WORLD BANK MIDDLE EAST
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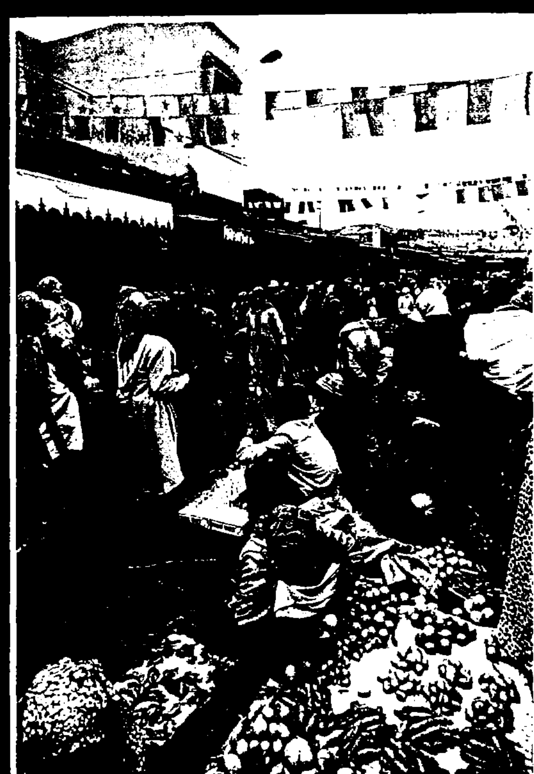
Growing Faster, Finding Jobs

Choices for Morocco



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The World Bank
Washington, D.C.

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Library of Congress Cataloging-in-Publication Data

Growing faster, finding jobs : choices for Morocco.
p. cm. — (World Bank Middle East and North Africa economic studies)
"This report was prepared by a team led by Roumeen Islam and is based on background papers prepared by Jean-Paul Azam . . . [et al.]" —P. .
Includes bibliographical references.
ISBN 0-8213-3717-3
1. Morocco—Economic conditions. 2. Privatization—Morocco. 3. Monetary policy—Morocco. 4. Labor market—Morocco. I. Islam, Roumeen. II. Azam, Jean-Paul. III. Series.
HC810.G76 1996
338.964—dc20 96-32184
CIP

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Foreword

This report—the first of a series of Middle East and North Africa Economic Studies to be published by the World Bank—outlines a strategy for promoting rapid medium term economic growth in the Kingdom of Morocco. Its proposals reflect the achievements of the past ten years, in which Morocco has already taken major steps to build an outward looking, private sector oriented economy. Macroeconomic stabilization and adjustment in the latter 1980s and early 1990s substantially reduced budget deficits, while liberalization of the economy helped to improve domestic competitiveness, attract foreign investment, and support the emergence of non-traditional exports. Meanwhile, national income has expanded, the population growth rate has declined, and Moroccans have experienced modest but real increases in living standards.

But as the report notes, Morocco in the mid-1990s faces major challenges. The economy is still heavily dependent on agriculture and susceptible to exogenous shocks, as last year's drought-induced fall in Gross Domestic Product (GDP) illustrates. Broadly based private sector development needs to be accelerated by removal of market constraints, by legal and regulatory reform, and by cutting the still substantial role of the public sector. Unemployment is high and rising; bringing it down and absorbing rapid projected labor force expansion will mean doubling historic rates of GDP growth over the medium term. Poverty, though greatly reduced, remains a problem, especially in rural areas. On the environmental front, the prospect of serious water scarcity early in the next century poses a potential threat to sustainable growth. And finally, macroeconomic balances have deteriorated since the early 1990s.

The signature earlier this year of an Association Agreement with the European Union (EU) demonstrates Morocco's commitment to the deeper integration with the global economy on which more rapid growth will depend. But the Agreement is no panacea. Realizing the opportunities it presents will need to rely as much on implementing a wide-ranging domestic strategy of efficiency-enhancing economic reform as on actions by external partners. This report, written on the eve of the signature of the Agreement, describes the key elements of such a strategy. These include: giving top priority to restoring and maintaining macroeconomic balances; making renewed efforts to liberalize the trade regime; undertaking substantial labor market reform and productivity-enhancing human capital development; pressing forward with financial sector development; and speeding up privatization and public enterprise reform. All this should lead to a more integrated society and a reduction of the income and educational gaps that remain too large for balanced and rapid growth.

This is a large agenda. But Morocco today stands at a turning point, which will determine whether it can deliver rapid economic growth and rising living standards to its people during the remaining years of this century and beyond. Based on successive governments' generally strong past record of good economic management and of determinedly undertaking sometimes difficult reforms when they are needed, I believe that the prospects are good. The World Bank has strongly supported Morocco's development strategy in the past: we stand ready to to continue to do so with operational lending and policy and analytical advice designed to help make the reform agenda a success—and its benefits in terms of better incomes and opportunities for all Moroccans a reality.

Kemal Dervis
Vice President, Middle East and North Africa Region
The World Bank

Acknowledgments

This report was prepared by a team led by Roumeen Islam and is based on background papers prepared by Jean-Paul Azam, Jacques Coudol, Luc De Wulf, Khadija Khoudari, Benoit Millot, John Nellis, Sethaput Suthiwart-Narueput, Anita Schwarz, and Kouassi Soman. Ishac Diwan, Ross Levine and Klaus Schmidt-Hebbel made valuable suggestions. Additional advice and support was provided by Christian Delvoie, Miria Pigato, John Underwood, and Réne Vaurs. Bruce Ross-Larson served as the editor for the Executive Summary, while Mark Bock of American Writing Corporation worked on the text layout. Carine Bolou-Mansilla and Alexandra Bernardin provided production support.

The report could not have been written without the active collaboration of the Government of Morocco. It incorporates the results of previous studies and data prepared by Government agencies and World Bank staff, as well as the views of many senior Government officials.

Acronyms and abbreviations

BAM	Banque Al- Maghrib
CDG	Caisse de Depot et de Gestion
CEN	Caisse Nationale de l'Epargne
CDVM	Comité Déontologiue des Valeurs Mobilières
CIOR	Ciment de l'Oriental
CNSS	Caisse Nationale de Securité Sociale
DH	Dirham
EU	European Union
FDI	Foreign Direct Investment
FTA	Free Trade Accord
GDP	Gross Domestic Product
GPBM	Groupement Professionelle des Banques Marocaines
ICOR	Incremental Capital Output Ratio
MFA	Multi-Fiber Arrangement
MODULEC	A private company
OCP	Office Cherifien des Phosphates
ONE	Office Nationale de l'Electricité
ORMVA	Office Régional de Mise en Valeur Agricole
PE	Public Enterprise
PEP	Plancher des Effets Publique
RAM	Royal Air Maroc
SAMIR	An oil refinery
SCP	An oil refinery
SMIG	Salaire Minimum Industrielle Guarantie
SMAG	Salaire Minimum Agriculturelle Guarantie
SNI	A public enterprise
UR	Uruguay Round

Currency and exchange rate

Currency and exchange rate
Currency unit = Dirham (DH)

	1984	1985	1986	1987	1988	1989	1990	1991	1992	1993	1994
DH per US$, end of period	9.55	9.62	8.71	7.80	8.21	8.12	8.04	8.15	9.05	9.65	8.96
DH per US$ period average	8.81	10.06	9.10	8.36	8.21	8.49	8.24	8.71	8.54	9.30	9.20

Fiscal year

January 1–December 31

Summary

Morocco has made real progress in the past ten years. Fiscal and current account deficits have been sharply reduced and have averaged 3% and under 2% respectively during 1990–94. External debt as a share of GDP and debt service have declined in 1994 to 68 and 33% respectively. Inflation has stabilized at around 4–6%. Thanks to structural reforms, progressive liberalization of the economy, and sustained macroeconomic adjustment, the kingdom has grown at an average annual rate of about 4% over the last decade.

