

## Morocco Country Brief – September 2008

During the last 30 years, Morocco has embarked on a gradual, but solid program of human development and political liberalization. Since the 1970s, gross national income per person more than quadrupled from \$550 to \$2 300. The average life expectancy has increased from 55 in 1970 to 72.4 in 2007. During the same period, the average number of births per woman has seen a dramatic decline from 6.3 to 2.3 while the number of children dying before age one has dropped from 115 to 38 (per 1,000 live births). Substantial educational improvements during the past 30 years include a primary school net enrollment increase from 47 to 89 percent by 2006. Substantial progress was made in reducing poverty incidence. Recent data shows that poverty was reduced from 15.3 percent in 2001 to 14.2 percent in 2004 (estimated figure), and further to 9.0 percent in 2006-07. However, vulnerability remains a serious concern and an important challenge to human development.

**Despite important challenges, Morocco is one of the most reformist countries in the MENA Region** and beyond. There are key changes at all levels and in various sectors as well as a clear ambition to project Morocco to new heights in terms of competitiveness and growth. However, and despite progress, Morocco still confronts formidable challenges. These include volatile economic growth; vulnerability to variable rainfall; inadequate social indicators relative to the country's income level per capita; high urban unemployment; and increasing pressure on natural resources, especially water. Large segments of the population remain socially and economically marginalized. The greatest challenge (and opportunity) in addressing the weak economic performance of the past is to succeed in employment generation and labor-force growth. The diagnostic of the 2005-2009 CAS still stands: If the economy does not accelerate and new jobs do not materialize during the coming decade, poverty and exclusion are likely to increase and might be a source of social tensions.

**In July, the King underscored the necessity to speed-up the reform efforts in the fields of justice, education, agriculture, industry, energy, and water, setting the priorities of the government's political agenda.** The aim is to create proper conditions for accelerated growth, faster employment creation, and sustained economic development leading to the improvement of living conditions of the population and the emergence in the society of a larger middle class. The modernization of justice is viewed as a prerequisite for the success of any major political or economic reform. Increased independence and credibility of justice that would be a catalyst to stimulate investment and development.

The King also instructed the government to adopt the Consumer Protection Code (CPC), to put in place a Central Institution for the Prevention of Corruption (CIPC), and to activate the Competition Council (CC). The aim is to enrich the arsenal of laws with new legal and institutional mechanisms to preserve the living standards of the population, to control prices, and to fight corruption. These institutions would not only protect consumers from speculative abuses, but also would contribute to the good economic governance required for a healthy competition and improved investment climate.

**Good growth performance is expected for 2008 after the sluggish economic growth of last year.** The growth rate would be slightly more than 6 percent in 2008, up from the low 2.7 percent registered in 2007. The pattern of growth continues to mirror the erratic results of the agricultural sector, although with less intensity owing to more vigorous and stable non-agricultural activities. The Moroccan financial sector is resilient to external shocks thanks to strengthened macroeconomic policies, improved banking supervision enabling monitoring risks more closely, low exposure of foreign debt to market risks as most of the debt is owed to official creditors, and sufficient international reserves that exceed external debt. As a result, Morocco has not been affected by the ongoing turmoil in international financial markets and Morocco's risk perception relative to other emerging markets remains low. The last update of FSAP underlines the fact that the financial sector has consolidated its fundamentals, but commanded the Authorities' efforts to

continue strengthening banking soundness and supervision and in particular reducing concentration risk and preparing Moroccan financial institutions for a more open economic and financial system.

The non-agricultural sector continues to be driven by activities benefiting from steady reform efforts in the sectors of telecommunications, finance, and constructions. Structural reforms, liberalization and privatization policies transformed the telecommunications, financial, and constructions sectors into fast growing activities. The three sectors have been growing between 8-10 percent per annum in average over the last 5 years, and they continue to grow. The sound development of these three sectors over the last decade translated into a significant change in the production structure in less than a decade. Their total share in GDP gained 5.3 percentage-points since 1998 mostly at the expense of manufacturing and agricultural sectors.

**Sectoral reforms gain momentum.** First, the government adopted a Vision for the Development of Industry. The VDI aims at further developing and diversifying the industry to contribute more to the creation of employment, to the reinforcement of exports, and to the attraction of FDI. Second, the government also adopted a “Green Plan (GP)”, a strategy for the development of the agricultural sector. The aim is to transform agriculture into a modern sector able to contribute to growth and development. The recent surge in the prices of the basic food in the global markets reignited the food security concern and stressed the importance of a strong domestic agricultural sector. The latter would provide the needed food to the population, improve living standards and employment in the rural areas, ease the pressure on the Balance of Payments, and shield the country from imported inflation.

