Morocco’s Potential Still Unrealized

Morocco approaches the 21st century in a stronger position than most countries in the Middle East and North Africa, but very important challenges remain. An OED study of the World Bank’s assistance strategy for Morocco since 1983, the year the government began a comprehensive program of reforms, concluded that the country has performed well in the face of considerable obstacles but that it remains below its true potential and needs. Similarly, the Bank could adjust its strategic approach and improve the overall effectiveness of its assistance.

In the first few years of adjustment, considerable progress was made in policy reform, stabilization, and growth. But these improvements allowed the Bank to become overly confident. Meanwhile, progress in some badly needed reforms proceeded very slowly. In the early 1990s, the Bank’s bullish assessment of the situation came face to face with external shocks and with the effects of important policy shortcomings. Morocco lost ground and today still faces major structural issues.

The study found that the Bank’s focus on deficit reduction was not matched by sufficient attention to structural reforms and social development. While the Bank and the government need to pay continued attention to fiscal stability, the Bank should do more to help the government promote public investment in rural development and human resources, increase the budget shares of health and education (especially for rural women), improve public spending efficiency, and reduce the public enterprise sector. Efforts should be made to ensure that private sector growth is encouraged and that future loans do not increase Morocco’s external debt without a commensurate increase in growth. The Bank could also put the excellent economic and sector work done so far to better use.

In the early 1980s, Morocco’s economic conditions became quite dire. A financial and external debt crisis had been in the making for some time, and growth prospects were weak. The deficit exceeded 12 percent of GDP, the current account deficit in the balance of payments was close to 10 percent of GDP, foreign reserves were depleted, and the country was unable to service its external debt.

In 1983 the government, with support from the World Bank, initiated a comprehensive program of reforms that were to be phased in over several years, starting with stabilization and industrial incentives. The program was radically different from past efforts in that stabilization was to be accompanied by structural reforms.

Bank strategy

The aims of the Bank’s assistance strategy in Morocco since 1983 have been threefold: to stabilize the economy, increase the economic growth rate, and reduce income inequality, extending social services to the poor.

The Bank’s financial support to Morocco (already a major Bank borrower in the 1970s) totaled $5.53 billion through 1983-95. The Bank’s commitments amounted to $1.4 billion between 1979-83, rose to $2 billion in 1984-88, and reached $2.6 billion in 1989-93. More important, the composition of lending changed as reforms evolved: almost 40 percent of loans from 1983-95 were for sector adjustment and, unlike many Bank loans to other countries at the time, the first six adjustment loans were for sector adjustment programs. A sectoral approach was expected to be more effective because it responded to the government’s preference for phased reforms.

Early success

In the early years of adjustment, Morocco made considerable progress. Between 1983 and 1988, Bank programs focused primarily on sectoral reform, while the IMF took the lead in stabilization efforts. In addition, the Bank addressed long-term structural change through project lending, economic and sector work (ESW), and dialogue with

the government. As reducing the deficit was very urgent, it was decided that structural fiscal problems would be addressed at a later stage. Four adjustment loans (in trade, agriculture, education, and public enterprises) were approved during this time. With the exception of education sector reform, which encountered political resistance, and irrigation, which faced shortages of public funds, all were successful.

During this period, overall GDP rose by almost 5 percent a year, manufacturing exports grew rapidly, the deficit was halved, and the balance of payments current account reached a surplus. Restrained demand, tax reform, favorable weather, debt relief, and a sharp drop in oil prices contributed to this good performance. Even after five years of adjustment, however, key structural problems with fiscal and public sector management were still not being addressed. For example, a wage freeze from 1981-85 helped contain the public sector wage bill, but no efforts were made to help reduce the number of public employees.

Overoptimism

Toward the end of the 1980s, the Bank was excessively bullish in its assessments of Morocco’s economic future. Progress in public enterprise and financial sector reforms was considered excellent. Two adjustment loans approved during this period carried relatively light conditions for disbursement because they were considered a continuation of a smoothly running reform program. The Bank’s ESW, which was of very high quality, was not sufficiently used and disseminated.

The Bank’s overoptimism continued through 1993, despite the fact that there had been hardly any economic growth since 1990. Growth slowed from almost 5 percent a year in the second half of the 1980s to 2 percent in the early 1990s. The Bank attributed the slowdown to adverse external factors, such as drought and recession in Europe, while downplaying policy factors. It underestimated the structural and sectoral reforms needed. Meanwhile, the real exchange rate was appreciating, the import liberalization program had slowed considerably, and external flows fell as Morocco graduated from IMF programs and rescheduling. Progress continued on some key reforms, notably financial sector reform, privatization, and a new investment code, but the country’s medium-term strategy was no longer clearly defined.

New awareness

Since 1994, the Bank has shown a new awareness of the unfinished business in several structural areas and in the agenda for reform. Adjustment lending resumed in 1995, and the Bank’s 1997 country assistance strategy recognizes that progress on several important development issues facing Morocco has been limited.

