in its latest edition.

A brief review of the most recent data from these efforts to rank countries provides an overview of key dimensions of the business climate in Morocco. In 2006-7 The USAID Improving the Business Climate in Morocco Program has actually employed some of the same tools for assessing the business climate and competitiveness factors across the level of Morocco's regions. The Program used the Executive Opinion Survey of the World Economic Forum and gathered data on selected indicators of the Doing Business team in order to identify any variations for selected regions of the Kingdom. Together, these assessments can provide guidance in encouraging and supporting further reform efforts. The results of these two surveys will be published separately.

The analysis also touches briefly on three other assessments—an assessment of Morocco's attractiveness for 2006 prepared by Ernst & Young for the *Direction des Investissements*, an appraisal of the country's compliance with the US FTA provisions prepared by the Commercial Law Development Program at the US Department of Commerce, and a somewhat dated survey of the American Chamber of Commerce in Morocco for 2003. Together, these sources provide a rich canvass for understanding the strengths and weaknesses of the business climate in the country.

### The World Bank Institute's global governance indicators

The underlying idea of the World Bank Institute (WBI) global governance indicators is actually rather simple. With the large and growing number of different assessments proffered by a range of institutions and organizations, is it possible to generate some kind of summary measure for particular elements that reflect a kind of consensus of the rating institutions? The approach starts

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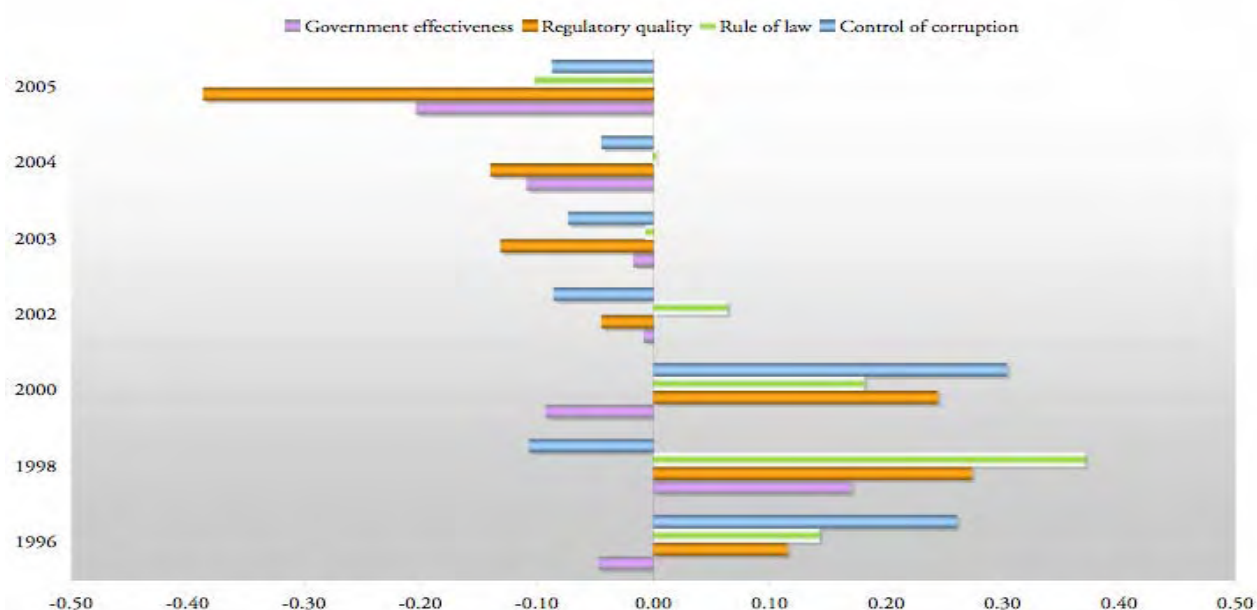
<sup>17</sup> Until 2004, the WBI published the global governance indicators bi-annually. In 2006, it moved to an annual reporting cycle, providing data for 2005 as well as for 2003 to complement the already published indicators for 2004.

by defining a set of summary descriptors that define a politico-economic range for global governance:

- voice and accountability;
- political stability;
- government effectiveness;
- regulatory quality;
- rule of law; and
- control of corruption.

It is reasonable to assume that all ratings and rankings by the various observers and institutions grouped under these six measures in effect seek to define the same phenomena, albeit from different angles and perspectives. Thus, by combining related measures from different sources, it should be possible to tease out the underlying “true” measure itself, within a (statistical) margin of error. The WBI team relies on an econometric technique, the unobserved components model, to generate point estimates for the six underlying phenomena, normalized over a range -2.5 to +2.5.

**Figure 8: Selected global governance indicators for Morocco**



Source: World Bank Institute

Figure 8 illustrates the evolution of four of the six global governance indicators for Morocco: control of corruption, rule of law, regulatory quality, and government effectiveness. The data available cover the period from 1996 (bottom of the chart) to 2005, with data for every two years until 2002, and annual data after that. If the bars go to the right, Morocco in effect scores higher than the median, if they point to the left, the rated performance is worse. The comparison over time seems to suggest that ratings have been getting worse, at least relative to the median. It is notable that the trend, whether absolute or relative, has been worst for the “regulatory quality indicator,” marked by the orange bar (or third bar from the top). Annex A provides an illustration of the sources that go into the estimation of the regulatory quality index.

Three caveats apply to any interpretation of these apparent trends. First, the rated performance is relative. The bars pointing to the left do not necessarily mean that things are getting worse in an absolute sense; they may just mean that Morocco is losing ground vis-à-vis other countries that are reforming faster. Second, changes over time may reflect both changes in the underlying

(unobserved) measure of the business climate, and changes in the composition and breadth of sources consulted for the estimation of the WBI indicator.<sup>18</sup> However, for the last few years, the number of underlying sources (or ratings) for Morocco has been fairly stable for the four indicators shown here, ranging from 8 to 15, which suggests that any effects of variations in sources are limited.

Third, and perhaps most importantly, the WBI's econometric techniques not only generates point estimates of the indicators, but also standard errors. For example, using the data for 2005, adding one standard error to the point estimate means potentially a positive score for two of the indicators—rule of law and control of corruption. Dealing with the point estimate as a “hard” criterion, as is being done in ranking countries for eligibility for assistance under Millennium Challenge Account (MCA), abstracts from the underlying statistical and substantive subtleties.

## **The *Doing Business* indicators (World Bank/IFC)**

### **Overall rankings**

The annual publication of the *Doing Business* indicators, launched in 2004, represents an attempt to measure the “transaction costs” of accomplishing certain business processes, such as starting a business, closing a business, or enforcing contracts, in a standardized manner that allows for comparisons across countries.<sup>19</sup> The basic approach is to formulate a particular “standard” case, like the construction and operation of a warehouse, and to go through all the administrative and related procedures needed in a particular environment. The estimates are derived by talking to experts in the respective fields, such as lawyers, notary publics, architects, etc.

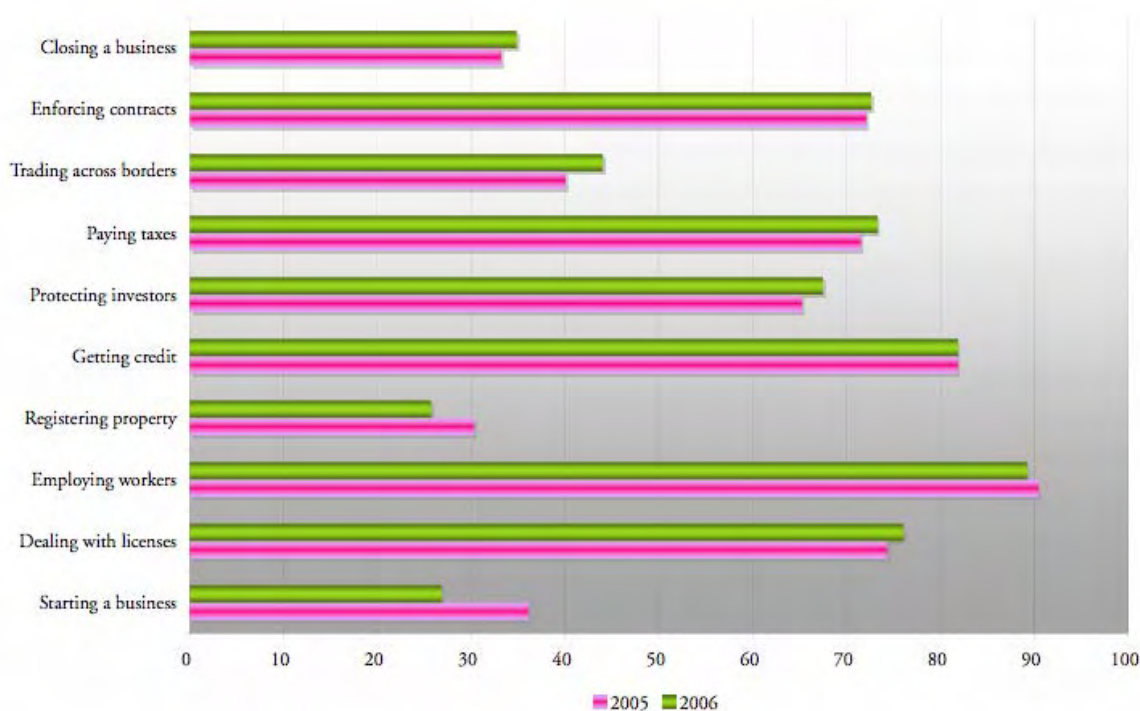
There are two things to remember about the *Doing Business* indicators. First, they are *not* based on an actual survey. Rather, the approach is in effect to sit down with practitioners in the different fields and estimate the number of procedures, time, and so forth. The approach seeks to get estimates from a few people, but more for verification or “triangulation.”

The second point is linked to the interpretation of the results. For the presentation and review, the *Doing Business* series often uses abbreviated descriptions. To understand the implications, it is essential to go back to the original definitions of the indicators and subindicators. For example, the “Dealing with licenses” indicator reflects not only the time and cost required to get the necessary licenses and permits, but also the time it takes to obtain utility connections. Similarly, the “starting a business” indicator combines both the time and cost involved, and the minimum capital required. In the case of Morocco, the authorities lowered the minimum capital requirements drastically between 2005 and 2006, from 700 percent of capita income to 67 percent. As a result, the overall ranking on this measure improved significantly (as shown at the bottom of Figure 9). Meanwhile the time required to start a business stayed the same, while its cost declined slightly, although both subindicators were losing ground in comparison with other countries.

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<sup>18</sup> For example, in one country, some of the WBI indicators used to determine MCA eligibility for 2002 were based on a single source providing underlying ratings; the country failed to qualify for MCA funding. The addition of a second source in 2004 meant that the country scored above the median, and therefore became eligible for participation in the MCA program.