Yet Morocco is losing ground and has a long way to go to prepare for the next century. New jobs have not been created fast enough to absorb a growing labor force; at the current growth rate, urban unemployment could soon rise to over 20%. The economy remains dependent on agriculture and vulnerable to weather conditions; three years of drought in the early 1990s have threatened the economic gains of a large part of the population. Two divided Moroccos, one rural and one urban, remain with huge disparities in income, in access to education and medical attention, and in opportunities for individuals and families to improve their standard of living.

To meet the challenge of rising unemployment and a weakening economy, Morocco needs to deepen macroeconomic stabilization and to put in place other policies that will help it achieve a high rate of sustainable growth with benefits more equitably distributed to the rural population.

By 1991 the number of people in the country below the poverty line had fallen from 21% in the mid-1980s to 13%. However, about 8% of the population still hovers just above the poverty line. While overall social indicators have also improved, Morocco lags behind the average lower-middle-income country. Moreover, there are wide variations in income and quality of life, especially between urban and rural areas. A two-pronged approach, consisting of higher economic growth coupled with targeted government expenditures in the social sectors, will have a positive payoff. Sharing the benefits of growth should raise labor productivity.

New policies for renewed growth

The government's challenge is to promote greater and more efficient investment as well as a large increase in domestic savings. The main policy actions to accomplish this are:

- Continued fiscal adjustment.
- A trade policy that provides larger markets for exports and increases internal competition from imports.
- Further development of the financial sector.
- Reform of the labor market aimed at faster human capital development, labor market flexibility, and social sector progress.
- Changes in regulations and policies to ensure rational use of natural resources.
- Further and faster privatization and better management of the public sector—including the legal and judicial frameworks.

The government has started the process of reforms, and a long term economic strategy is being developed. Below are the specific steps needed in each of six main areas.

The macroeconomic framework. Central government expenditures, about 27% of GDP, will need to be reduced. Wage expenditures are particularly high. Implementing a freeze of the wage bill would be a first step toward more comprehensive civil service reform. The government is providing, usually at a loss, many goods and services that could be supplied by the private sector. Significant improvements are possible in the internal efficiency of public expenditures through greater cost recovery and divestiture of public enterprises. A reallocation of public expenditures towards basic education to raise literacy is desirable; public health expenditures need to be better targeted to the poor; and, in the longer run, the social security system will have to be reformed. On the revenue side, reliance on trade taxes will need to be reduced while other tax revenues are raised. Some of the tax advantages granted to agriculture, housing,

and land ought to be reconsidered. The government may need to adjust the normal value-added tax (VAT) rate temporarily in order to maintain revenues during the transition period.

International trade. Morocco faces increased competition for its main exports (textiles, clothing, and agricultural products) to its main customer, the European Union (EU). However, an export-based growth strategy will in the medium term, benefit from the more liberal, international trade environment that is evolving as a result of the Uruguay Round. A Free Trade Accord with the EU will open the Moroccan market to competition from European goods and, in time, lead to improved Moroccan production. (Moroccan manufactured goods already have free access to the EU.) The trade accord needs to be supplemented with nondiscriminatory reduction of trade protection to maximize Morocco's gains. Given the current reliance on trade-related taxes, however, liberalization has to be synchronized with fiscal reform and, to maximize employment gains, labor market reform. Labor market reform will help the private sector balance the supply of labor between firms that grow through export promotion and those that contract because of increased import competition.

Financial sector development. To support growth, financial policy should aim at providing essential services and tools for the private sector. These include interest rates and equity share prices that provide information on productivity and investment risk; risk-hedging instruments such as well-developed stock, bond, and forward foreign exchange markets; means to mobilize the resources of small and large savers in order to finance long-term investment; lower financial transaction costs; and provision of credit based on the creditworthiness of the borrower and the feasibility of the financed project. For Morocco this means liberalization of interest rates, promotion of capital markets, elimination of the government's preferential access to credit, strengthened bank supervision, and eventual capital account convertibility.

Labor market reform. A high minimum wage in the nonagricultural sector, high social charges, and rigid restrictions on worker dismissals all contribute to unemployment and slow growth in the formal sector. International experience indicates that workers are better protected by market-determined wage rates, rising employment opportunities, and a flexible labor market. Thus the nonagricultural minimum wage should be allowed to fall in real terms, and at the very least maintained constant, while the minimum wage in agriculture should be raised only in line with increases in agricultural productivity. These moves would induce a decline in urban unemployment and perhaps a slowdown in rural-urban migration (currently stimulated by a 36% differential in the two minimum wages). At the same time, human capital development needs more attention. Government expenditures on education are reasonably high for a country at Morocco's stage of development. However, greater focus on basic education and on efforts to improve educational opportunities for women, particularly in rural areas, will have a payoff in terms of growth. The government could also take steps to shift vocational training from the public to the private sector with such changes as a revision of the mandatory payroll tax now used to finance these public sector programs.

Sustainable use of natural resources. The country's water supply per capita is dropping rapidly while the quality of water is being degraded. At the present rate of decline Morocco will be a chronically water-stressed economy by 2020. Without a national strategy that ensures that potable water is available to the rural and urban populations, economic growth will not be sustained. Beyond water, a national environmental action plan needs to address soil erosion (which is being aggravated by overgrazing and deforestation), air pollution in certain urban areas, and waste management.

Privatization and private sector development. Faster growth will require greater change in the government's role from being directly involved in productive activities to promoting the private sector. Morocco has a strong private sector. It accounts for more than 80% of value added, but it has been hobbled and has not grown to its potential. Private business people encounter legal, judicial, and regulatory constraints from start to finish. Establishing a new business requires a long and cumbersome trek through bureaucracy. Foreclosing on failing entities is even more difficult because of the underdeveloped judicial system and rigidities in the labor code.

