MOROCCO: ECONOMIC PROFILE
Poised at a Strategic Juncture between Culture and Modernization

SPP 542
International Financial Policy
Winter, 2003

Motoko Fujisawa
Bulbul Gupta
Priya Naik
Kari Wolkwitz
OVERVIEW

Morocco is a country with a unique geo-political location in the world, and in history. An Islamic country, Morocco was also a French protectorate from 1912 – 1956, and is today at a strategic juncture between the values and traditions of the Western World, the Middle East, and Africa. This location has also contributed to interesting political partnerships and trade relations with the United States, Europe, and its North African neighbors, and has allowed it to become a middle-income country within the context of developing nations.

Although Morocco suffered an overwhelming debt management crisis in the 1980’s, it has since enacted several reforms to move towards a more open economy, with increased privatization efforts, a new debt repayment schedule, tourism, and other efforts to attract foreign direct investment and modernize its economy. However, it still suffers from a sizeable public sector wage bill, a weak education system lacking in labor readiness, and an internal struggle between preserving an ancient culture while modernizing to compete in the global arena.

1980’S DEBT MANAGEMENT CRISIS

During the 1980’s and into the early 1990’s, Morocco experienced a severe debt management crisis, when a large percentage of its GDP was used to repay loans from the IMF and World Bank. In 1992, the Moroccan government rescheduled its debt through an agreement with the Paris Club, and has been steadily repaying its external debt since this rescheduling. In part, this reduction has been financed through conservative external borrowing policy and debt-equity swaps, which means that external debt has been financed by taking on internal debt, also known as fiscal deficit (this inverse relationship can be seen in Figure 1).

OVERALL ECONOMIC GROWTH

As can be seen in the GDP growth chart to the left, Morocco’s economy has been very unstable, with fluctuations in GDP growth largely due to its agriculture sector. The peaks in 1994 and 1996 can be explained largely due to the two phases of privatization, and the drops in 1995 and 1999 illustrate periods of droughts.

INTEREST RATE & INVESTMENT

From 1996-2000, gross investment in Morocco steadily increased, and remained constant in 2001. Beginning in 1995, the Dirham has been gradually depreciating, and as a result, the interest rate in Morocco has been declining. The decreased interest rate contributed to higher levels of investment. As shown in the Appendix II, private investment makes up the majority of total investment, with the government contributing roughly 25% of total investment. The chart below shows how closely the Moroccan interest rate has followed the Euro’s interest rate since 2001, when the Moroccan government realigned the currency basket weights more heavily towards the Euro and away from the U.S. Dollar.

![% Change in Morocco-Europe Interest Rates since changes in currency basket weighting](chart1)

Sources: IFS * An increase in the index reflects an appreciation.

EXCHANGE RATE

The Moroccan Central Bank (Bank al Maghrib) has pegged the exchange rate for the Dirham against a currency basket. As can be seen in graph above, the Dirham appreciated by about 10 % in real effective terms from 1993 to 2001 and this caused slow growth for Morocco exports. In April 2001, the Bank al Maghrib changed the composition of the basket to increase the weight of Euro and devalued the Dirham by 5 %. This devaluation resulted in a relatively small depreciation of the nominal effective rate. Since Bank al Maghrib has reserves of about US $8 billion, the pegged currency system seems to be sustainable in the near future. However, stagnating economic growth and deterioration in government savings may threaten the future of the pegged system. (See recommendation #2).

CURRENT ACCOUNT

During the 1990s, the Current Account\(^1\) in Morocco was constantly in deficit. In particular, the current account deteriorated in 1995 (-3.90% of GDP) and in 2000 (-1.50% of GDP). In both years, Morocco experienced serious droughts and a large amount of agricultural produce was imported in order to offset the fall in domestic production. Also in 2000, the current account was influenced by large imports of telecommunication equipment goods due to the increase in mobile phones, an increase in oil import prices, and a decline in export phosphate prices. However, the current account has seen a significant improvement in 2001 (4.85 %), caused largely by the increase of credit transfers from abroad, and significant revenues earned from privatization.