<sup>19</sup> The World Bank also maintains a database of enterprise surveys ([www.enterprisesurveys.org](http://www.enterprisesurveys.org)) which covers a total of 77 countries, including Morocco. The survey data for Morocco are based on a 2004 survey of some 850 enterprises. It is difficult, however, to reconcile the findings reported there with other data sources, which implies that considerable effort is warranted to reconcile these data with others. It is also not entirely clear how the respondents were selected. For example, the 2004 survey in Morocco reported that some 56 percent of enterprises are involved in exporting directly.

**Figure 9: *Doing Business* rankings, 2006 versus 2005**

Source: Doing Business web site; the data show percentiles, that is, the number of countries has been standardized to 100.

Overall, between 2005 and 2006, the positions of Morocco on virtually all the scores changed little, as Figure 9 illustrates. On the basis of the 175 countries covered in 2006, the country moved from rank 117 to rank 115, mostly on the basis of improvements in the “starting a business” indicator. The worst scores—where Morocco ranks lowest—were for “employing workers” and “getting credit,” though the rankings for “dealing with licenses,” “enforcing contracts,” and “paying taxes” were also unfavorable, putting Morocco into the lower third of the countries ranked.

### Comparing subindicators

In interpreting the results of these comparative assessments, the devil is—as always—in the details. Looking at the country’s overall rankings may be of some interest, but what matters more is how the country is doing on individual subindicators, especially relative to “reference countries,” in this case to the average scores for countries in the MENA region. In addition, it is also useful to compare scores to the average for OECD countries. Table 1 shows the values of the subindicators for the ten main indicators used in the Doing Business rankings for Morocco for 2005 and 2006. It also presents comparative data for the region and the OECD countries for 2006. The table includes brief definitions of these subindicators to clarify their interpretation.<sup>20</sup>

<sup>20</sup> Commenting on data from the *Doing Business* surveys tends to be a little confusing because of the system for naming each issue. For example, the first issue, *Doing Business in 2004*, contained data for 2003. The latest one, *Doing Business in 2007*, reports data collected in 2006.

**Table 1: Comparison of *Doing Business* subindicators, 2005 and 2006, to reference countries**

	Doing Business in 2006		Doing Business in 2007	
	Morocco	Morocco	Region	OECD
<b>Starting a business</b>				
The subindicators refer to the number of steps entrepreneurs can expect to go through to launch, the time it takes on average, and the cost and minimum capital required as a percentage of gross national income (GNI) per capita.				
Procedures (number)	6.0	6.0	10.3	6.2
Time (days)	12.0	12.0	40.9	16.6
Cost (% income per capita)	13.4	12.7	74.5	5.3
Minimum capital (% of income per capita)	700.3	66.7	744.5	36.1
<b>Dealing with licenses</b>				
Subindicators refer to the number of procedures, time, and costs to build a warehouse in the economic capital, including obtaining necessary licenses and permits, completing required notifications and inspections, and obtaining utility connections.				
Procedures (number)	21.0	21.0	19.9	14.0
Time (days)	217.0	217.0	206.9	149.5
Cost (% of income per capita)	269.2	264.9	499.9	72.0
<b>Employing workers</b>				
The first three subindicators assign values between 0 and 100, with higher values representing more rigid regulations. The Rigidity of Employment Index is an average of the preceding three subindicators.				
Difficulty of hiring index	100.0	100.0	29.7	27.0
Rigidity of hours index	40.0	40.0	44.7	45.2
Difficulty of firing index	50.0	50.0	32.9	27.4
Rigidity of employment index	63.0	63.0	35.8	33.3
Hiring cost	17.7	17.7	15.6	21.4
Firing cost	85.1	85.1	56.9	31.3
<b>Registering property</b>				
The subindicators measure the ease with which businesses can secure rights to property. Included are the number of steps, time and cost involved in registering.				
Procedures (number)	4.0	4.0	6.6	4.7
Time (days)	46.0	46.0	49.4	31.8
Cost (percent of property value)	7.0	4.4	6.9	4.3
<b>Getting credit</b>				
The Legal Rights Index ranges from 0-10, with higher scores indicating that laws are better designed to expand access to credit. The Credit Information Index measures the scope, access, and quality of credit information available through public registries or private bureaus. It ranges from 0-6, with higher values indicating that more credit information is available from a public registry or private bureau.				
Legal rights index	3.0	3.0	3.9	6.3
Credit information index	1.0	1.0	2.4	5.0
Public registry coverage (% adults)	2.0	2.3	3.2	8.4
Private bureau coverage (% adults)	0.0	0.0	7.6	60.8

<b>Protecting investors</b>				
The subindicators describe three dimensions of investor protection: transparency of transactions (Extent of Disclosure Index), liability for self-dealing (Extent of Director Liability Index, shareholders' ability to sue officers and directors for misconduct (Ease of Shareholder Suits Index) and Strength of Investor Protection Index. These subindicators vary between 0 and 10, with higher values indicating greater disclosure, greater liability of directors, greater powers of shareholders to challenge the transaction, and better investor protection.				
Disclosure index	6.0	6.0	5.8	6.3
Director liability index	6.0	6.0	4.6	5.0
Shareholder suits index	1.0	1.0	3.5	6.6
Investor protection index	4.3	4.3	4.6	6.0
<b>Paying taxes</b>				
The subindicators show the tax that a medium-size company must pay or withhold in a given year, and the administrative burden in paying taxes. The measures include the number of payments an entrepreneur must make; the number of hours spent preparing, filing and paying; and the percentage of their profits they must pay in taxes.				
Payments (number)	28.0	28.0	29.6	15.3
Time (hours)	468.0	468.0	236.6	202.9
Total tax rate (% profit)	52.7	52.7	40.8	47.8
<b>Trading across borders</b>				
The subindicators refer to costs and procedures involved in importing and exporting a standardized shipment of good. Every official procedure involved is recorded—starting from the final contractual agreement between the two parties, and ending with the delivery of the goods.				
Documents for export (number)	6.0	6.0	7.1	4.8
Time for export (days)	18.0	18.0	27.1	105.
Cost to export (USD/container)	n/a	700.0	924.0	811.0
Documents for import (number)	11.0	11.0	10.3	5.9
Time for import (days)	30.0	30.0	35.4	12.2
Cost to import (USD/container)	n/a	1,500.0	1183.0	883.0
<b>Enforcing contracts</b>				
The subindicators refer to the evolution of a payment dispute and tracking the time, cost, and number of procedures involved from the moment a plaintiff files the lawsuit until actual payment.				
Procedures (number)	42.0	42.0	41.6	22.2
Time (days)	615.0	615.0	606.1	351.2
Cost (% of debt)	16.5	16.5	17.7	11.2
<b>Closing a business</b>				
The subindicators measure the time and cost required to resolve bankruptcies. The data identify weaknesses in existing bankruptcy law and the main procedural and administrative bottlenecks in the bankruptcy process. The recovery rate measures how many cents on the claimants recover from the insolvent firm				
Time (years)	1.8	1.8	3.1	1.4
Cost (% of estate)	18.0	18.0	12.1	7.1
Recovery rate (cents on the dollar)	35.1	35.1	25.7	74.0

Source: Doing Business.

This detailed analysis of the various subindicators suggests that little has changed in the business climate in Morocco between 2005 and 2006 (as reported in *Doing Business in 2006* and *Doing Business in 2007*, respectively). The comparison of the subindicators for the two years indicates that most of

the measures are quite “sticky.” Of the 36 subindicators for which we have data for both years (two, under trading across borders, were introduced in 2006), only five show any kind of change, and only two—the minimum cost of capital for starting a business, and the cost of registering property—registered significant changes. Changes in the ranking of other subindicators, such as for closing a business, meant that things Morocco remained the same, while there were improvements in other countries.<sup>21</sup> Table 1 also provides some sense of where it exceeds the standards of the region, and how it relates to the standards set by the OECD countries.

With respect to the region, Morocco is clearly ahead in terms of the subindicators for starting a business. For this measure, it is even ahead of the OECD average in terms of number of procedures and time. For dealing with licenses, it exceeds the regional average with respect to the number of procedures and time, but the cost is about half of the regional comparison value. Still, both Morocco and the region are lagging behind the OECD measure. For registering property, all the indicators are below the measures for the region, and Morocco’s scores compare favorably to the OECD averages for the number of procedures and the cost.

Morocco is lagging behind the region (and the OECD countries) in terms of getting credit, but is doing better with respect to closing a business. The remaining indicators offer a mixed picture.

### Going to the level of the regions

Clearly, the national scores and rankings reflect both legal requirements and administrative practices. The results of the ongoing sub-national *Doing Business* survey is expected to help identify best practices and opportunities for improvement within this framework.

## The World Economic Forum’s *Global Competitiveness Report*

### Largely a self-assessment of competitiveness

Each year, the World Economic Forum in Davos publishes the Global Competitiveness Report (GCR).<sup>22</sup> The GCR shows a ranking of countries (125 for the latest edition) which is based on perceptions of business leaders about a range of competitiveness factors and a series of “hard data,” such as budget deficits, disease incidence, or descriptors of infrastructure development, especially communications. The views of business leaders are gathered through a survey, the Executive Opinion Survey (EOS). The average sample size for the Executive Opinion Survey in each of the countries covered is roughly 85. The GCR offers three summary measures of the competitiveness of countries:

- The Global Competitiveness Index (GCI) is calculated on the basis of selected responses to the survey and the “hard data.” The GCI was introduced in the 2005-2006 edition of the GCR as a more comprehensive alternative. The Global Competitiveness Index comprises nine “pillars”—institutions, infrastructure, macroeconomy (defined almost completely by “hard data”), health and primary education, higher education and training, market efficiency (which includes labor markets), technological readiness, business sophistication, and innovation.
- The Business Competitiveness Index (BCI), which is entirely based on EOS responses, that is, without using “hard” data. For the BCI, selected responses are grouped into two subsets, (1) company operations and strategy, and (2) national business environment. The individual EOS responses are aggregated into these two measures using the results of a principal factor analysis. Per capita GDP (adjusted for purchasing power parity) for t+1 is

<sup>21</sup> The “stickiness” of the estimates may also reflect a feature of the data collection approach, which relies primarily on experts familiar with the cases and estimation techniques of *Doing Business*, who tend to be contacted for successive editions of *Doing Business*.

<sup>22</sup> The World Competitiveness Center at IMD in Lausanne publishes an annual World Competitiveness Yearbook (WCY) which is in some respects an early “spin-off” of the work on the GCR. The WCY ranks 61 countries and economic regions within countries. Morocco, alas, is not one of the countries ranked.



then regressed on these two subindices. The results of that regression analysis in turn define the weights of these two measures for calculating the overall BCI; the weights are 0.116 for company operations and strategy, and 0.834 for the national business environment. The subindex describing the business environment by far outweighs the subindex for company operations.