In addition to reform of the regulatory system and better public sector management, privatization needs to be pursued aggressively (public enterprises still account for around 20% of GDP)—by accelerating the process for 112 companies already on the privatization list and, then, by accelerating the divestiture of those that remain in industrial and commercial activities. Beyond that, the government will need further to encourage private participation in energy and water distribution and other infrastructure activities, such as telecommunications, mining, port, and transport activities, as well as in the industrial branches of the phosphate industry.

The payoffs to concerted reform

Since all these policy instruments are interdependent, the objectives of each will be better and more rapidly achieved if they are implemented together. Among the many strong linkages:

- First, *deepened macroeconomic adjustment* will reduce the substantial crowding-out of private investment by the public sector. Higher public savings will raise the overall domestic savings rate needed to finance investment. Conservative fiscal management will also raise the country's creditworthiness in international markets. At the same time, current fiscal policies constrain the development of the financial sector. Improved management of public finances will benefit private enterprise and could reduce the cost of public debt. Better management of public finances will also be needed to support trade reform.
- Second, a more liberal *trade policy* will promote export growth, overcome the anti-export, anti-labor bias of the current regime, and help offset the negative effects of the Uruguay Round on Morocco's traditional exports of textiles and clothing. However, trade liberalization will have its greatest impact if it is accompanied by reform of the labor market and of the financial sector and prudent macroeconomic policy.
- Third, *further development of the financial sector* will increase the total amount of investment and domestic savings as well as help allocate them to their most productive use. Over time, this will lower the cost of domestic borrowing for the Government, ease labor reallocation, and enhance the benefits of trade liberalization. At the same time, an improved financial market will contribute to the success of public enterprise reform and privatization.
- Fourth, *reform of the labor market,* specifically more efficient investments in human capital and a reduction of rigidities in the labor market, will promote growth and the creation of jobs by raising labor productivity and facilitating the reallocation of labor to more productive activities. Targeted investments in the social sectors, by spreading the benefits of growth equitably, will ensure the necessary public support for reform. Overall labor market reform will reduce costs for businesses, raise employment and investment, and increase Morocco's international competitiveness.
- Fifth, regulatory and institutional reforms aimed at the *rational use of natural resources,* particularly water, phosphates, and land, are necessary if growth is to be sustained.
- Sixth, *improved conditions for private enterprise* through faster, bolder privatization and aggressive legal, regulatory, and judicial reforms will increase the amount of efficient private investment. Additionally, receipts from privatization could be used to reduce the government's debt, helping it lower the public sector deficit and finance infrastructure improvements needed to support economic growth.

In sum, establishing the conditions for sustainable and equitable growth is a big task for Morocco—but no greater than that faced by other developing countries at a similar stage of development. Most important, the kingdom is well placed to advance a reform agenda. It has a good track record. The private sector is dynamic. It is well located geographically and will benefit from increasing its outward orientation as well as from its open policies for private investment. The key will be quick and strong decision-making by the authorities to realize Morocco's potential.

Introduction

The purpose of this report is to identify key elements of a medium-term strategy to promote higher growth in Morocco. Higher growth is essential to improve the living standards of the Moroccan people: it will create much-needed employment opportunities and make Morocco's social objectives easier to fulfill. Improvements in social conditions will, in turn, ensure that growth is sustainable over the longer run. Lack of concerted action at this time and continuation of past policies could lead to a worsening and eventually unsustainable macroeconomic situation as well as to higher unemployment rates over the medium term.

To address the goal of achieving higher growth this report focuses on four critical cross-sectoral issues: (1) the need for a more prudent macroeconomic framework to raise domestic savings and to encourage private investment; (2) increasing growth in international trade and the importance of an outward orientation in gaining access to larger markets and in raising product and factor market efficiency; (3) factor markets—ensuring that labor, capital and natural resources are allocated efficiently so that productive domestic investment rises and provides increasing employment opportunities; (4) accelerating privatization of the large public enterprise sector and promoting the private sector through regulatory reform to raise efficiency in production, to ensure that investments crucial for the acceleration of growth are funded, and to achieve a better allocation of scarce government resources in essential areas.

Background

To raise growth rates in the medium term in Morocco to an average of 7–8 percent a year from its historical average of 3–4 percent a year is not trivial. It will require time, concerted action on a variety of fronts and interim adjustment costs. However, the impact on employment generation over the medium term would be significant. Given the existing high urban unemployment rate (16 percent), the pressing need to improve social conditions, and its natural resource constraints, Morocco must strive to move toward this goal. Failure to do so will exacerbate current problems and make changes harder to implement down the road.

The challenge

The past decade in Morocco has witnessed a great deal of progress in the area of macroeconomic stabilization with budget and current account deficits falling from 12 and 9 percent of GDP in the early 1980s to about 3 and 2 percent of GDP in the early 1990s, respectively. Morocco increased its outward orientation and manufacturing exports grew in importance relative to traditional exports (mainly phosphate-based). Manufacturing exports in real terms have grown at an average of 4 percent a year during the early 1990s; real growth is much lower if 1990 is excluded, due to the recession in the EU.[1] The increase in employment related to rising exports, growth in GDP per capita, as well as government efforts to reduce poverty has resulted in better living standards for its population so that the percentage of people with average consumption below the poverty line has fallen from 21 percent in 1984/85 to 13 percent in 1990/91.

However, the stabilization and adjustment achieved remain fragile, as demonstrated by the deterioration of macroeconomic indicators in the first half of the 1990s with budget and current account deficits rising, and as demonstrated by continuing high debt to GDP and debt service ratios at around 68% and 33% respectively in 1994. There has been little diversification of the production structure of the economy. GDP growth remains extremely vulnerable to weather conditions because of the extreme variations in agricultural output and the relatively large share of agriculture in GDP.[2] The public sector continues to play an important role in many sectors. Export growth in the manufacturing sector has come from low value-added activities and in areas for which, in the new international environment of the Uruguay Round (UR), future growth seems unlikely. In addition, the overall levels of domestic savings and investment remain low at 16 and 21 percent, respectively, in 1994.

These facts suggest that the first policy priority, as Morocco moves towards higher sustained growth, will need to be a substantial deepening of past stabilization efforts. The public sector deficit will need to be reduced and the Government's role in the economy will need to be changed further: along with better public sector management there will need to be a greater focus on the social sectors, such as education and health. This will need to be complemented by further structural reform in key areas.

The determinants of higher growth

Higher growth in Morocco will depend on faster total factor accumulation, such as higher rates of investment and human capital formation, as well as on increases in total factor productivity.[3] Empirical evidence demonstrates that some key elements can affect factor accumulation, factor productivity, and growth. First, cross-country work has demonstrated the overriding importance of prudent macroeconomic management to growth. Macroeconomic stability and in particular sustained small budget deficits (or preferably surpluses) play a significant role in raising domestic savings and in signaling the government's commitment to reform. (Chile and Thailand for example, both fast growers, have preserved persistent budget surpluses in the after-reform period). While Morocco has undertaken significant macroeconomic adjustment and as a result has attracted significant foreign investment, recent economic developments indicate that progress in this area remains fragile and needs to be deepened.