\(^{\text{1}}\) We follow the IFS definition; Current Account = Exports - Imports + Current Transfers
FISCAL POLICY

The Moroccan government has been running up fiscal deficits in recent years due to a huge public sector wage bill and external debt repayment obligations. For example, in 1999-2000, public expenditure amounted to US $13.7 billion, or 39% of the GDP. Operating costs, comprising mostly of wages and salaries, constituted 45% of the budget, while 28.5% of the budget was used for debt repayment. The main objective behind the fiscal expansion in the last two years has been to offset the decrease in private consumption caused by droughts. Although the government did succeed in partially raising aggregate demand, it was unable to provide a significant boost to the depressed economic activity.

The earnings from privatization have been utilized for the purpose of fiscal expansion. Privatization receipts, if used to implement structural reforms and stimulate export led growth, can lead to faster economic growth. The government needs to ensure that room is created for private investment and competitiveness is maintained by adopting a more flexible exchange rate. Acceleration of structural reforms and maintaining a stable real exchange rate are policy measures that can stimulate and sustain an increased growth rate.

We believe that the Moroccan government needs to reduce its fiscal deficit in the coming years by limiting expenditures, reducing non-interest current spending, and freezing new hiring of public sector employees. The stimulus to growth should come from liberalization and modernization of the economy, enhancing political visibility and credibility, strengthening transparency and accountability, and upgrading human resources and institutional framework. (See Appendix III: AA-DD diagram)

MONETARY POLICY

The Bank al Maghrib has consistently followed a prudent monetary policy. Following the fiscal expansion in mid-2000 and the tightening of bank liquidity as a result of an accumulation of budgetary arrears, the Central Bank has adopted an expansionary fiscal policy. This was done by injecting liquidity through the purchase of government securities and by extending advances to commercial banks. Lowering the interest rates has helped stimulate private investment. Bank al Maghrib believes that there will be a significant decline in money velocity as a result of an improved economic climate and agricultural production.

There is good coordination between Bank al Maghrib and the Treasury. The Central Bank carefully monitors any negative effects that an expansionary fiscal policy might have on the macroeconomic stability of the country by controlling both the rate of inflation and the exchange rates. Although
Morocco has controls on capital flows for residents, the monetary authorities continue to impact monetary policies under a fixed exchange rate.

In May 2001, Bank al Maghrib devalued the currency by 5%, which has improved terms of trade by reducing the cost of Moroccan exports, thereby increasing the volume of exports. While the Central Bank has succeeded in maintaining low rates of inflation in recent years, an expansionary fiscal and monetary policy and the devaluation of the Dirham could inflict inflationary pressure on the economy. (See Appendix IV: Real Money Balances).

**POLICY CHALLENGES & RECOMMENDATIONS:**

1. **Problem: Large Fiscal Deficit**  
   **Recommendations: Adjustment of Government Expenditure and Promotion of Privatization**

A primary economic stabilization problem that Morocco faces is its high government spending. Morocco can successfully reduce its fiscal deficit in two ways. First, Moroccan officials can target the public wage bill, and redirect its government spending on wages to other industries, making government spending more efficient and effective. Second, the Moroccan government may wish to privatize additional industries. Privatization forces stated-owned enterprises, typically inefficient due to the absence of foreign competition, high labor costs, and soft budget constraints, to increase productivity. Privatization will reduce the government subsidies that the government currently allocates to some industries. It will also create a more competitive market, which will ultimately increase revenues for the government. However, these methods to reduce fiscal spending carry limitations. Cutting the public wage bill may be politically infeasible, and history has shown that permanently reducing government spending is a difficult and complex task. In addition, it will further increase Morocco’s already high unemployment levels. Consequently, privatizing industries will require careful and time-consuming planning and restructuring of government systems.

2. **Problem: Out of Internal and external balance**  
   **Recommendation: Adopt a floating exchange rate**

Since the average unemployment rate (1995-99) in Morocco was 19.8%, the internal balance point is far below the II curve. On the other hand, the average current account rate for GDP (1993-2001) was -0.72%, which means that the external balance point is also below the XX curve. As can be seen in the graph above, the internal and external balance-point of Morocco is at point 1, which is far from the desirable equilibrium point 2. In order to improve this situation, Morocco should devaluate the Dirham from S1 to S2 and pursue an expansionary policy to improve fiscal ease from F1 to FE (Full employment level)
theoretically. In fact, Morocco devaluated the Dirham by 5% against the Euro and this devaluation should have a positive impact on exports. Also, since the inflation rate in Morocco has been low after 1996, (the average is 1.2% from 1996 to 2001), this is a good time to devalue the currency. However, there is a difficulty in conducting fiscal expansion, since Morocco already faces a huge fiscal deficit (3.1% in 2001) and an expansionary policy will just worsen the internal balance that could cause the deterioration of balance of payments.