- Finally, the GCR also presents the Growth Competitiveness Index (GrCI—to distinguish it from the GCI) which was the predecessor to the GCI, using a more range of indicators. Its main use right now is for historical purposes, to track longer-term changes in a country's competitiveness as defined by the GCR.

These competitiveness indices are then used to “rank” countries. They also serve as the basis for additional analysis identifying the sources of or obstacles to competitiveness for individual countries.

### The most problematic factors for business

The overall ranking among the countries included in the GCR may be of some interest, but what matters more from a strategic point of view are the relative strengths and weaknesses along different dimensions. Table 2 shows the most problematic factors for doing business reported by the respondents in Morocco for 2004, 2005 and 2006. There have been some changes across the three years, but the overall pattern remains the same. “Access to financing” tops the list in all three years. Corruption, inadequate infrastructure, and taxes (tax regulations and tax rates), and inefficient bureaucracy round out the top five. One aspect worth noting is that the importance of the inefficient bureaucracy as an obstacle to business performance seems to be diminishing. It was cited in by 13 percent of the respondents in 2004, by 10 percent in 2005, but by only 6 percent in 2006.

**Table 2: Most problematic factors for doing business in Morocco (from *GCR*)**

Global Competitiveness Report 2004-2005		Global Competitiveness Report 2005-2006		Global Competitiveness Report 2006-2007	
Problematic factor	Percent of responses	Problematic factor	Percent of responses	Problematic factor	Percent of responses
Access to financing	19	Access to financing	21	Access to financing	20
Inefficient bureaucracy	13	Corruption	16	Tax rates	14
Inadequate infrastructure	13	Tax regulations	11	Corruption	13
Corruption	11	Inadequate supply of infrastructure	11	Tax regulations	12
Tax regulations	10	Inefficient government bureaucracy	10	Inadequate supply of infrastructure	10
Restrictive labor regulations	8	Tax rates	10	Inadequately trained workforce	6
Inadequately educated workforce	7	Inadequately trained workforce	7	Inefficient bureaucracy	6
Tax rates	6	Poor work ethic	4	Poor work ethic	5
Poor work ethic	5	Restrictive labor regulations	3	Foreign currency regulations	4
Policy instability	3	Policy instability	2	Restrictive labor regulations	4

## Tracking Morocco's competitiveness position over time

As already mentioned in the introductory remarks, Morocco's competitiveness rankings dropped sharply between 2004 and 2005 in the *Global Competitiveness Report*. In addition, in terms of the Global Competitiveness Index, the country slipped from 43<sup>rd</sup> percentile to the 65<sup>th</sup>, and from the 45<sup>th</sup> percentile to the 67<sup>th</sup> for the Business Competitiveness Index.<sup>23</sup> What specifically accounted for that slippage? To trace the reasons, it helps to understand in more detail how the surveys are conducted, and how the questions are asked. The average sample in each of the countries ranked is roughly 85. In opinion surveys, a sample size of 100 implies that the reported percentage has a margin of  $\pm 10$  percent.<sup>24</sup> Thus a sample size of 85 implies that reported answers have an error margin exceeding 10 percent. On the GCR the standard deviation reports the standard deviation for each EOS question. For example, in the 2005 sample for Morocco (published in the Global Competitiveness Report 2005-2006), the average for the question on production process sophistication<sup>25</sup> was 2.9, with a standard deviation of 1.2. That means that we can be certain, at a modest confidence level of less than 70 percent, that the true average for the population will fall somewhere in a range of 1.7 to 4.1. The individual rankings therefore need to be interpreted with some care.<sup>26</sup>

Another aspect of the survey which is useful to understand is how the questions are asked and scored. For the most part, the Executive Opinion Survey questions ask the respondent to rank performance on a given issue on a scale of 1 (worst) to 7 (best); there are a few important exceptions to that, and the "hard" data used do not follow this pattern at all (but are then converted to the 1 to 7 scale). One of the fundamental problems with the EOS is therefore that the answer depends on the respondent's estimate or expectation of what determines a "7"-performance. For example, one question asks how the respondent ranks the performance of the country's R&D institutions relative to "world class standards." If the respondent has only a vague notion of what constitutes world class standards, the rated performance may end up higher than for a respondent with a very clear understanding of the best—yet the responses are then used in ranking countries on that particular question. As a result, many of the country rankings on specific questions can hold an element of surprise.

Comparing responses over time is further complicated by the fact that the Executive Opinion Survey keeps changing from year to year. Some questions are added, some questions are dropped, and the overall organization is different. Comparing responses over time therefore applies only to those questions that were asked in successive surveys (and requires one-by-one tracking). For the 2006 survey, the Program analyzed data for the country as a whole (collected essentially in Casablanca), and for seven regions in Morocco, using questionnaires supplied by the World Economic Forum.<sup>27</sup> The numbering and sequence of the questions in the regional EOS differ from the ones reported in the Global Competitiveness Report 2006-2007.<sup>28</sup> As a

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<sup>23</sup> By 2006, it had recovered some lost ground, as reflected in a ranking of 56 for the Global Competitiveness Index, and 54 for the Business Competitiveness Index, all standardized by setting the number of countries to 100.

<sup>24</sup> This error margin is  $\pm 3$  percent for the "normal" sample size for political opinion surveys of 1,000 respondents.

<sup>25</sup> "Production processes use (1 = labor-intensive methods or previous generations of process technology, 7 = the worlds best and most efficient process technology)"

<sup>26</sup> This problem also applies to the World Bank Institute global governance indicators, where point estimates are used to rank countries (in particular for eligibility for the Millennium Challenge Account) without regard for the error margin, which is also reported.

<sup>27</sup> The implementation of the EOS in seven selected regions of Morocco was made possible by a grant from USAID (Washington) to the World Economic Forum, which provided the survey questionnaires for application by its local partner, Professor Fouzi Mourji of the Université Hassan II.

<sup>28</sup> World Economic Forum, *The Global Competitiveness Report 2006-2007. Creating an improved business environment.* Houndmills/New York: Palgrave Macmillan, 2006.

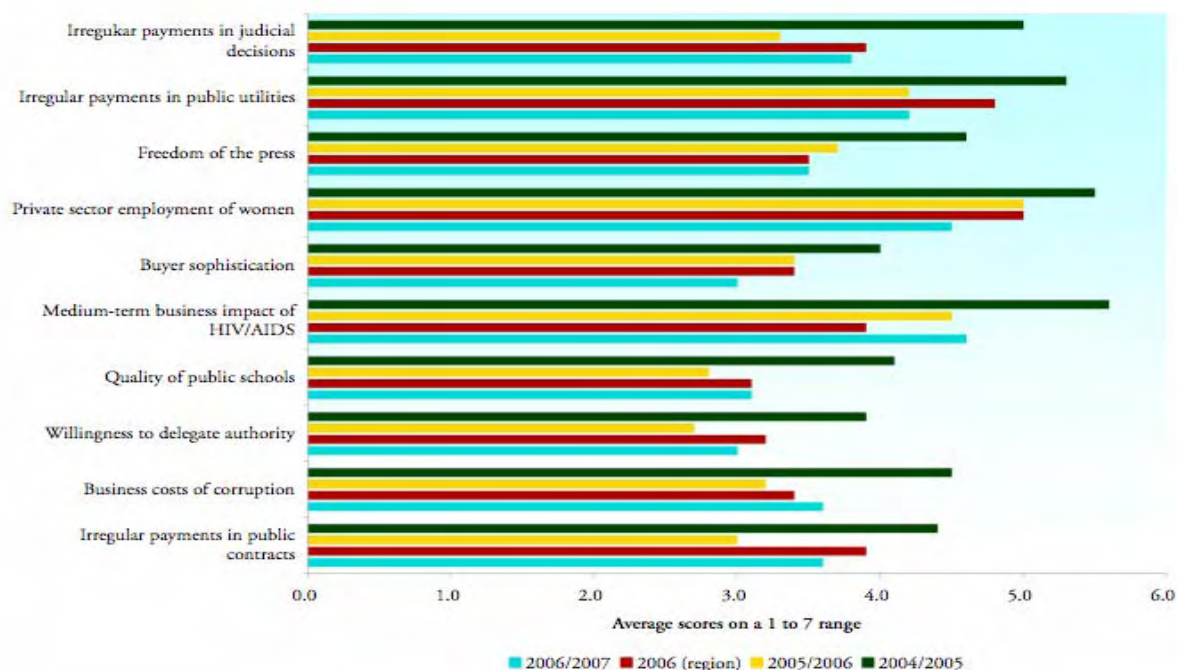
result, some sleuthing was needed to match up the questions for 2004, 2005 and 2006 (both for the national and the regional surveys). We found that 98 questions were asked consistently across those four surveys. The analysis of selected aspects of changes over time is limited to these 98 questions. Annex B presents the complete overview of the changes in scores for all 98 questions across the four surveys.

### Leading causes for a decline in scores

For the 98 questions asked consistently across the four surveys results confirm the overall trend cited earlier in this report: between the GCR 2004-2005 and GCR 2005-2006, Morocco's average score dropped by 0.6 points, or effectively 10 percent for the 1-7 range. With the GCR 2006-2007, Morocco had (re)gained an average of 0.3 points across the 98 questions, however this still leaves the average score 0.3 points behind the GCR 2004-2005.

Between 2004 and 2006, what questions accounted for the worst slippage, and conversely where did the major gains occur? Figure 10 shows the ten questions where Morocco experienced the worst slippage between 2004 and 2006.<sup>29</sup> It is clear that increased skepticism regarding corruption caused much of the decline in rankings. The major drop occurred in reported the perception of the incidence of irregular payments in judicial decisions, and irregular payments for public utilities. It is noteworthy that the average perception for the irregular payments for utilities is better for the regional survey (the brown bar, third from the top in each question). The next drop refers to freedom of the press, where both the national score (Casablanca) and the average for the regional survey are the same.

**Figure 10: GCR scores with the greatest drop between 2004 and 2006**



Because of the nature of the EOS, it is difficult to say whether these responses reflect an increasingly critical attitude toward corruption and the desirable level of the freedom of the

<sup>29</sup> The numbering system for the GCR (as well as for the Doing Business surveys) tends to look to the future. The GCR 2004-2005 refers to data for 2004, and the GCR 2006-2007 to data for the first half of 2006.