Most countries that have grown in the post-reform period have undertaken structural reforms in various areas along with macroeconomic stabilization. One such area is the financial sector. Cross-country work has also demonstrated that there are strong correlations between growth and financial sector development. In fact, financial sector development has been found to be a robust predictor of long-run growth.[4] Financial sector development entails both deepening and liberalization of financial markets and the implementation of a suitable regulatory and supervisory framework. While Morocco has begun financial sector reforms, a great deal remains to be done to ensure a financial system capable of supporting and promoting high growth. The financial sector plays an important role in improving the allocation and magnitude of investment and savings, and in influencing the success of nonfinancial policy reforms (trade and price liberalization, fiscal and public enterprise reform; pension reform can also reduce labor market distortions). It has also been associated with falling costs of capital and increased access to private international capital.[5]

The East Asian experience, as well as general country experience, has demonstrated the importance of human capital in promoting growth. In fact, some studies cite the initial conditions related to higher literacy and education levels (which also raised equity) as the single most important factor contributing to higher growth. This underlines the necessity of preparing the labor force as well as the labor market for growth in Morocco by investing directly in human capital and by facilitating labor mobility and employment growth. Country experience has also shown that growth that is shared, for example, through efficient investments in health, education, and social services, tends to be sustainable, while rising inequalities in the standard of living will be an obstacle to growth (often due to low labor productivity and thus low labor mobility and rising social tensions). Morocco needs to make a greater effort in the development of human capital and in the social sectors in general. One way to achieve greater efficiency in human capital formation would be through the reorientation of government expenditures and a better public-private mix in the provision of training and education. It is important to ensure, at the very least, that the income distributional consequences of the policy framework (of which government expenditure is an element) are not regressive in the long run.

Efficient allocation of labor, and, therefore, more productive use of the labor force, requires labor market flexibility. Most countries that have sustained high income and employment growth have done so by promoting labor mobility and market-based pricing for labor. Income growth has first been followed predominantly by employment growth and then by wage growth (which of course has also been tied to the rising skills of the labor force). Greater labor market flexibility can raise investment rates by reducing the entry and exit costs of investment; it can also mitigate the adjustment costs related to privatization and public enterprise (PE) reform.

Trade reform, of the non-discriminatory kind, has also been undertaken by many countries that have successfully stabilized and raised their growth rates. In fact, empirical studies have shown that low distortions in international trade are positively correlated with growth and, in fact, high levels of international trade are positively correlated with investment. Chile and Thailand are examples of countries where trade reform has led to a spectacular rise in trade volumes; Argentina and Poland are examples of countries where more recent trade reform is having strong results on trade volumes. Increasing outward orientation not only raises efficiency in production but will also provide a large market for Moroccan exports. Though Morocco has liberalized progressively over the past few years, it is recognized that far deeper policy reform is needed to encourage new sources of growth and to compete effectively in the new international environment of the Uruguay Round.

Increasing reliance on the private sector for the provision of goods and services, accompanied by large reductions in public spending, privatization, and the establishment of a legal and regulatory framework conducive to the growth of private business (including streamlining of business regulations)[6] has also characterized successful reformers. An increase in the magnitude of private investment, both in absolute terms, and relative to public investment, has been associated with improvements in the efficiency of investment both during and after reform. Moreover, privatization can provide a significant boost to capital market development, as Morocco's initial experience and that of other countries (such as Chile and Argentina for example) has shown. Many countries have successfully used the proceeds of privatization to enhance long-term fiscal adjustment by reducing public sector debt. Argentina is a good example of this. Such a policy increases fiscal flexibility, essential in Morocco, where increased attention to social priorities is needed. Privatization and private sector development in general would provide the means to finance essential investments in infrastructure to support higher growth in Morocco.[7]

Each of these main areas of reform is an essential input to an entire policy package. Accelerated growth will require the simultaneous deepening of reform in these areas since many of the policies suggested are either complementary or interdependent. For example, trade reform will not be sustained in Morocco without fiscal reform. The success of trade reform in reallocating factors will depend on development of the financial system and the labor market. Labor market development through faster human capital formation will make Morocco better able to compete in the international arena. Financial sector reform, which will aid labor reallocation, will to some extent depend on fiscal reform. The efficient conduct of monetary policy depends on financial sector development, which in turn will promote privatization and private sector development. Labor market reform will also reduce the costs of unemployment related to privatization, and will lower the entry and exit costs of private firms.

Changes in the policy framework are often accompanied by adjustment costs in terms of temporarily falling output or increasing unemployment. Morocco's past adjustment experience did not, on average, result in either (partly due to the large financial inflows provided by the international community). The implementation of a comprehensive reform package would help in reducing the duration as well as the magnitude of possible adjustment costs in Morocco.

Chapter 1
The macroeconomic framework

Conclusion. The essential elements of higher sustained growth will be more efficient and increased investment and productivity increases, which will raise output, particularly exports. To finance this, higher domestic savings will be necessary. To raise savings and private investment the most important prerequisite will be a prudent macroeconomic framework. Past stabilization efforts need to be deepened so that the public sector deficit reaches a surplus over the medium term in order to raise domestic savings and reduce crowding out of private investment. Such a scenario will require cuts in the overall government expenditure to GDP ratio, and an increase in the efficiency of recurrent and capital expenditures within the reduced envelope. Rationalization of expenditures will increase the government's ability to safeguard essential investments in the face of deficit-reducing expenditure cuts. In this regard, expenditure allocations should ideally be determined within a multi-year framework and in accordance with government priorities over the medium term rather than in annual allocations. The maintenance of revenues as a proportion of GDP through better tax collection, the adoption of a regulatory framework that will encourage the formalization of production (and raise the tax base), and the reduction of tax exemptions will also be required. As recognized by the authorities, to ensure consistent implementation of a forward-looking macroeconomic strategy, the current management of public finances needs to be strengthened and decentralized. The consolidation of expenditures and revenues for all levels of government would help in determining total financing needs. The maintenance of the current strategy toward public sector finances could eventually lead to an unsustainable public fiscal balance and/or lower growth.

Key objectives. (a) Reduce expenditures as a proportion of GDP: the overall level of expenditures seems high relative to other middle-income countries including the fast growers. (b) Increase the efficiency of public expenditures within a reduced envelope by improving sectoral management. This will involve the redirection of expenditures toward the social sectors with better targeting toward the poor within the sectors. Improving social indicators can help sustain growth by raising the productivity of labor (by improving literacy, health, and nutrition indicators) and by helping to maintain social consensus for reform. (c) Reconsider present tax exemptions and improve tax collection partly by promoting greater formalization of the economy. (d) Improve management of public finances by adopting a medium-term framework in allocating expenditures and implementing decentralization of government.