Current issues

Public sector

Morocco has applied rigorous and skillful fiscal management and has successfully stabilized its economy. But three issues stand out:

- Progress in stabilization was achieved in part at the expense of structural reform. Two examples are the slowdown in trade liberalization and the lack of efforts to promote rainfed agriculture—a fundamental source of income for most poor farmers—and small-scale irrigation.
- Priority sectors (agriculture, infrastructure, and human resources) still need increased public investment. The Bank addressed the issue with the first structural adjustment loans, but the concept has been slow to take root. In 1990, when budget cuts were called for, the government decided to cut its investment by 15 percent across all sectors, including priority sectors.
- The public wage bill is still too high and remains a drain on the budget. The Bank’s assistance strategy in Morocco could help the government improve the efficiency of public enterprises and pricing policies and speed up privatization.

Private sector

Strong private sector development has yet to be achieved. Low agricultural production (and droughts) played an important role in the slowdown of the economy in the early 1990s, but so did the slow growth of the manufacturing sector. Morocco’s industrial sector absorbed one-fourth of Bank lending to the country between 1983 and 1994, yet the sector grew only 3 percent a year in real terms during the period. Private investment peaked at 13.7 percent of GDP in 1989-91 but fell to 11.7 percent in 1994—the same level as in 1983.

The reasons for this weak performance are many. They include slow trade liberalization, an appreciating real exchange rate since 1990, deficient infrastructure and human resources, and bureaucratic obstacles. A new investment code and sharp reductions in corporate taxation have been introduced, but other hurdles remain. Further rationalization of the public sector and financial sector reform are still to be fully implemented. Privatization, which now appears well under way, should be seen as an opportunity for enhancing the scope of private sector activity, especially in infrastructure. Efforts must now focus on increasing the external competitiveness of the economy.

The social sector

While progress has been made over the past several years in reducing poverty and improving social indicators, it has been insufficient, especially for women in rural areas. When compared with countries at similar economic levels, Morocco still rates poorly in terms
of primary and secondary school enrollments and literacy rates, especially among females. Health indicators are also poor, especially maternal and infant mortality and access to health care in rural areas. Morocco’s lagging social indicators remain a major obstacle to economic growth.

Although school enrollments have increased in recent years, excessive public spending on higher education has taken resources from basic schooling. Education sector reforms championed by the Bank failed because they proved politically unfeasible. The Bank’s efforts in the health sector have been more successful, yet here, too, there has been excessive spending for hospitals (with poor cost recovery) in urban areas.

Bank strategy since 1994 has focused more strongly on poverty, social issues, and the role of women in Morocco’s development. Recent Bank-funded projects have incorporated these findings, but education reform remains a high priority.

The environment

Recent droughts have highlighted Morocco’s dependence on water and the economy’s vulnerability to climatic change. Air pollution and soil erosion are also becoming more severe. The country has made progress toward defining a national environmental action plan, but overall institutional awareness and coordination are weak. A 1993 Bank project designed to strengthen the institutional and regulatory framework for managing environmental protection has been slow in mobilizing the necessary cooperation among institutions.

Water is the most urgent environmental problem. Morocco is now defined as a “water-stressed” country. Per capita supplies and water quality are declining, rural areas are poorly served with potable water, and there are substantial losses in both irrigation and drinking water systems in urban areas. Irrigation currently accounts for 85 percent of water use, but future industrial growth and economic development will increase the demand for other water uses. Cost recovery has improved considerably in urban areas but not sufficiently in irrigation. Integrated water management in rural areas and rehabilitation of existing irrigation perimeters are needed.

Conclusions and recommendations

The Bank has helped Morocco improve its fiscal balance and liberalize trade. It has helped the government break away from some past policies and initiate across-the-board reform. The economy has grown without major interruptions since the mid-1980s. Yet the Bank’s perseverance, as well as the overall pace of reform, weakened near the end of the 1980s. As a result, the full potential of Bank assistance has not been tapped, and results have been mixed.

The study makes the following recommendations:

In public sector management, the Bank should focus on:

- The structural aspects of fiscal problems. If these problems remain unresolved, they are likely to derail any adjustment program. In Morocco, these problems still include a large public sector wage bill and public enterprise sector, inefficient allocation of public spending, and the need for greater and more equitable cost recovery.
- Rationalization of public enterprises. Not all public enterprises are likely to be privatized soon, and there is an urgent need to improve the operational efficiency and pricing policies of public enterprises.

In private sector development, the Bank should help the government:

- Restore momentum in trade and incentive reforms. Adherence to commitments made to the World Trade Organization and to the association agreement with the European Union will be of great benefit, while interruptions and policy reversals would be especially damaging. Trade liberalization needs to be expanded in a nondiscriminatory fashion.