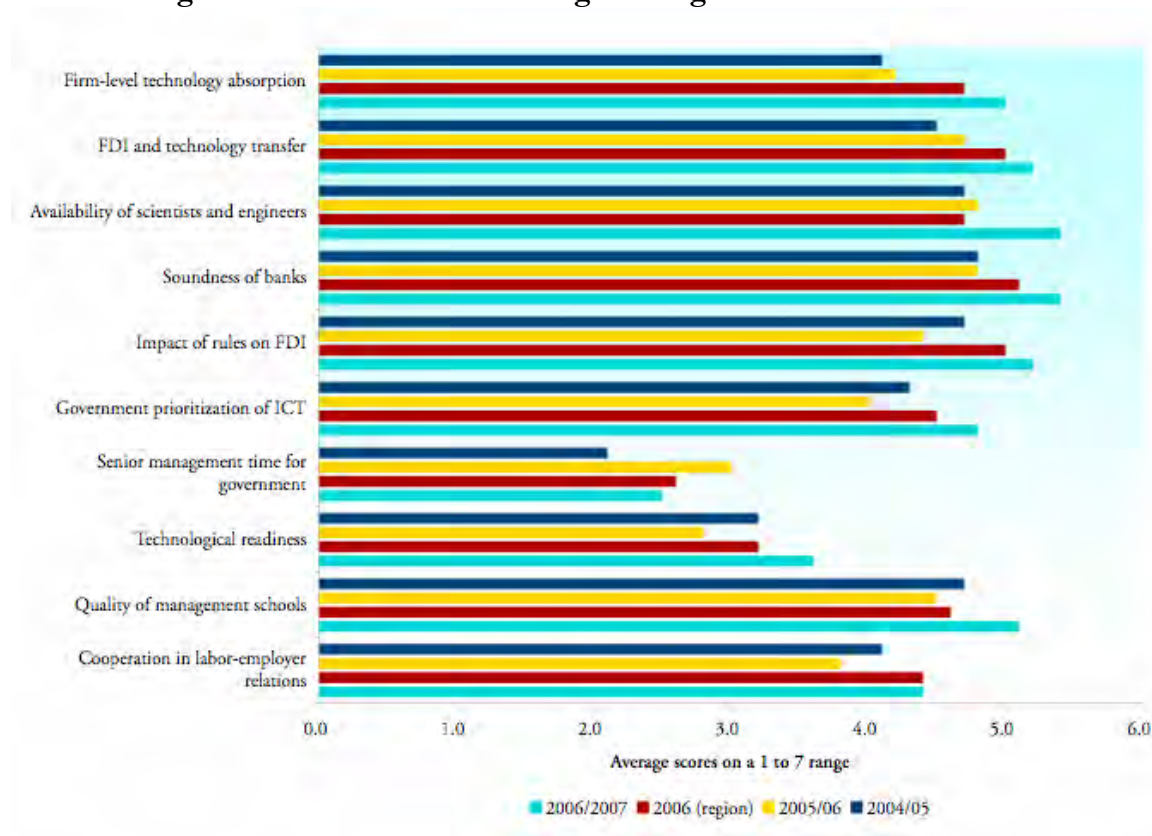
press, or whether they indicate an “objective” worsening of the situation. The same applies to other questions shown here. For the question regarding the quality of public schools, it is likely that expectations played a major role, since it is difficult to imagine how schools could deteriorate by something like 32 percent (the decline in the ratings) within a year or two.

### And now for good news: Leading gains

Figure 11 shows where Morocco recorded gains in business perceptions of competitiveness factors. The declines shown in Figure 10 focus primarily on systemic problems; only two issues, private sector employment of women and willingness to delegate authority, are under the “control” of business itself. With respect to gains, the emphasis appears to be on the readiness of the economy for technological innovation. There are also gains in the perceived soundness of banks.

The available evidence suggests that while Morocco slid in the GCR rankings between 2004 and 2005, it has since regained some lost ground. The perceived level of corruption—cited fourth in 2004, second in 2005, and third in 2006 among the most problematic factors for doing business—is largely to blame for the decline, although other factors have come into play. What is remarkable, however, is the conviction that Morocco is achieving greater competitiveness through the adoption of new technology.

**Figure 11: GCR scores with the greatest gains between 2004 and 2006**



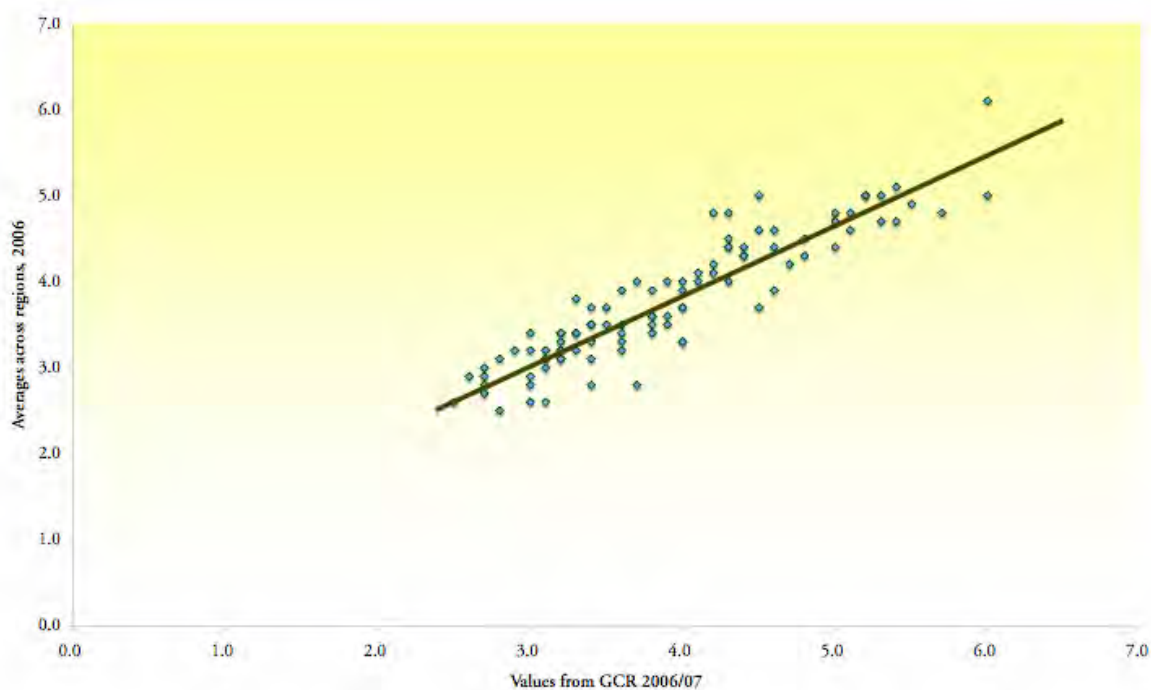
### More moderate views regarding competitiveness factors in the regions?

With support from USAID (Washington), the World Economic Forum conducted a full-scale EOS in seven regions in Morocco for the Improving the Business Climate in Morocco Program. The seven regions are identified by the capitals: Agadir, Marrakech, Settat, Meknes, Kenitra, Tangier, and Oujda. The detailed results of this survey will be analyzed in a separate report; however, the question-by-question comparison (for the 98 questions) allows us to compare the

average scores for the regional EOS with those for the national EOS, which focused essentially on Casablanca, as shown in Figure 10 and Figure 11, and in Annex B.

How do the average of regional scores relate to the national results? Figure 12 maps the responses for the two datasets (for the 98 questions). It is clear that the regional averages pretty much track the responses for the national report. However, it is interesting to note that the respondents to the regional survey seem almost more moderate in judging the competitiveness of the economy. On the basis of a simple regression (Average of regional scores =  $0.6116 + 0.8119 * \text{national score}$ , as shown by the solid line in Figure 12), for a national score of 2.5, the corresponding regional average would be somewhere around 2.64. For a national score of 6.5, the corresponding regional average would be around 5.89. In other words, the group of respondents to the regional EOS tends to be more “even-tempered” when it comes to judging the highs and lows of Morocco’s competitiveness factors. It is of course entirely possible that respondents in Casablanca are prone to have more defined views.

**Figure 12: GCR scores for 2006, national versus regional averages**



### The Ernst & Young “Attractiveness barometer”

The apparent FDI trends examined in Part I largely tally with the findings of an “attractiveness barometer” (*Baromètre attractivité du Maroc*) compiled by Ernst & Young on behalf of the *Direction des Investissements* for the conference *Les Intégrales de l’Investissement* held in December 2006.<sup>30</sup> This assessment is based on a survey of over 200 investors, mostly in European countries (77 percent of the total number of respondents). That sample size implies that the margin of error for any particular question is  $\pm 7$  percentage points, which suggests caution in interpreting point comparisons between 2005 (which had the same sample size) and 2006. A little more than a third of the respondents, 38 percent, are already operating in Morocco.

<sup>30</sup> Ernst & Young, *Baromètre attractivité Maroc 2006. Vers la première division économique (Résultats de l’étude Ernst & Young sur l’attractivité du Maroc par les investisseurs étrangers)*. December 2006.

Basically, the survey sought to determine how Morocco as a target for investments is faring with respect to competitors. The comparison groups tend to change with the individual questions. Overall, 46 percent of the respondents reported that they view Morocco as more attractive than the year before. That is about the same percentage as for Portugal, but lags behind the improvements for southern Europe (Greece, Romania, Bulgaria, and Turkey). Sixty-three percent of the respondents viewed that group of countries as more attractive than the year before, probably in part because of the entry of Romania and Bulgaria into the European Union. There is a higher percentage of respondents who wish start or expand operations in Morocco (39 percent) than in southern Europe (33 percent); however, that percentage includes firms already active in Morocco (38 percent of the total number of respondents), and the “intentions” percentage includes these enterprises.

Some of the factors that international investors are looking for is competitiveness in terms of labor costs (57 percent), availability and price of land (47 percent), financial charges (41 percent), and support by the public sector (33 percent). For investors, the first three factors have become less significant, while public sector support has gained. For Morocco itself, the leading factors include proximity to European markets and a stable social climate (both with 67 percent—), followed by personal and property security, language skills, telecommunications infrastructure, a clear and stable political and legislative environment, a skilled labor force, and the country’s transport and logistics infrastructure.

The improved perceptions of Morocco have lifted it from a low-cost/small-market position to a higher plateau in terms of market size and investment attractiveness. Some 50 percent of the respondents expect that the situation in Morocco will improve over the next three years, while the corresponding figures for Romania and Bulgaria are significantly higher (68 and 62 percent, respectively). For Morocco, the expected improvements include infrastructure, education and training, its international image and administrative procedures.

With respect to education and training, the respondents (39 percent) drew attention to the need for improved language skills (the development of call centers in Morocco is apparently becoming constrained by a lack of qualified people with good French-language skills). In addition, the development of improved linkages between business and universities was noted as a priority by 30 percent of the respondents. These responses are consistent with the World Economic Forum’s Executive Opinion Survey, where university/business linkages were seen as a problem: the average score for the national survey was 3.0 for the 2007/2006 edition (significantly below the overall average of 4.0), and for the regional survey, the average score was even lower, 2.6 vs. an overall average of 3.8. Other priorities cited in the Ernst & Young barometer included improved vocational training and applied management training.