The current situation

As table 1 shows, Morocco has reduced its budget and current account deficits since the early 1980s. During this process of stabilization, growth rates were on average positive and around 4 percent a year. Inflation has also fallen since the 1980s. However, both budget and current account deficits have increased during 1993–95. In addition, Morocco remains a highly indebted country: the debt to GDP ratio was just under 70 percent in 1994 and debt service over 30 percent. Investment as a proportion of GDP remains low, as does domestic savings. GDP growth has been very volatile in the 1990s due to changing weather conditions and has contributed to the deteriorating budgetary situation. The average growth rate during 1990–94 has been around 3 percent (2 percent if 1995, a bad drought year, is included). The average growth rate of merchandise exports has been over 4 percent, unless 1990 is excluded (growth was high in 1990 and made up for the sharp decline in 1989) when it falls to under 2 percent a year partly due to a recession in the EU. (In fact the growth rate of manufactured goods exports during 1991–94 was –0.9 percent).

Where Morocco would like to be

Table 2 shows two possible paths that Morocco could follow in the future, depending on the policy framework

TABLE 1

Historical macroeconomic indicators

(Percent)

	Averages			Actual		
	1980–83	1984–87	1988–92	1992	1993	1994
Rates of change						
Gross domestic product	3.6	4.7	3.9	-4.4	-1.1	11.5
Agriculture	-0.7	10.3	1.8	-36.0	-6.2	63.0
Industry	1.6	2.6	3.4	1.9	-2.0	2.3
(without manufacturing)	3.8	3.9	4.4	1.8	-1.5	2.0
Services	6.3	4.1	4.7	5.1	0.7	4.3
Exports of GNFS[a]	4.4	4.6	4.0	0.9	4.8	5.1
Imports of GNFS	-1.8	4.8	7.3	7.7	0.4	4.8
Ratios to GDP						
Gross investment	25.6	24.1	23.1	22.7	21.2	21.0
Domestic savings	13.5	16.5	18.3	16.2	15.7	15.9
National savings	16.1	20.3	22.0	21.1	19.1	18.7
Current account balance	-9.6	-3.7	-1.1	-1.6	-2.0	-2.3
Government revenue	21.6	20.3	23.7	26.4	27.6	24.1
Government expenditure	33.8	29.2	27.6	28.6	30.0	27.2
Fiscal deficit, commitment basis	-12.2	-8.8	-3.9	-2.2	-3.3	-3.8
ICOR (5 years)	5.2	6.1	4.7	5.8	14.7	6.5
External debt burden						
Debt outstanding (DOD/GDP)[b]	74.6	113.0	85.7	74.6	80.5	68.3
Debt service (TDS/XGS)[c]	37.7	31.3	25.7	23.3	30.4	32.6
Inflation (GDP deflator)	8.0	8.1	5.1	4.5	3.8	2.7
Real effective exchange rate[d] (1990=100)	—	114.4	102.6	104.1	105.1	107.9
Real GDP per capita (in 1980 $US)	958	1021	1120	1097	1063	1162

a. GNFS denotes goods and nonfactor services.
b. External debt includes medium- and long-term, IMF, and short-term.
c. XGS denotes export of goods and services; includes workers' remittances.
d. This is the IMF's definition and is obtained from *International Financial Statistics*.
Source: Government of Morocco and World Bank staff estimates.

adopted. The high-case scenario is based not only on improved management of public sector finances (a budgetary surplus, improving debt indicators, and better budgetary procedures) but also on the implementation of various structural reforms discussed elsewhere in the report. These include the structural reforms suggested for the financial sector, the labor market, international trade, the PE sector, and the establishment of a regulatory, legal, and institutional framework conducive to private sector development. These reforms will be essential to raise investment and savings to the levels necessary for higher growth. The low-case scenario is based on the continuation of the existing policy framework. The numbers in the low-case scenario indicate that, if present policies continue, there would be continued crowding out of the private sector. Estimates indicate that this could eventually lead to an unsustainable situation, as growth would not be sufficient to absorb the growing labor force.

Employment effects

Estimates show that only under a high-growth scenario of the type envisaged here, can Morocco achieve substantial reductions in unemployment. If Morocco continues on its historical growth path of 3–4 percent on average a year, the rate of unemployment can be expected to worsen considerably. The current rate of unemployment at 16 percent in urban areas would probably rise to over 20 percent by the end of the decade even without rising labor force participation rates. However, it could decline several points under the high-growth scenario even with labor force participation rates rising twice as fast over the medium term.[8]

Fiscal policy

To provide a boost to private investment, and to raise public savings, the consolidated public sector deficit would need

TABLE 2

Key macroeconomic indicators: medium-term outlook and resource allocation

(Percent)

	High-case scenario				Low-case scenario		
	1995	1996–2000	2000–03	2004–05	1996–2000	2000–03	2004–05
Rates of change							
Gross domestic product	-5.1	5.2	6.1	7.5	4.2	3.8	3.8
Agriculture	-36.5[a]	9.1	4.0	4.0	8.9	3.5	3.5
Industry	3.8	6.3	8.6	9.0	4.1	4.2	4.2
(without manufacturing)	4.0	7.4	9.5	10.0	4.0	4.0	4.0
Services	1.8	3.6	5.4	7.6	3.0	3.6	3.7
Exports of GNFS[b]	4.8	7.9	8.8	8.9	4.8	5.0	5.1
Imports of GNFS	8.6	5.6	7.0	6.7	3.7	4.0	4.2
Ratios to GDP							
Gross investment	21.6	24.5	28.3	31.8	21.8	22.5	22.1
Domestic savings	15.0	18.1	23.2	28.0	15.8	17.5	18.1
National savings	18.3	22.4	27.3	31.0	18.4	19.4	19.3
Current account balance	-3.4	-2.2	-1.1	-0.8	-3.5	-3.1	-2.8
Government revenue	24.4	23.6	24.2	24.1	22.9	22.9	22.9
Government expenditure	28.6	25.8	24.3	23.6	27.5	27.4	27.2
Fiscal deficit, commit. basis	-4.2	-2.2	-0.1	0.5	-4.7	-4.5	-4.3
ICOR (1 year)	-4.0	4.7	4.3	4.0	5.6	6.2	6.2
External debt burden							
Debt outstanding (DOD/GDP)[c]	69.8	58.7	46.6	37.2	54.4	44.0	36.3
Debt service (TDS/XGS)[d]	26.5	22.7	21.2	18.2	25.5	28.7	29.6
Inflation[e]	5.6	2.6	2.0	2.0	5.7	6.2	7.0
Real GDP per capita (1980 US$)	1082	1224	1388	1621	1194	1275	1362

a. The numbers for 1995 reflect policy adjustments that should be made under the high-case scenario. The figures for the fiscal deficit do not include privatization receipts.
b. GNFS denotes goods and nonfactor services.
c. External debt includes medium- and long-term, IMF, and short-term.
d. XGS denotes export of goods and services; includes workers' remittances.
e. The inflation figure is derived from the GDP deflator.
Source: Data for 1995 are from the Government of Morocco. Data for other years are World Bank staff projections.