### **Current challenges**

Inflation accelerated over the first semester 2008, reflecting increasing imported inflation and acute domestic food supply shortages. However, specific policies to control domestic prices—food and fuels subsidies, waiver on some customs duties of cereals, and efforts to fight price speculations—helped maintain global inflation at relatively low levels (3.5 percent over the first semester) compared to those of many countries in the region. At the same time, food inflation gained 6.5 percent in average over the first semester 2008, with peaks of 10.3 and 8.7 percent in May and June respectively. At the same time non-food inflation continued to remain very low at 1.2 percent.

**Reforming the subsidy system in a context of rising prices of basic commodities** would prove challenging considering the other important concerns of ensuring the welfare of the poor and keeping social peace and political stability.

**Unemployment continued to fall to 9.4 percent, reflecting the relative recovery of the economy.** However, unemployment among the urban younger job seekers (15-24 years) did not improve and remained high at 30.2 percent. The current skills scarcity is stemming from the widening mismatch between the profiles graduating from universities and vocational training centers and the profiles required by emerging markets.

**The worsening of the trade deficit is becoming worrisome but the balance of payments remains solid.** Over the first semester of 2008, the trade deficit to GDP ratio deteriorated by more than three and a half percentage-points compared to that of the same period last year, reaching 19.6 percent. The current account ran a deficit of 1 percent of GDP, thanks to rising workers' remittances and stable tourism receipts. Foreign direct investments and private loans (5.3 percent of GDP) together with the contribution of net flows of public loans helped the overall balance of payment to remain in surplus. The gross foreign reserves represented 7.5 months of imports of goods and non-factor services, down from 8.8 months the same period last year.

## **Bank Group activities**

**IFC: In 2008, IFC has achieved a complete turnaround of its investment and advisory activities** in the country, reaching record levels of commitments, establishing important partnerships with the government and restoring its own confidence in the Moroccan market. In FY08, IFC's investment activities picked up significantly with over US\$240 million committed, up from US\$23 million in FY07 and US\$4 million in FY06. Commitments were distributed through six projects in a large span of sectors - commercial banks, microfinance, wastewater local public utilities, investment funds for SMEs and property development in low-income housing. On the advisory side, IFC established key partnerships with government entities such as with the Ministry of Justice on commercial mediation; the Casablanca Regional Investment Center on business simplification; and with the Central Bank on the credit bureau project. These projects aim at strengthening the business environment for the private sector in Morocco.

## **IBRD**

### ***Analytic and Advisory Services/Recent Products***

**A New Investment Climate Assessment (ICA) was finalized at the end of FY08.** It noted that the pace of structural change of the economy remains slower than in most emerging countries. The main constraints identified are: the tax regime, access to land, the availability and cost of a skilled workforce, and the cost of electricity. It also brings forward the need for coordinated structural investment climate reforms.

**The PESW on Poverty** provides technical assistance for the development and use of poverty maps and advanced analysis on poverty issues. Morocco is now one of only three Bank members (with Brazil and Thailand) able to use poverty maps autonomously. In this context, a work program focusing on poverty dynamics and urban targeting is being implemented with close participation of specialists from the Moroccan "Observatoire sur le Niveau de Vie" and the newly created "Observatoire du Developpement Humain".

**The FSAP update:** The IMF and the World Bank have recently finalized an FSAP update. The objective is to take stock of the major reforms implemented in the Moroccan financial sector: autonomy of the Central Bank; new Banking Law; adherence to international regulatory standards in banking, insurance and capital markets; improvement of the payments system; anti-laundering money and settlement of the pending issues related to public banks).

**The PESW on Water** aims to inform reform planning. Completed or on-going analytical tasks address i) Regional restructuring of multisector distribution utilities; ii) Sector financing; iii) Technical assistance for the development of sustainable groundwater management strategies; iv) Strategic review of the National Sanitation Program, and v) Poverty and Social Impact Analysis (PSIA) of water tariff reforms. An FY08 ESW is under consideration on climate change adaptation of water management strategies.

**FAA:** The Bank has finalized the report and discussed it with government. The report assesses the fiduciary risk potentially associated with the various reforms launched in the areas of Public Financial Management. The report shows that the reforms have so far been undertaken according to international best practices. In parallel, the authorities have initiated an innovative reform of expenditure control, gradually introducing ex-post controls and stressing increased responsibility of budget managers. The report concludes that the overall fiduciary risk in Morocco is low.

**ESW on land markets:** This recent piece of analytical work has identified serious shortcomings in the current land titling policy, especially in rural land. The urban real estate boom and new

zones development is absorbing most of the capacity of the titling agency, at the expense of slower titling of rural land. The Bank report recommends reallocating resources towards rural land titling and introducing a radical change in the rural land titling policy, away from large group-titling projects to smaller demand-driven titling projects.