In terms of possible locations in the country, Casablanca remains the most attractive region, as seen by 63 percent of the respondents, followed by Tangier (46 percent), Marrakech (25 percent) and Rabat (24 percent). All four of these regions, however, have lost ground in terms of attractiveness since 2001; others, such as Fez and Oujda seem more attractive.

In terms of overall perspectives, 23 percent of respondents cited Morocco as the most attractive place for establishing industrial plants. For enterprises operating in Morocco, that percentage doubles to 47 percent. Eastern Europe and Southeast Asia follow with 10 and 9 percent of respondents. For back offices and call centers, 19 percent of the respondents find Morocco most attractive, vs. 10 percent for Spain; only 2 percent find Tunisia attractive. With respect to the establishment of headquarter operations, Morocco is viewed as most attractive by 27 percent of the respondents vs, only 7 percent for Tunisia or Egypt. For the creation of R&D centers, Morocco has moved from 4 percent of the respondents to 9 percent.

The Ernst & Young survey concludes with an assessment of the expectations and preferences of investors from different regions. Overall, the emphasis is on the development of infrastructures

and education and training. For all investors, tourism, telecommunications and commercial and residential developments are currently most attractive. Other functions for the future include the development of call centers and options for the establishment of headquarters for Africa.

The Ernst & Young survey provides some background about the perceptions and concerns of international investors with respect to Morocco. Overall, the reported figures are encouraging, but the results also highlight some of the same issues identified in the competitiveness assessments presented above: development of infrastructure and major improvements in terms of education and training are needed to take advantage of the opportunities Morocco offers.

### **A recent assessment of US FTA compliance**

Morocco has in fact outlined a comprehensive agenda for regulatory reform through its WTO commitments, in the Association Agreement with the European Union, and in a series of free trade agreements, in particular the recent Free Trade Agreement with the US.<sup>31</sup> In 2005, the Commercial Law Development Program (CLDP of the US Department of Commerce) prepared an assessment of the status of Morocco's compliance with its commitments under the US FTA Agreement. The summary examined each of the 17 substantive chapters in detail.<sup>32</sup> This assessment concluded overall that most of the enabling legislation and implementing regulations are in fact in place or are treated as "work in progress." The main needs are therefore in developing the institutional capacities to implement these laws and regulations in a fair and consistent manner. The report identified as one of the primary targets of assistance to these efforts the Moroccan customs service which is expected to play a stronger role in enforcing regulatory constraints at the border, in particular with respect to the protection of intellectual property rights.

The assessment also argues that key regulatory agencies, such as OMPIC (Office for Industrial and Commercial Property), need technical assistance and training to build their capacity to render final decisions that keep the parties from having recourse to judicial proceedings. These efforts are needed to lighten the load of the commercial courts.

The CLDP assessment also suggested that development of Morocco's quality infrastructure—norms, standards, testing and certifications—are critical to deal with the issues regarding technical barriers to trade (TBT). The main agency in this field is the *Service de Normalisation Industrielle Marocaine* (SNIMA) in the Ministry of Industry, Commerce and Economic Modernization. The Improving the Business Climate in Morocco Program is actively engaged in providing support to SNIMA which is scheduled to become an independent agency as the *Institut Marocain de Normalisation* (IMANOR).

### **American Chamber of Commerce in Morocco survey**

In the past, the American Chamber of Commerce in Morocco (AmCham) has conducted its own survey of executive perceptions about business and investing in Morocco. For a number of reasons, this survey has not been conducted in recent years; the most recent results refer to 2003. That survey overall indicated a very positive perception of the Moroccan business environment. It did show traces, however, of what is often referred to as the "Moroccan paradox"—the tendency among respondents to give relatively negative answers to specific questions while being satisfied in general with their investment decisions. Still, this Moroccan paradox was much less pronounced in 2003 than in the previous survey for 2001.

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<sup>31</sup> The country is also engaged with the OECD program in articulating and pursuing a National Investment Reform Agenda.

<sup>32</sup> Chapters 2-18; Chapter 1 is an introduction, and Chapters 19-22 refer to administrative aspects.

Respondents to the AmCham survey indicated general satisfaction with the trade regime and existing free trade agreements, confirming the findings of the World Economic Forum's Executive Opinion Survey. The main focus of respondents was on the existing EU Association Agreement. Respondents also indicated considerable progress with respect to their interaction with government agencies, in particular customs. However, taxes emerged as a much more serious problem in this survey compared to 2001. Taxation was "... the aspect of the business environment with the most unfavorable rating. An excessive taxation burden is indicated by respondents, and the taxation regime is regarded as a major disincentive to hiring." (AmCham Survey 2003) That concern once again tallies with the major obstacles expressed by respondents to the Executive Opinion Survey where tax rates and tax regulations rank among the four most problematic factors for undermining productive investment in Morocco.



## **PART III. FROM RED TAPE TO SMART REGULATION**

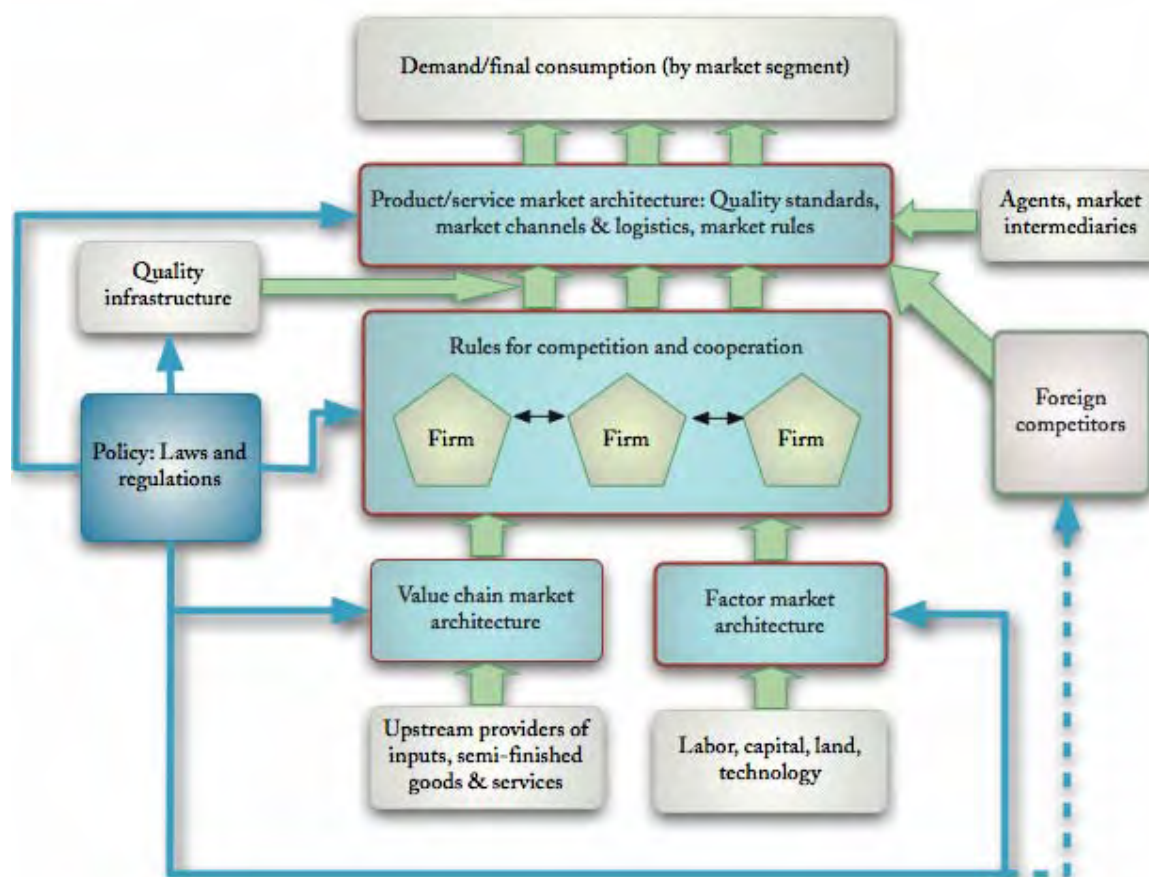
### **Value chain evolution and the legal and regulatory framework**

The consensus that a poor legal and regulatory framework—heavy on red tape and deficient in providing the public services needed to make a market economy work efficiently—retards growth rests primarily on a priori reasoning. For example, the approach of the Doing Business indicators and its numerous variants is based on the (entirely reasonable) assumption that raising the costs or risks of activities that matter in business impairs competitiveness. Reducing these transaction costs therefore raises the competitive position of any business undertaking, making it easier to prosper in increasingly global markets. Yet reducing red tape is only one side of the coin. “Smart regulation” is also critical to create the conditions for the smooth functioning of markets for products and services, for factors of production, and for upstream services.

Since Adam Smith, we know that specialization is the source of productivity growth. Today’s version of that argument is Clayton Christenson’s value chain evolution theory (which borrows many arguments from the focus on the “make or buy decision” of the New Institutional Economics). For specialization to work in a market context, the legal and regulatory framework must ensure that exchanges can be conducted in a fair and low-risk manner, that producers observe common standards, that contracts can be enforced, that entry and exit are easy, that competition as well as cooperation are protected, and that markets for land, capital, labor and technology function with little risk and restriction.

“Proving” that smart regulation, that is, higher standards of regulatory quality, raises overall productivity requires tracing the multiple effects of rules and standards, monitoring and enforcement throughout the economy. In effect, the legal and regulatory framework defines what may be called the market architecture that sets the rules for all exchanges. Tracing these effects, however, is an extremely challenging task, since it needs to account for the full range of markets and market exchanges. The framework for such a task can be illustrated as shown in Figure 13. This schematic presentation identifies three major market types—for goods and services (the upper part of the graph), broken down by market segment, including exports, the market for upstream services in a value chain context, and factor markets for land, labor, capital and technology.

In this context, policy is expressed through laws, regulation and especially administrative structures and procedures. How existing (or proposed) policies, or laws, regulations and administrative practices, in fact help or hinder the efficient functioning of markets so far has been examined only in a piecemeal fashion. Much of the attention in the Doing Business analysis and related efforts has focused on the administrative costs of complying with regulations, and coping with the risks of uncertainty. However, very little is known about the precise way in which these policies affect market microstructures, or more broadly, the market architecture for a particular sector or value chain. Understanding these causal linkages in greater detail is likely to rank high on the agenda for analysis and action.