to be falling over the medium term and the central government deficit would need to move toward a surplus. A lower public sector deficit will be associated with reduced crowding out of the private sector and, as recognized by the government, will also signal the continued commitment of the government to reform. The experience of other countries suggests that the magnitude of the budget deficit is important for investment. (Both Chile and Thailand, for example, had budget surpluses during and after reform and have high private investment rates). A budgetary surplus will allow debt indicators to improve: this will also encourage private investment. Moreover, the current fiscal policy of the government could, over the longer run, lead to an unsustainable public sector deficit, currently estimated at 4–5 percent of GDP (a lower bound), particularly if revenues are not maintained as a proportion of GDP due to declining trade taxes; expenditures do not fall; and the financial conditions of PEs, of the local governments, and of the public social security system worsen.[9]

On the expenditure side, several measures could be implemented in each sector to raise efficiency within the given envelope of expenditures. Moreover, central government expenditures at 27 percent of GDP are high in Morocco relative to comparable countries including the fast growers and need to be reduced. Under a high-growth scenario, overall expenditures are assumed to decline to about 24 percent of GDP over the medium term. Greater reductions in expenditures will be needed, however, if revenues fall more than assumed (see below). A key measure includes reduction of the high wage bill of the government (which amounts to about 10 percent of GDP). Non-wage recurrent spending is low by international standards. In the past decade the drop in overall expenditures has been borne mostly by reductions in non-wage recurrent spending and capital expenditures. Other import measures include implementing cost recovery for publicly provided goods and services, and reducing the size of the public enterprise sector by encouraging the private provision of many goods and services currently produced solely or primarily by the public sector. Increased efficiency of expenditures within sectors will also be needed. For example, public expenditures on education and health would need to be better targeted to the poor.[10] In addition, to pursue a high-growth scenario, government expenditures will need to be directed relatively more toward investment expenditures (to provide investments complementary to private investment) and away from current expenditures within the reduced envelope. Rationalization of the public investment program will thus be necessary to improve the efficiency of government expenditures.

Revenues at around 24 percent of GDP (they have fallen somewhat due to recent changes in the tax regime) are high in Morocco compared to other fast growers (for example Thailand at 19 percent and South Korea at 17 percent). However, under a scenario of increased trade liberalization, Morocco could face substantial trade-related revenue losses.[11] Tax reform in the last decade has included the introduction of a value-added tax (VAT) and the lowering of income taxes. Though tax collection has improved and tax reform was implemented without revenue losses, this was partly aided by supplementary taxes imposed on external trade. Given recent developments in international trade, the heavy reliance on trade-related taxes will be neither a feasible nor a desirable alternative. Continuing improvements in tax collection will be needed, as will a re-evaluation of the tax system. Simplification of the various investment codes and eliminations of some tax exemptions may need to be considered to boost revenues. For example, the implicit subsidy for agriculture (which is tax exempt) may not be justified either on economic grounds or for poverty alleviation reasons.[12] The case is similar for taxes in the housing and land markets. In addition, as a temporary measure, an upward adjustment in the normal VAT rate may be an option to consider to replace trade revenues.[13] Unification of the various investment codes and simplification of business procedures, labor market reform, and greater private sector development can play an important role by broading the tax base through greater formalization (for tax purposes) of production and employment.

The privatization of a large part of the PE sector should have a beneficial effect on public finance on two fronts: future loss-making investments will be avoided by the government and revenues will be generated for the Treasury. Receipts from privatization, if used to reduce the debt stock, will enable the government to further improve debt indicators. Financial sector development, while temporarily increasing the costs of borrowing for the government, will, in the long run, allow more flexibility in the financing of fiscal deficits, and lower the cost of borrowing for the Treasury, as evidenced by the experience of many Latin American countries that have undertaken financial sector reform. Improvements in the overall management of public finances will, in turn, be needed to complement financial sector reform.

Public sector management

As widely recognized by the authorities, the current system of public finance management hinders the efficient allocation of expenditures in Morocco. First, management within the central government is overcentralized. Expenditure decisions for each ministry are decided a priori and individual expenditures must be approved. Second, local governments do not have control over expenditures due to lack of effective decentralization. Third, a definition of medium-term priorities is lacking (and thus hinders continuity in fiscal policy) in the allocation of expenditures; financing for longer-run sectoral objectives is determined on an annual basis and is too dependent on year-by-year ad hoc deficit containment attempts. Fourth, the current management of PEs does not ensure efficient resource use. To promote greater efficiency in the allocation of government resources and to ensure continuity in the financing of activities in accordance with government priorities, it is recommended that the budgetary process be made more flexible. One suggestion would be to prepare 3–4 year rolling investment programs. The same strategy would be required for recurrent expenditures. Efficiency in decision making would be increased if the government were effectively decentralized. This can be implemented only gradually and will require the strengthening of the administrative capacity of local governments and the implementation of an efficient resource transfer system to local governments from the central government. The regulatory system governing PEs will also need to be overhauled to reduce the drain on government resources. (See chapter 4 on PE management issues.)

Investment and savings

Gross investment at around 21 percent of GDP, and private investment in particular at just over 12 percent, are low compared to fast growing countries, even though

Morocco's reform program began several years ago. In addition to an increase in overall investment, a shift in investment from the public to the private sector will be needed.[14] One of the key ingredients necessary to boost private investment is a much tighter budgetary policy aimed at near balance to reduce crowding out and to signal government commitment to continued reform, as mentioned above. Other elements that will encourage increases in the magnitude and efficiency of private investment include: (a) leveling the playing field between the public and private sectors in all sectors of the economy, and accelerating privatization, (b) reforming the legal, judicial and regulatory systems, and generally reducing the cost of doing business (including excessive administrative requirements); these reforms will also encourage formalization of the economy and have been detailed in the Private Sector Assessment; (c) reducing entry and exit costs of private businesses (for example, by increasing labor market flexibility and privatization); (d) providing a competitive environment and access to larger markets (for example, by trade liberalization); (e) allowing better allocation of resources and better risk management through financial sector development; (f) improving human capital formation through more efficient public sector provision and encouragement of private provision of education and training;[15] and (g) developing domestic infrastructure through higher private sector provision (privatization and foreign direct investment) and a redirection of central government expenditures toward capital expenditures to complement private investment. These reforms should raise foreign direct investment (FDI) as well, which in turn could raise productivity by contributing to inflows of foreign technology. The implementation of the entire package of reforms will be important to raise private investment to 20–22 percent of GDP over the longer run. Together they would raise the returns to investment. This ratio would be comparable to that in many countries that have sustained high growth rates (some examples are Chile and Malaysia). Increases in private investment in this scenario can be expected to be associated with productivity gains and a falling ICOR. (Many countries have shown significant improvements in productivity during and after reform leading to low ICORs, for example Chile at 3 and China at 3.7.)