Devaluation could also bring a negative effect in terms of balance of payments; once the Dirham is devaluated, the expectation of further devaluation could arise. This expectation could lead people to change the Dirham into other currencies such as the US Dollar or the Euro and, as a result, that could lead to capital flight and consequently, a deterioration of Morocco’s foreign reserves.

As can be seen in Appendix I, foreign reserves in Morocco have sharply increased in 2001 (8,474 million dollars). This balance, although impressive, may not be enough to prevent a currency crisis. Thailand for example had $3.8 billion dollars immediately before the currency crisis in 1996 and was still unable to prevent their crisis. If Morocco employs the floating exchange rate instead, the market will reflect the appropriate exchange rate of the Dirham and Morocco can avert the risk of the balance of payments crisis. In conclusion, we recommend that Morocco adopt a floating exchange rate in the near future.

One of the limitations of this recommendation is that either devaluating a currency or going to a floating exchange rate with the expectation of depreciation may improve the current account, but will also increase Morocco’s already large outstanding debt to foreign governments. Another issue of concern is politics around a decision to devalue/depreciate, where government officials are hesitant to implement such a policy in fear of reprisal or loss of jobs.

3. Problem: Large Unemployment and inflation  
Recommendations: Boost Economic Growth and Create More Job Opportunities

The increasing urban unemployment is an issue that the Moroccan government needs to tackle immediately. While maintaining a low rate of inflation is critical for macroeconomic stability, the government needs to decide on a balanced trade off between inflation and unemployment. Given Morocco’s chronic unemployment situation, a more holistic approach needs to be adopted. Stable real exchange rate, fiscal spending readjustments, trade liberalization, and creation of social security mechanisms are necessary to boost economic growth and create more opportunities for unemployed Moroccans. One of the limitations of this recommendation is the coordination required among the many policies that intersect to keep both unemployment and inflation in check.

The graph to the left plots corresponding unemployment and inflation figures for the years 1993-1999. As indicated, Morocco is facing high unemployment rates while maintaining fairly low inflation rates. The Phillip’s Curve model implies that Morocco’s high unemployment may be attributable to its low inflation. However, there does not seem to be a clear correlation between the two variables.
Appendix I: Graphs behind the Internal-External Balance Model

Unemployment Rate (Average: 19.8%)

- Percentage: 0, 5, 10, 15, 20, 25

Current Account as Percent of GDP (Average: -0.72%)

- % of GDP: -6.00%, -4.00%, -2.00%, 0.00%, 2.00%, 4.00%, 6.00%

Foreign Reserves

- Million of US Dollar: 0, 2000, 4000, 6000, 8000, 10000
Source: IFS
Appendix II: Gross Investment of Morocco as Percent of GDP

The graph above indicates the expansionary fiscal and monetary policies adopted by the government of Morocco and the Central Bank respectively. The Moroccan government increased its investment expenditure and drought-related spending to provide a stimulus to the economy and raise aggregate demand that had declined in previous years due to droughts. This increased spending shifted Morocco’s DD curve out, increasing output and appreciating its currency. To counter the effect of a rise in interest rates and an appreciation of the currency, the central bank increased the money supply by an amount greater than the effects of the expansionary fiscal policy. Morocco’s AA curve shifted out as well, causing output to further increase and the Dirham to depreciate from its original value.

In sum, while output increased significantly from Y1 to Y3, the greater degree of increase in money supply led to a depreciation of the currency and a decrease in interest rates. The devaluation of the Dirham and the adoption of trade liberalization measures by the Moroccan government have resulted in a growth in GDP.
In 2000, Bank al Maghrib increased the money supply by purchasing Treasury bills to prevent an increase in interest rates due to the expansionary fiscal policy adopted by the government. This lowered the real interest rate, and in turn, depreciated the value of the home currency, the Dirham. Moroccan consumers expected a further depreciation of the Dirham, which caused the “Returns on Foreign Investments” curve to shift out. The ultimate effect of the increase in money supply, in the short run, was lower interest rates and a depreciation of the Dirham. The readjustment of the currency basket to accord more weight age to the euro led to a further devaluation of the Moroccan Dirham.

Source: IFS