**Figure 13: Creating adaptive market architectures**

Tracing the linkages between policy and market architectures empirically at the microeconomic level is not a straightforward proposition, which in turn means that the prescriptions for regulatory reform often are deficient in their persuasive power. Minogue (2005)<sup>33</sup> highlights one of the effects in actual practice:

“Development agencies are still inclined to proffer models based on conditions and practices ... from high-income countries, then become frustrated when such models do not seem to work elsewhere, or receive little more than diplomatic lip service. There is a reality gap between donor ideas of best practice, and the actual legal, administrative, political, and economic processes that exist in low and middle income countries.”

Efforts are underway to find ways to trace the effects of regulation on market architecture and market performance at the microeconomic level. The Ronald Coase Institute has carried out a survey to assess transaction costs, with some reference to value chains. The Foreign Investment Advisory Service (FIAS) of the World Bank/IFC has developed a conceptual and practical framework for the analysis of value chains, although the impact of regulations does not appear to play a prominent role in that analysis. In addition, there are a number of efforts underway from adherents of the New Institutional Economics (NIE) to look at different factors influencing the “make or buy” decision which underlies the emergence of value chains. Finally, USAID/Washington has commissioned a study to develop a toolkit for assessing the impact of the regulatory regime on value chain development and performance, which in turn influences

<sup>33</sup> Minogue, Martin, “What connects regulatory governance to poverty?” (Paper No 118), June 2005, Centre on Regulation and Competition.

overall productivity. One approach focuses on tracing the effects of the institutional environment on labor productivity, accounting for other factors, such as skills (human capital), or capital per worker. In general, however, much of the broader empirical work has focused on macro level associations between regulatory quality and economic performance. The discussion here reviews briefly these two approaches.

### **Effects of the institutional environment on labor productivity**

The basic approach in this line of inquiry seeks to examine productivity differences for otherwise comparable labor in different environments, tracing the effects of labor mobility. Specifically, researchers compare the productivity of immigrants to developed economies to the productivity levels of otherwise comparable workers in their home countries. The underlying assumption is that using workers in the home countries of immigrants as a control group, differences in productivity can be attributed in part to more capital-intensive production processes in developed economies, and in part to the “institutional environment,” primarily a function of the prevailing legal, regulatory and administrative framework.

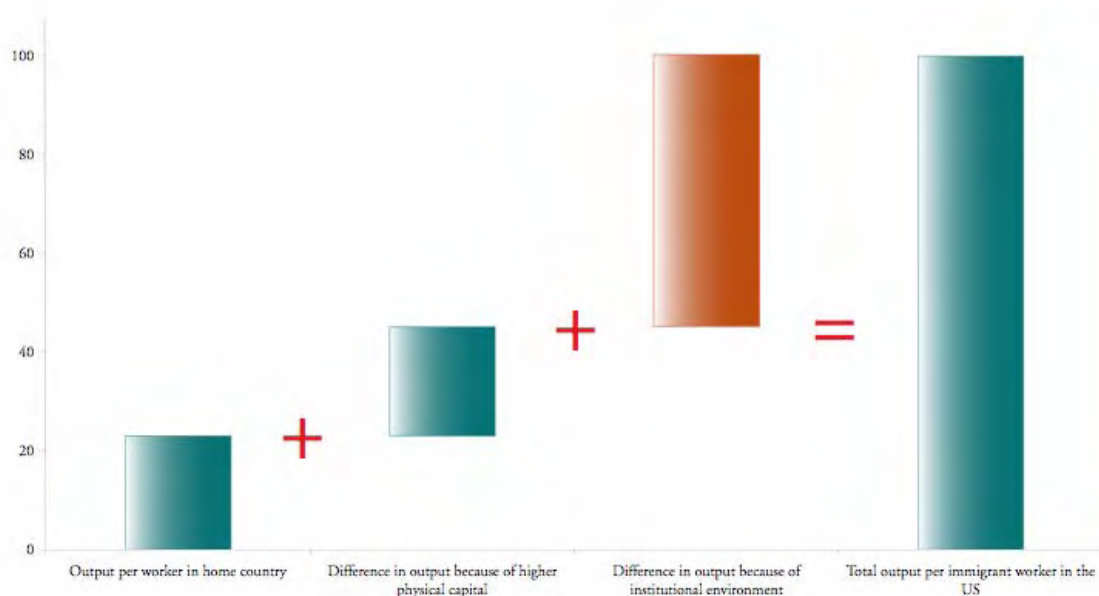
This approach is exemplified by an article by Lutz Hendricks that appeared in the *American Economic Review* in 2002.<sup>34</sup> Hendricks sought to contribute to the debate regarding alternative explanations of observed productivity differences—different endowments in human capital vs. the “total factor productivity” argument that focuses on the broader institutional environment. In short, the approach focused on the sources of productivity for immigrant labor in the US.

The arguments and conclusions presented in the article itself are somewhat difficult to follow. However, Michael Klein of the World Bank summarized the results in a striking graph, shown in Figure 14. The graph disaggregates the total productivity of an immigrant worker into three components: (1) the “innate” productivity of the worker in his/her home country, presumably an expression of the productivity impact of human capital, (2) the productivity effect of a higher capital-labor ratio in the US, and (3) the effect of differences in what Klein calls the institutional conditions, that is, the total factor productivity attributable to differences in value chain evolution (specialization), incentives, risks, practices and culture. In this presentation of the basic argument, innate productivity and higher capital-labor ratios explain somewhere around 45 percent of the total labor productivity of the immigrant worker. Differences in institutional conditions account for the lion’s share in the productivity differential, or approximately 55 percent of the total. This particular example provides a striking illustration of the effect of differences in the business environment on (total factor) productivity.<sup>35</sup>

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<sup>34</sup> Lutz Hendricks, “How important is human capital for development? Evidence from immigrant earnings,” *American Economic Review*, 2002, 92(1): pp. 198-219.

<sup>35</sup> This kind of analysis has a long tradition in economics, going back to the early analysis of the sources of growth across countries. One of Robert Solow’s contributions was to show that economic growth could not be explained by a combination of the growth of labor and capital alone. The remainder, the so-called Solow residual, was attributed primarily to technological progress. Obviously, it combines technological progress and the development of market-enhancing economic institutions. In studies of productivity among enterprises, the Solow residual also reflects differences in incentives—it increases with the degree of private ownership.

**Figure 14: Institutions matter in shaping productivity**

his analysis per se does not identify the contribution of the legal, regulatory and administrative structures on productivity differentials. It does, however, suggest strongly that they play a major role in shaping overall productivity levels.

### The statistical association

Macro level analysis seeks to relate differences in economic performance across countries to measures of regulatory quality through some form of regression analysis. The problems with this type of analysis are well known. A major issue is that regression analysis can demonstrate association, but not necessarily causality. There are statistical techniques which can shed light on the possible direction of causality beyond any *prima facie* argument, but the issue remains. Does better economic performance contribute to better regulatory quality, or is improved regulatory quality a prerequisite for stimulating economic growth?

Ultimately, the answer to this question depends on intrinsic logic. It is possible to attribute higher transaction costs to poor regulatory and administrative structures, which implies a higher cost per value of output, or a lower level of (total factor) productivity. There does not appear to be a sound argument why better economic performance would trigger steps to change regulations and administrative practices. That logic has shaped the statistical analysis of the relationship between regulatory quality and economic performance.

Simeon Djankov and his colleagues<sup>36</sup> found a consistently significant relationship between more business-friendly regulations and higher growth rates. Jalilian et al. (2003) conclude that the causal effects of better governance on higher per capita incomes have been identified in a number of papers.<sup>37</sup> Their analysis used an econometric model to link growth in per capita GDP to a combined measure of regulatory quality and effective governance from the World Bank Institute set, together with other explanatory variables. The explanatory value of these equations

<sup>36</sup> Simeon Djankov, DCaralee McLiesh and Rita Ramalho, "Regulation and growth," March 17, 2006

<sup>37</sup> Hossein Jalilian, Colin Kirkpatrick and David Parker, "Creating the conditions for international business expansion: The impact of regulation on economic growth in developing countries—A cross-country analysis," July 2003 (Centre on Regulation and Competition, University of Manchester, UK)

is relatively acceptable, and once regional dummy variables (for continents) are added, the  $R^2$  (a measure of the fit for regression equation between 0, no relationship, and 1, a perfect match) for the regression equations increases to over 0.55. In another study, Kirkpatrick and Parker (2005) find that a unit change in a combined variable of the quality and effectiveness of regulation is, on average, associated with approximately 0.6 to 0.7 percent increase in economic growth.<sup>38</sup>

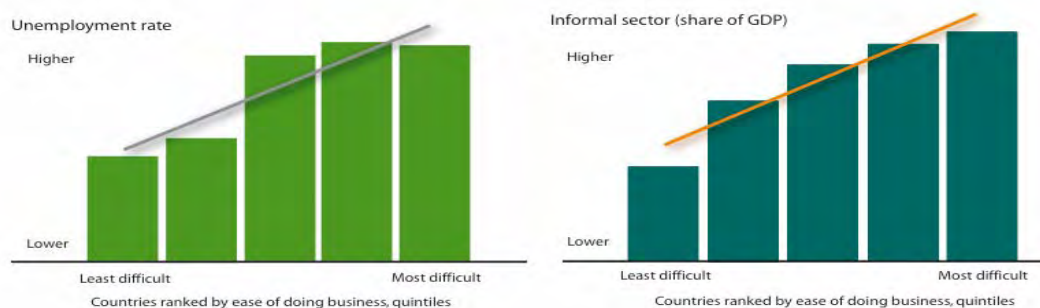
A related exercise was undertaken by USAID-funded project in Vietnam (implemented by Development Alternatives, Inc.), which developed a Provincial Competitiveness Index (PCI). The PCI was based on a survey of some 1,900 enterprises in all provinces of Vietnam, focusing on regulatory quality and administrative procedures. After accounting for major economic factors, including location and infrastructure, the addition of the PCI to the statistical analysis resulted in modest improvements in the power of the equations used to explain the behavior of key economic performance measures available at the level of the provinces. Even so, it attracted considerable attention and is reported to have energized provincial officials to implement reforms and “learn from the best.”

### Unemployment and the informal sector decline with the ease of doing business

Two illustrations from the Doing Business in 2006 edition demonstrate the relationship between employment and the prevalence of the informal sector on one side and lower transaction costs for business—ease of doing business (the inverse of the cost of doing business)—on the other.

**Error! Reference source not found.** illustrates that as the cost of doing business increases, the unemployment rate goes up, and the share of the informal sector in GDP expands. In other words, regulatory and administrative barriers stymie growth.