Domestic savings are very low in Morocco at around 16 percent of GDP, and particularly so compared to fast growing countries. The reduction in the total public sector deficit, and eventual balance in the Treasury budget (and the corresponding increase in public savings) should have a significant positive effect on domestic savings. Private savings will also be boosted by income growth and lower unemployment. In addition, financial sector reform, by changing the incentive structure for financial intermediaries and by increasing confidence in the financial system, should increase domestic financial savings. Direct action to reach savers, particularly small savers, can also help (such as the development of the postal savings system). As the performance of savings improves with income growth and as active policies are undertaken to attract savings in financial institutions, domestic savings are expected to increase as a proportion of GDP. At around 31 percent of GDP, national savings would be comparable to that in many fast growing countries (all the East Asian countries for example). (See table 2.)

Under an accelerated program of privatization, improvements in the fiscal position of the overall public sector, financial sector, labor market, and trade reform, FDI is expected to increase to reach about 3 percent of GDP over the longer run (comparable to the level in Thailand, though much below that for Malaysia). However, even if FDI remains below this level under the high-growth scenario, Morocco could borrow more externally to finance its expenditures and still maintain debt indicators at an acceptable level.

The rural-urban factor

Development and growth have historically entailed redistribution of factors from lower to higher productivity activities, generally a move away from agriculture to industry, and increasing urbanization. In Morocco, similarly, the agriculture sector as a percentage of GDP can be expected to fall. Efficiency increases and technological improvements may lead to faster and more intensive growth in agriculture (such as through the development of drought-resistant varieties of crops) than in the past, but slower growth relative to industry and services, which can be expected to rise as a proportion of GDP. These changes need to be accompanied by supportive government policies in rural areas especially to strengthen social infrastructure and to rationalize the incentive framework in agriculture. Any increases in agricultural value added must come under market conditions, keeping in mind Morocco's very serious water constraint, if it is to be part of a sustainable growth strategy. The future of irrigated crops and the net additional benefit from investments in irrigation need to be reconsidered. Under the current distorted incentive structure (including trade policy in agriculture),[16] sustained, efficient growth and alleviation of poverty in the rural sector will not be possible.

Monetary policy

Monetary growth in Morocco has been conservative, leading to low inflation at around 4–5 percent in the early 1990s; the continuation of similar policies will be important for the growth of investment and savings. Financial sector development will facilitate the conduct of monetary policy by providing the authorities with indirect instruments and lessening their reliance on direct controls on the financial sector.

Balance of payments

Increasing outward orientation should have positive effects on exports and on the composition of exports. Growth in manufacturing exports and services is expected to average 8–9 percent a year in the longer term as trade reform reduces the antiexport bias and macroeconomic stability promotes investment. Increasing integration with the international community should also promote the tourism sector. Trade liberalization and rising investment needs will be associated with rising imports, particularly of investment goods, and the trade balance can be expected to deteriorate somewhat in the short run.

The real exchange rate

The Moroccan dirham is pegged to a basket of currencies. Since 1990 the real effective exchange rate in Morocco has appreciated by about 8 percent by end 1994 (and is appreciating further in 1995 as a result of the higher rate of inflation in Morocco with respect to partner countries). Such an appreciation undermines external competitiveness and its reversal will help raise exports.

Chapter 2
International trade

Conclusion. To realize its growth objective, given the small size of its domestic market, Morocco will have to turn more aggressively to its export sector, especially to new sources of export growth. The direct and short run effects of the Uruguay Round (UR) will be negative for Morocco's traditional exports and will erode the benefits that Morocco currently reaps from preferential access to the European Union (EU) market. However, over the longer run, there will be gains from increased access to other markets and technology, and trade volumes should rise. Morocco is engaged in negotiations concerning the formation of a Free Trade Accord (FTA) with the EU. Such an association will increase competition for domestic producers in Morocco; there will also be gains from the harmonization of standards. The net trade-related welfare effects of such an agreement depend on the relative magnitudes of trade creation with the EU, trade diversion, and the drop in tariff revenues.[17] Currently, there are no other agreements directly tied to the successful conclusion of the FTA. There may be nontrade gains from forming an FTA; for example, the magnitude of total grants from the EU to Morocco may increase; an FTA may result in greater investor confidence as it would signal the commitment of the government to reform, and could raise FDI. It may also result in quality improvements for Moroccan goods. Many of these gains would also be obtained with nondiscriminatory liberalization. Other benefits to Morocco could include lower trading costs if the EU finances improvements in infrastructure to facilitate trade. The current trade regime continues to be significantly protective, which engenders a bias against exports and also favors capital-intensive production. Thus, further trade liberalization measures are desirable. To maximize welfare gains for Morocco, nondiscriminatory liberalization would need to accompany the FTA with the EU.

Key objectives. (a) Lower trade protection in a nondiscriminatory fashion: both the average level of protection and the dispersion of tariffs should be lowered to reduce the anti-export and anti-labor bias and to encourage outward-oriented growth. This reduction in tariffs could accompany the signing of the FTA. (b) Synchronize trade liberalization with fiscal reform to ensure the sustainability of both trade and public sector reform (see chapter 1). (c) Allow employment and relative price adjustments: a decline in real labor costs and higher labor market mobility will boost exports and maximize the gains from factor reallocation.

Impact of the Uruguay Round

Morocco will benefit relatively less in the short run from the worldwide reductions in developed country tariffs on industrial products under the UR since it already enjoys essentially duty-free access to the EU markets for its industrial exports under a 1976 agreement.[18] However, there will probably be benefits associated with increasing exports to other geographical areas and overall increases in trade volumes over the longer run. Under existing trade patterns, the primary and direct implications for Morocco of the UR stem from the dismantling of the Multifiber Arrangement (MFA) and the liberalization of trade in agriculture. These developments could effect Moroccan textile, clothing, and agricultural exports (especially fruits and vegetables) to the EU negatively. Textiles and clothing accounted for over 25 percent and agricultural products for 11 percent of total exports in 1993.

Multifiber Arrangement

Morocco was not party to the MFA but benefits from preferential access to the markets of the EU.[19] Under the UR, export quotas on MFA-restricted goods will be freed and import tariffs reduced over a ten-year period. Outstanding import quota restrictions (QRs) will also be expanded. This will cause prices of textiles and clothing to fall in currently MFA-restricted markets and to rise in other markets. Since Morocco sells 86 percent of its total textiles and clothing exports to the EU, a MFA quota-constrained market, while facing no quota constraint itself, it will unambiguously lose from the dismantling of the MFA through a significant loss of quota rents on its textile and clothing exports to the EU. While much of the quota phaseout occurs in the tenth year, Moroccan competitors party to the MFA will benefit from significantly expanded quota growth rates to the EU in the interim under the UR agreement. Moroccan exports may be particularly vulnerable since its cost competitiveness relative to the countries with expanded quotas is not favorable. For example, its unit labor costs in the sector are estimated to be 58, 100, and 262 percent above those for Malaysia, Thailand, and Indonesia respectively.[20]

Agriculture

The UR provides for the tariffication of agricultural imports and a reduction in these tariffs over time. While there is likely to be a limited impact on Moroccan imports, the terms of the EU offer at the UR would erode Morocco's preferential access to the EU market, consisting of duty-free quotas for fruits and vegetables (notably tomatoes, clementines, and oranges). Moroccan exports to the EU in 1993 represented 76 percent of total exports for these products. Morocco was also subject to various minimum selling prices (*prix de reference*) during the year, which excluded it from the market during certain periods.