**ESW Skills Development, Social Protection and Employment.** This is the first report in the region that takes a multi-sectoral approach to the problem of employment creation by coordinating policies related to the macro-economy, the business environment, the education and training systems, and the social protection system (including labor regulations). The report has already led to a request for further project work at the crossroads of issues of employment and higher education.

**The 2009 Doing Business Report** ranks Morocco 128th out of 181 countries analyzed, down from 129th last year. In spite of its stable results, Morocco has increased its score for three indicators: credit information, tax payments (reduction of corporate income tax from 35% to 30%), and international trade logistics. Morocco remains challenged by indicators related to labor law, rights of minority shareholders in corporate entities, and provisions of the code of civil procedure. Several reforms currently under implementation will have later impact on DB indicators, in particular the creation of a credit bureau, the new corporate law, the modernization of the regional centers for investment and the regional declination of DB indicators. . This ranking, however, has not significantly improved since 2006. This reflects the poor coordination among agencies in charge of addressing investment climate reforms. During the recent mission of Michael Klein to Morocco (May 2008), detailed discussions were conducted on the extent and limits of the DB methodology, as well as on the possible avenues for pragmatic improvements in the investment climate environment. This constructive moment led to a new opportunity to engage technical assistance on the follow-up of both the DB and the ICA.

### **Portfolio review**

As of September 1, 2008, the Bank portfolio in Morocco consisted of **9 operations** (of which 2 development policy loans) for a total net commitment of **US\$640.1 million**. FY08 disbursements to date have reached US\$ 207.7 million. The disbursement ratio improved from 10 percent in FY04 to 27.1 percent for FY07, and is currently at **32.percent** for FY08. The average disbursement rate of investment loans has considerably increased in comparison to FY07.

### **Portfolio / Key recent highlights**

**The single-tranche Public Administration Reform Loan III was approved by the Board on May 15<sup>th</sup>.** The loan is co-financed by the EU and the AfDB. This operation consolidates and generalizes past achievements in the three main areas covered by the loan—budget management modernization, human resources management and payroll control—while introducing a new component on e-government. The operation also takes into account work developed under the CFAA.

**ONE Transmission Project (\$150m):** An investment loan attached to the Office National d'Electricité, went to the Board at the end of FY08, with components focused on: (1) transmission and distribution infrastructure; (2) energy efficiency initiatives; and (3) technical assistance to adapt the incumbent utility ONE to the new market environment. The loan therefore supports infrastructure development but also transformation of the company to make it financially viable and better adapted to modern electricity markets.

**The Programmatic Water DPL:** (up to four \$100m loans), signed in FY07, and supporting reforms to improve sector governance, integrated water resources management, irrigation

efficiency and water supply and sewer service had its first disbursement in early FY08. Preparation of DPL2 cannot start however, as all triggers are not yet met.

**The Programmatic Energy DPL.** The energy sector has been identified as a priority sector reform by the new Government. Given the high import dependency (96% of energy needs are imported), the large contribution of oil to the primary energy mix ( 58%) and the weight of energy subsidies in the “Caisse de Compensation” ( 80% of the total subsidies are for oil), the country is very vulnerable to international energy markets and developments in the energy sector, both domestically and internationally, have implications that ripple throughout the economy. The Bank is already active in the energy policy dialogue and in assisting Morocco with implementation of energy sector reforms, through a set of programmatic Energy DPLs. The Programmatic Energy DPL1 (\$100m) disbursed in early FY08. Extensive TA and ESW are under way to support the Government in the implementation of reforms called for to trigger the second DPL.

**The National Initiative for Human Development (INDH)** is supported by a SWAP Bank loan of US\$100 million approved in December 2006. There has been considerable progress in the implementation of the innovative and ambitious National Initiative for Human Development (INDH) but many weaknesses remain: participatory methods have not yet fully taken ground, more infrastructure projects are materializing than Income Generating Activities (IGA), inclusiveness is weak, capacity building programs are too scarce, and the M&E system is not fully functional. A mid-term evaluation mission will endeavor to monitor and accompany carefully the implementation challenge. The team will also insure that the operational manuals are fully implemented, the fiduciary and safeguard requirements are met and the M&E system is functional. This will be done in coordination with other development partners, namely UE and KFW, which jointly participated with the WB in the last mission.

**Output-Based Aid (OBA) Service Connection pilots (\$7m).** Three pilots are on-going, funded by a GPOBA grant (Output-Based Aid), to test subsidy mechanisms to help households access water supply and sanitation service in poor peri-urban areas of Casablanca, Tangiers and Meknés. The success registered to date by this initiative is calling for scaling-up which is currently being envisaged.

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