**Figure 15: Impacts of ease of doing business**



### Tracing the impacts of regulation at the microeconomic level

A promising approach to dealing with the issue of the contribution of regulatory quality to economic performance at the microeconomic level borrows some of the techniques of regulatory impact analysis (RIA). The “gold standard” of regulatory impact analysis requires a separate cost-benefit analysis of the net impacts of a particular regulation, whether proposed or existing.

<sup>38</sup> Colin Kirkpatrick and David Parker, “Towards better regulation? Assessing the impact of regulatory reform in developing countries,” paper prepared for the presentation at a workshop, 22-24 June 2005, University of Manchester.

Even regulations that appear to be economically justified—where market failure is not just introduced as an ex-post justification, but provides a sound rationale—still require careful analysis before promulgation retention. Their efficiency (the cost-benefit ratio), and the incidence of these costs and benefits, which need to include social and environmental impacts, have to be assessed systematically, following the same criteria across all areas of regulation. Such regulatory impact analysis is needed both in the preparation of new legislation or regulations and in the continuing appraisal of existing ones. Regulators in developing countries and transition economies have traditionally shifted all of the costs to businesses, even if the gains in risk (consumer protection) were small. If there are risks associated with, say, externalities, any RIA must also include alternative scenarios of sharing these risks between the different parties. Similarly, in the case of market power, some regulators may decide that increased market power is acceptable if it benefits the consumer, while others may focus more on curbing market powers and ensuring competition.<sup>39</sup> Obviously, any changes as a result of this continuing review have institutional implications: regulators need both incentives and capacity to administer the revamped body of regulations.

Another promising trend is related to the increasing use of technology to deal with the information requirements of drafting, interpreting, implementing and complying with regulations. Through mechanisms as simple as providing access to relevant texts to assisting in vetting proposed regulations to ensuring that any given situation has the same resolution, information technology can play a major role in implementing a reliable rule-based approach to applying the existing body of regulations. While the institutional challenges of getting to that point are formidable, administrative costs and risks of complying with regulations can be lowered significantly.<sup>40</sup>

Both the emphasis on analysis and the opportunities created by a careful deployment of the tools of information technology can provide the basis for involving the economic actors affected. By providing opportunities to comment and suggest improvements, transparency provides the means for building a market-supportive regulatory framework that balances benefits and costs and provides a hospitable environment for enterprise growth.

### **Implications for structural reform in Morocco**

While there is a growing devotion to the principle of regulatory reform, there is often a somewhat shadowy understanding of the appropriate tools and programs to get there. This gap between knowing, what constitutes a hospitable business climate, and doing, how to get there, remains, even in the light of many successful experiences. These experiences range from tinkering in the margins, through efforts to lower administrative costs to businesses by consolidating administrative functions—the “one-stop shop” principle—to more radical approaches. By now there is a body of experience that can guide policy makers and their advisers to focusing on the main argument for sound regulatory policy.

There can be little doubt that a commitment to reducing the transaction costs of doing business contributes to accelerating growth. This conviction underlies regulatory and administrative reform initiatives in countries across the entire range of the development spectrum. Yet the available evidence does not provide a secure guide for strategic choices and priorities. As a result, regulatory reform efforts have to be fairly broad in scope. One of the ways to achieve that is to

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<sup>39</sup> That, in a nutshell, describes the different approaches of the US and the EU to dealing with complaints about the market power of Microsoft.

<sup>40</sup> Cf. Ulrich Ernst, “From e-government to e-governance: Deploying information technology to advance regulatory reform,” *Breaking the rules that bind. Developing Alternatives*, Volume 11, Issue 1, Spring 2006.

focus on the “culture” of regulatory rulemaking and of the administrative application of existing laws and regulations. Moving to smart regulation ultimately depends on the participation of a broad range of economic actors.

Our analysis here suggests that Morocco has some locational and other advantages that are beginning to show the economy’s enormous potential. Growth, especially of non-agricultural GDP, FDI and (apparently) employment have improved over the last five years or so. Investors look favorably on Morocco, yet in spite—and not because—of the quality of its business climate. The international comparisons reviewed here suggest that in terms of its business climate, Morocco is not gaining vis-à-vis its competitors. Making real headway in structural reform, becoming the champions of reform not just in the region, but on the worldwide stage will be critical in supporting the kind of proactive industrial policy outlined in the country’s Emergence program, announced in November 2005. In the sectors targeted by the *Emergence* program, Morocco is facing considerable competition from other countries. The analysis here has shown that Morocco has a number of specific advantages, but they are undermined by little progress toward improving the business environment where competitors are moving forward. One of the lessons that have been learned from successful regulatory reform is the importance of central leadership.<sup>41</sup> Regulatory reform certainly has the highest support, as expressed perhaps best in the 2004 address to Parliament by HM King Mohamed VI:

The government is also called upon to step up its efforts in order to remove all the obstacles which hinder greatly-needed productive investment and which prevent optimal use of all our resources and energies, inside as well as outside the country.

And there are many efforts under way. The *Comité National de Procédures liées à l’Investissement* (CNPI) is working diligently on simplifying the procedures for registering and obtaining approval for investment projects. The Improving the business climate in Morocco Program is providing support to that effort. Individual agencies are engaged in efforts to improve the transparency of the regulatory process, and to lower the cost of complying with administrative procedures. Reportedly, interministerial committees are overseeing some of these efforts. Yet it would be very difficult for an outside observer to identify the locus of leadership in managing the process of reform.

The Emergence program offers a comprehensive strategy for Morocco’s industrial policy with the goal of (a) attracting new investment, (b) developing more competitive products, and (c) developing a greater focus on export markets that have the potential for expansion. The first steps in the Emergence program have focused on the issue that has topped the list of factors that hamper business development in Morocco identified in the Executive Opinion Survey—access to credit. These steps have focused on improved access to the *Mise à Niveau* Fund, and the creation of a guarantee fund to facilitate lending by commercial banks. They also include technical assistance to the enterprises taking out these loans. That particular approach may alleviate pressures in the short run, but it is likely to retard further the development of efficient financial markets and market-based solutions.

From the vantage point of the brief review here, several priorities emerge, some of which are already targeted to some extent. In terms of the *Doing Business* indicators, two areas stand out—“employing workers” and “access to credit.” With the new banking law, which authorizes the Bank Al-Maghrib to develop credit reporting systems and delegate this responsibility, we can expect real progress in this area, which are likely to be reflected in next year’s indicators in some

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<sup>41</sup> See Scott Jacobs, “Freeing the economy: Lessons learned,” in: *Breaking the rules that bind. Developing Alternatives*, Vol. 11, Issue 1, Spring 2006.

form. As for the labor issue, the World Bank in its Country Economic Memorandum (CEM) expresses skepticism: "...[r]eform of the labor compact may be necessary though not politically feasible in the short term, perhaps not even sufficient for addressing the scope of the growth and employment challenge." (p. 65). The CEM suggests trade liberalization and tax modernization as the two most likely reforms to be adopted in the public sector.

Finally, efforts to reduce red tape by simplifying administrative procedures are moving forward, and initiatives to improve transparency in regulations, in particular in the area of technical regulations as pioneered by SNIMA, are maturing. For the former, the *Comité National des Procédures liées à l'Investissement* is expected to continue to play a lead role. For the latter, administrative agencies appear to develop approaches and specifications on their own, since any central coordination appears to be lacking. The suggestion has been made that a *cahier des charges* drafted and promoted from a central agency, such as the *Secrétariat Général du Gouvernement* would be needed to ensure some consistency and compatibility of systems of transparency, such as rudimentary regulatory impact assessments.



## ANNEX A: ELEMENTS OF THE WBI'S REGULATORY QUALITY INDICATOR

### Institution Key Indicators

#### Representative Sources

DRI	A15	<p><i>Regulations -- Exports</i>: A 2% reduction in export volume as a result of a worsening in export regulations or restrictions (such as export limits) during any 12-month period, with respect to the level at the time of the assessment.</p> <p><i>Regulations -- Imports</i>: A 2% reduction in import volume as a result of a worsening in import regulations or restrictions (such as import quotas) during any 12-month period, with respect to the level at the time of the assessment.</p> <p><i>Regulations -- Other Business</i>: An increase in other regulatory burdens, with respect to the level at the time of the assessment, that reduces total aggregate investment in real LCU terms by 10%</p> <p><i>Ownership of Business by Non-Residents</i>: A 1-point increase on a scale from "0" to "10" in legal restrictions on ownership of business by non-residents during any 12-month period.</p> <p><i>Ownership of Equities by Non-Residents</i>: A 1-point increase on a scale from "0" to "10" in legal restrictions on ownership of equities by non-residents during any 12-month period.</p>
EIU	A9	<p>Unfair competitive practices</p> <p>Price controls</p> <p>Discriminatory tariffs</p> <p>Excessive protections</p>
GCS	A30	<p>Administrative regulations are burdensome</p> <p>Tax system is distortionary</p> <p>Import barriers as obstacle to growth</p> <p>Competition in local market is limited</p> <p>It is easy to start company</p> <p>Anti monopoly policy is lax and ineffective</p> <p>Clusters are frequent</p> <p>Environmental regulations hurt competitiveness</p> <p>Cost of tariffs imposed on business</p> <p>Government subsidies keep uncompetitive industries alive artificially</p>
HER	A16	<p>Regulation</p> <p>Government Intervention</p> <p>Wage/Prices</p> <p>Trade</p> <p>Foreign investment</p> <p>Banking</p>
MIG	A21	<p><i>Unfair Competition</i>. When entering a non-domestic market the corporate may find that established players and competitors often resort to unethical and illegal means to create obstructions that will cause the enterprise to underperform.</p> <p>The rules of doing business are different in different markets, and so are the routes that companies choose towards success. For any company, the</p>

most important factor in assessing the risk of unfair competition is how much knowledge it has of its local and international competitors. Pertinent issues to consider: competitor behaviour; competitor links; information security; political involvement in the sector; transparency. *Unfair Trade*. In some parts of the world, companies and governments' interests are so closely intertwined that they are almost indistinguishable. The principals of those companies, some of whom are government ministers, use their position to trade unfairly and put obstacles in the way of foreign business to ensure that they retain the dominant position within the market. Occasionally, activities border on the illegal when government legislation is deliberately amended to favour local business, and/or enforcement bodies are deliberately obstructive to ensure that the local business succeeds at the expense of the foreign investor.

PRS	A23	<i>Investment Profile</i> . Includes the risk to operations (scored from 0 to 4, increasing in risk); taxation (scored from 0 to 3), repatriation (scored from 0 to 3); repatriation (scored from 0 to 3) and labor costs (scored from 0 to 2). They all look at the government's attitude towards investment.
WMO	A31	<i>Tax Effectiveness</i> : How efficient the country's tax collection system is. The rules may be clear and transparent, but whether they are enforced consistently. This factor looks at the relative effectiveness too of corporate and personal, indirect and direct taxation. <i>Legislation</i> : An assessment of whether the necessary business laws are in place, and whether there any outstanding gaps. This includes the extent to which the country's legislation is compatible with, and respected by, other countries' legal systems.