- Intensify efforts to fully liberalize the financial system, with full convertibility of the dirham and a market-determined foreign exchange rate.

- Focus on human and physical infrastructure. Constraints to industrial growth need to be addressed urgently. These include the quality of human and natural resources, private financing of infrastructure, and the ability to generate, adopt, and diffuse technological innovation.

In social sector development, Bank assistance should help:

- Redirect public spending toward the social sectors. An increasing share must be allocated to basic services, rural areas, and women.

- Increase the focus on poor farmers. More needs to be learned about the types of assistance that will promote farming improvements in rainfed areas. The Bank may need to increase its efforts to persuade the government to give higher priority to small- and medium-sized irrigation schemes.

- Focus on Morocco’s scarce water resources. Full cost pricing of irrigation water and integrated resource management would lead to important efficiency gains and to shifts toward less water-intensive crops. Water pollution practices should be stemmed.

In terms of Bank assistance, the recommendations are for:

- More selective structural adjustment lending and stronger project design. Projects should always include measurable performance indicators. Lending that does not lead to accelerated growth would be counterproductive. The high proportion of projects that have had satisfactory outcomes but limited long-term
returns raises questions about the relevance and appropriateness of some project and program designs. Financial intermediation operations in particular seem to have had very limited impact on industrial growth.

- Better use of ESW. A careful review of past trends is indispensable for diagnosis and prescription. More resources need to be allocated to dissemination and constituency building.

- Realism in the country assistance strategy (CAS). The CAS should provide a realistic assessment of conditions and thus design an appropriate and relevant Bank assistance strategy. The 1993 CAS failed to do so, but the 1997 CAS tries to rectify these shortcomings.

- Resident mission. Establishment of a Bank resident mission in 1998 will strengthen contact with local stakeholders, especially women, helping to improve project design.

Bank management, in its response to the study, agreed with most of the review's assessments and recommendations but stressed that the report could have placed greater emphasis on Morocco's vulnerability to external shocks. It said that Morocco deserves strong credit for maintaining a consistent track record in economic management in the face of such external shocks.

Management noted that stabilization and adjustment are complementary objectives and that one cannot be pursued in the absence of the other. At times, this has required trade-offs, but overall, Morocco has consistently demonstrated continued progress on both objectives. Management agreed that the lack of a medium-term program, as well as droughts, has had an impact on adjustment but noted that the government has given clear signals that it intends to liberalize trade and recognizes the need for a detailed medium-term program of reform.

Management noted that the government's concern for social and political stability throughout the adjustment period has been a key factor behind the gradualism highlighted in the report. In this regard, the process of economic opening has been accompanied by social stability in a somewhat volatile region, within a continuing process of political opening. Management agreed that the slower social progress made in rural areas needs to be addressed urgently and forcefully.

Management concurred that Morocco's performance has been on the whole satisfactory but remains below its true potential and needs, and that major structural issues require continued attention. Fiscal stability, however, should not overshadow other necessary structural measures. Management noted that most of the recommendations of the report are fully integrated into the Bank's new country assistance strategy.

The Committee on Development Effectiveness, in its discussions of the OED study and of the response from management, noted that Morocco continues to face major structural problems in its efforts to enhance sustainable growth and improve social equity. While acknowledging that stabilization and adjustment are complementary objectives, the committee stressed that Bank lending should focus on projects that contribute measurably to accelerated growth and enhanced equity.

The committee agreed that the priority areas for public investment are agriculture and human resources. It emphasized that the Bank should do more to help the government promote rainfed farming and to give higher priority than in the past to infrastructure and small- and medium-scale irrigated agriculture. In the social sectors, the Bank should build on its ongoing efforts to increase the share of the government budget allocated to basic health, education, rural areas, and women. In public sector management, major structural fiscal problems, including the very large public sector wage bill, the public enterprise sector, and the efficient allocation of public spending remain unresolved and should receive adequate attention. In policy dialogue, the Bank should try to convince the government to reduce its subsidies to higher education and expensive urban health services and to redirect public spending to the areas mentioned above.

The committee emphasized that in view of Morocco's debt to the Bank, every effort should be made to use all of the Bank's instruments in a cohesive fashion and to ensure that loans to Morocco do not merely increase the country's debt but are used to contribute materially to structural reform and improved resource utilization.

In light of Morocco's vulnerability to external shocks, the committee agreed that the Bank, through country dialogue, portfolio management, and the design of new operations, should support Morocco's efforts to develop policies aimed at economic diversification, more efficient use of water resources, and improved sustainability of Bank-financed interventions. The committee emphasized that a partnership should be forged among the Bank, government, and donors to maximize the effectiveness of development assistance.

The committee concluded that Morocco's potential gave reasons for optimism and acknowledged that the country had achieved a solid record in economic performance compared with many countries during the period under review. But with many fundamental issues still unresolved and low economic growth, the challenge for the future is to improve Bank and country performance.