### Non-representative Sources

ADB	A1	Trade policy Competitive environment Labor Market Policies
AGI	A27	Investment policies attractiveness Pro-investment tax policies Tax system efficiency/corruption
ASD	A3	Trade Policy and Forex Regime Factor and Product Markets and Prices Enabling Environment for Private Sector Development
BPS	A5	Information on the laws and regulations is easy to obtain Interpretations of the laws and regulations are consistent and predictable Unpredictability of changes of regulations How problematic are labor regulations for the growth of your business. How problematic are tax regulations for the growth of your business. How problematic are custom and trade regulations for the growth of your business.
BTI	A4	Competition Price Stability

CPIA	A8	Competitive environment
		Factor and products markets
		Trade policy
EBRD	A10	Price liberalization
		Trade & foreign exchange system
		Competition policy
WCY	A18	Access to capital markets (foreign and domestic) is easily available
		Ease of Doing Business
		Banking regulation does not hinder competitiveness
		Competition legislation in your country does not prevent unfair competition
		Customs' authorities do not facilitate the efficient transit of goods
		Financial institutions' transparency is not widely developed in your country
		Easy to start company
		Foreign investors are free to acquire control in domestic companies
		Legal regulation of financial institutions is inadequate for financial stability
		Price controls affect pricing of products in most industries
		Public sector contracts are sufficiently open to foreign bidders
		Real corporate taxes are non distortionary
		Real personal taxes are non distortionary
		The exchange rate policy of your country hinders the competitiveness of enterprises
		The legal framework is detrimental to your country's competitiveness
		Protectionism in your country negatively affects the conduct of business in your country
		Labor regulations hinder business activities
		New Legislation restricts competitiveness
		Subsidies impair economic development

### Key to institutions

A1	African Development Bank (ADB)
A2	Afrobarometer (AFR)
A3	Asian Development Bank (ASD)
A4	Bertelsmann Foundation (BTI)
A5	Business Environment & Enterprise Performance Survey (BPS)
A6	Business Environment Risk Intelligence (BRI, QLM)
A7	Columbia University's State Capacity Survey (CUD)
A8	Country Policy & Institutional Assessment (CPIA)
A9	Economist Intelligence Unit (EIU)
A10	European Bank for Reconstruction and Development (EBR)
A11	Freedom House (FRH, FNT, CCR)
A12	Furnar's Index of Budget Transparency (LAI)
A13	Gallup International (GAL, GLP, GMS)
A14	Global E-Government (EGV)
A15	Global Insight (DRI)
A16	Heritage Foundation/Wall Street Journal (HER)
A17	IJET Travel Intelligence (IJT)

- A18 Institute for Management Development (WCY)
- A19 International Research & Exchanges Board (MSI)
- A20 Latinobarometro (LOB)
- A21 Merchant International Group (MIG)
- A22 Political Economic Risk Consultancy (PRC)
- A23 Political Risk Services (PRS)
- A24 PriceWaterhouseCoopers (OPF)
- A25 Reporters Without Borders (RSF)
- A26 State Department / Amnesty International (HUM / PTS)
- A27 United Nations Economic Commission for Africa (AGI)
- A28 USAID / Vanderbilt University (USD)
- A29 World Business Environment Survey (WBS, WDR)
- A30 World Economic Forum (GCS, GCSA)
- A31 World Markets Online (WMO)

**ANNEX B: SCORES ON GCR QUESTIONS 2004-2006**

#	Issue/question	Morocco 2006/07	Morocco 2006 (region)	Morocco 2005/06	Morocco 2004/05
1	Irregular payments in judicial decisions	3.8	3.9	3.3	5.0
2	Irregular payments in public utilities	4.2	4.8	4.2	5.3
3	Freedom of the press	3.5	3.5	3.7	4.6
4	Private sector employment of women	4.5	5.0	5.0	5.5
5	Buyer sophistication	3.0	3.4	3.4	4.0
6	Medium-term business impact of HIV/AIDS	4.6	3.9	4.5	5.6
7	Quality of public schools	3.1	3.1	2.8	4.1
8	Willingness to delegate authority	3.0	3.2	2.7	3.9
9	Business costs of corruption	3.6	3.4	3.2	4.5
10	Irregular payments in public contracts	3.6	3.9	3.0	4.4
11	Judicial independence	3.4	3.5	3.1	4.2
12	Value chain presence	3.4	3.5	3.6	4.2
13	Ethical behavior of firms	3.7	4.0	3.6	4.5
14	Capacity for innovation	2.7	3.0	2.7	3.5
15	Extent of staff training	3.2	3.1	3.2	4.0
16	Railroad infrastructure development	3.1	2.6	3.1	3.9
17	Quality of educational system	2.9	3.2	2.7	3.6
18	Diversion of public funds	3.3	3.4	2.6	4.0
19	Venture capital availability	2.7	2.9	2.5	3.4
20	Financial market sophistication	3.2	3.4	3.1	3.9
21	Favoritism in decisions of government officials	3.2	3.4	3.3	3.9
22	Reliance on professional management	3.6	3.3	3.3	4.3
23	Local equity market access	4.3	4.8	4.5	4.9
24	Degree of customer orientation	4.1	4.0	4.1	4.7
25	Control of international distribution	3.8	3.6	4.1	4.4
26	Quality of port infrastructure	3.8	3.4	3.4	4.4
27	Agricultural policy costs	3.3	3.8	3.4	3.9
28	Extent of incentive compensation	3.4	3.7	3.2	4.0
29	Presence of demanding regulatory standards	3.6	3.5	3.6	4.2
30	Extent of market dominance	3.5	3.7	3.6	4.1
31	Public trust of politicians	2.7	2.8	2.4	3.3
32	Laws relating to ICT	3.2	3.2	2.9	3.8
33	Reliability of police services	5.0	4.8	5.1	5.6
34	Extent of marketing	4.0	3.7	3.8	4.6
35	Local availability of process machinery	2.6	2.9	2.8	3.1
36	Irregular payments in exports and imports	4.3	4.4	3.6	4.8
37	Ease of access to loans	2.7	2.7	2.4	3.2
38	Strength of auditing and accounting standards	4.0	4.0	3.8	4.5
39	Quality of competition in the ISP sector	3.2	3.2	3.0	3.7
40	Breadth of international markets	3.2	3.2	3.4	3.7

#	Issue/question	Morocco 2006/07	Morocco 2006 (region)	Morocco 2005/06	Morocco 2004/05
41	Pay and productivity	4.3	4.0	3.8	4.8
42	Recession expectations	4.3	4.4	3.9	4.7
43	Recent access to credit	4.1	4.1	3.6	4.5
44	Efficacy of corporate boards	4.0	3.9	4.0	4.4
45	Quality of electricity supply	5.0	4.7	4.7	5.4
46	Production process sophistication	3.2	3.3	2.9	3.6
47	Clarity and stability of regulations	3.1	3.1	2.8	3.5
48	Centralization of economic policy making	2.8	3.1	2.8	3.1
49	Stringency of environmental regulations	3.3	3.4	2.9	3.6
50	Local supplier quality	3.9	4.0	3.8	4.2
51	Effectiveness of law-making bodies	3.3	3.2	3.1	3.6
52	Irregular payments in tax collection	4.2	4.2	3.1	4.5
53	Efficiency of legal framework	4.0	3.7	3.6	4.3
54	Prevalence of trade barriers	4.0	3.3	3.5	4.3
55	Intellectual property protection	3.8	3.5	3.1	4.0
56	Business costs of crime and violence	5.0	4.4	4.2	5.2
57	Organized crime	5.3	4.7	4.6	5.5
58	Nature of competitive advantage	3.1	3.0	3.2	3.3
59	Effectiveness of antitrust policy	3.9	3.6	3.6	4.1
60	Property rights	4.8	4.3	4.1	4.9
61	Local availability of specialized research and training services	3.9	3.5	3.8	4.0
62	Internet access in schools	3.4	2.8	3.2	3.5
63	Quality of telephone/fax infrastructure	6.0	6.1	6.1	6.1
64	Extent and effect of taxation	3.2	3.1	2.5	3.3
65	Protection of minority shareholders' interests	4.4	4.3	3.9	4.5
66	Medium-term business impact of tuberculosis	5.7	4.8	4.7	5.8
67	Local supplier quantity	4.6	4.6	4.8	4.6
68	Government procurement of advanced technology products	3.8	3.6	3.4	3.8
69	Informal sector	3.0	2.8	1.6	3.0
70	Foreign ownership restrictions	5.3	5.0	5.1	5.3
71	University/industry research collaboration	3.0	2.6	2.0	3.0
72	Quality of air transport infrastructure	4.5	3.7	3.9	4.5
73	Brain drain	2.8	2.5	2.2	2.7
74	Burden of government regulations	3.1	3.2	2.8	3.0
75	Wastefulness of government spending	3.4	3.3	3.2	3.3
76	Company spending on R&D	3.0	2.9	2.9	2.9
77	Quality of scientific research institutions	3.4	3.1	3.1	3.3
78	Extent of regional sales	4.0	3.3	4.0	3.9
79	Overall infrastructure quality	3.7	2.8	3.0	3.6
80	Quality of math and science education	4.4	4.3	3.7	4.3
81	Government success in ICT promotion	4.5	4.6	4.0	4.3
82	Hiring and firing practices	4.2	4.1	3.7	4.0

#	Issue/question	Morocco 2006/07	Morocco 2006 (region)	Morocco 2005/06	Morocco 2004/05
83	Flexibility of wage determination	5.5	4.9	5.1	5.3
84	Medium-term business impact of malaria	6.0	5.0	5.0	5.8
85	Prevalence of foreign technology licensing	4.3	4.5	4.4	4.0
86	Intensity of local competition	4.6	4.4	4.3	4.3
87	Ease of hiring foreign labor	5.1	4.8	4.4	4.8
88	Business costs of terrorism	4.7	4.2	4.1	4.4
89	Cooperation in labor-employer relations	4.4	4.4	3.8	4.1
90	Quality of management schools	5.1	4.6	4.5	4.7
91	Senior management time for government	2.5	2.6	3.0	2.1
92	Technological readiness	3.6	3.2	2.8	3.2
93	Impact of rules on FDI	5.2	5.0	4.4	4.7
94	Government prioritization of ICT	4.8	4.5	4.0	4.3
95	Soundness of banks	5.4	5.1	4.8	4.8
96	FDI and technology transfer	5.2	5.0	4.7	4.5
97	Availability of scientists and engineers	5.4	4.7	4.8	4.7
98	Firm-level technology absorption	5.0	4.7	4.2	4.1