The EU offer to the GATT consists of (a) the replacement of reference prices by higher and more binding minimum entry prices (*prix d'entrée*); (b) the imposition of customs duties;[21] and (c) the application of the maximum tariff equivalent (*équivalent tarifaire*) if the selling price drops below 92 percent of the entry price. (In many cases, it appears that these minimum import prices have been set so high above the internal EU price that Morocco would be excluded from the market.) Moroccan estimates show that under the original terms of the EU offer to the GATT, it would lose approximately 90 percent of tomato and clementine exports and 40 percent of orange exports. Morocco reached a temporary agreement with the EU for its tomato and zucchini exports for the 1994/95 season. While the impact of the final agreement for agricultural products will depend upon its specific terms, the prospects for further growth of agricultural exports to the EU appear very limited.

TABLE 3

Total protection rates at 15 percent PFI

Tariff[a]	PFI[b]	Total
0.00	15.00	15.00
2.50	15.00	17.50
7.50	15.00	22.50
12.50	15.00	27.50
17.50	15.00	32.50
25.00	15.00	40.00
30.00	15.00	45.00
35.00	15.00	50.00

Note: Tariff rates on some consumer goods which are not produced domestically were lowered in November 1994, but these new rates are not reflected in this table.

a. Excludes some rates cited in circular, but not found in other data sources. Tariff rates on some consumer goods not produced domestically were reduced in 1995; these changes are not reflected in this table. In addition tariff rates on some agricultural commodities remain at 40 or 45%.

b. Free agricultural access to the EU is available only under full membership.

Source: Administration des Douanes et Impôts Indirects; Circulaire No. 4320 du 17/3/1994.

Protectionist trade regime

The trade regime still exhibits a significant degree of protectionism. In the nonagricultural sector, Morocco has no QRs in place and has eight tariff rates ranging from 0 to 35 percent with an unweighted average of 23 percent in 1993. To these must be added the Prélèvement Fiscal à l'Importation (PFI), an import surcharge ranging from 12.5 percent to the normal rate of 15 percent.[22] (The PFI, intended as revenue collection rather than a protection device, hardly varies across sectors.) Nominal statutory protection rates therefore run up to 50 percent. The sectors benefitting from higher nominal protection are clothing and textiles, food and drink, and metal-working. The actual tariff collection rate is around 12.8 percent; with an average PFI around 14–15 percent, the actual (average) nominal trade protection rate is around 27 percent.[23] Table 3 presents tariff and PFI rates. Note that if the 19 percent VAT were applied on the tariff-exclusive rather than the tariff-inclusive price of imports, the nominal protection afforded to domestic production would be lower.[24] Additional protection is provided by reference prices. The reference price system establishes minimum import values for a range of industrial goods, mostly textiles, clothing, and some household durables (such as washing machines and refrigerators).[25] This system provides additional protection for industrial goods whose tariffs are already at the maximum 35 percent rate. In principle, they cover no more than 10 percent of industrial production.

Agriculture remains by far the most highly protected sector. QRs in place are to be removed in 1995 and replaced with tariffs in accordance with the UR. However, unless

Morocco sets its actual tariffs significantly below the tariff ceilings submitted at the UR, there are likely to be few import liberalization benefits even after the GATT-required 24 percent tariff reduction over ten years. This is because the ceilings were set very high, e.g. 190 percent for soft wheat, 171 percent for barley, and 221 percent for sugar. These levels exceed current protection levels: the tariff equivalent on soft wheat in 1994 is estimated at 123 percent.[26]

Imports under the *admission temporaire* (imported inputs used in exports) and investment code categories are exempt from tariffs. The overall tariff collection rate,that is, excluding exemptions, was 12.8 percent for the first six months of 1994. Tariff collection rates tend to be significantly higher on final consumption products than on raw materials and semi-finished products. While such a tariff pattern is frequently observed and used as a means to encourage high value-added activities, it tends to create high and dispersed effective protection rates.

The most recent study of effective protection which was conducted in 1991 may still be roughly indicative.[27] This study showed that though export incentives significantly reduced the negative effective protection on exports (from –23 percent to –5 percent), the anti-export bias—given by the difference between local and export incentive rates—remained significant at 35 percent. Morocco already grants substantial export incentives; another way to reduce this anti-export bias is to further lower import protection levels.[28]

Lowering trade protection

To boost exports and growth Morocco should (a) lower tariff dispersion, which will result in positive welfare and efficiency gains, and (b) lower the average level of protection (inclusive of tariffs, PFI, and reference prices) in a nondiscriminatory fashion.

A free trade accord with Europe

The creation of an FTA with the EU is currently under negotiation. Under the current terms, the free access of EU goods into Morocco would be phased in over a period which remains to be determined. Since Morocco already has duty-free access to the EU for its industrial exports, these exports will not be affected. Trade in agricultural products will not be part of the FTA. The agriculture agreement will be concluded separately; Morocco is unlikely to get any improved access beyond what it already has.[29] Moroccan imports from the EU, on the other hand, will increase.

The welfare impact therefore depends largely on the effects within Morocco's domestic market. The net effect depends on the sum of trade diversion, trade creation, the drop in tariff revenue, and the extent to which domestic prices fall after the creation of the FTA. Foregone customs-related revenue would be quite substantial, on the order of 8.5 billion dirhams (DH). Large trade creation effects would offset the above and have a positive net welfare impact.[30] Though it is not yet determined what other benfits will be directly tied to the conclusion of an FTA, there are expected to be non-trade benefits such as higher grants from the EU. The association with Europe is viewed by the Moroccan authorities as more than a closer commercial linkage; it is viewed as bringing the two parties closer technologically, culturally, and sociologically.

Next steps

The above analysis suggests Morocco could maximize its welfare gains and promote exports through further non-discriminatory liberalization of the trade regime. The FTA will be phased in gradually over the next several years. Morocco could start a process of non-discriminatory liberalization: the first step would be a reduction in the number of tariff rates from the current eight rates to perhaps no more than four, and in average tariffs to 20 percent, followed by further reductions to 10–15 percent.

Fiscal considerations

Further trade liberalization should take place in the context of overall fiscal reform. Tariff and PFI revenue accounted for 25 percent of total tax revenue in 1993. This is almost as much as total value-added tax revenue (29 percent), a high proportion of which was from imports (52.7 percent). Broadening the domestic tax base for the application of the VAT is an issue that is recognized as a priority of the reform agenda.

In an attempt to curb smuggling, the authorities have lowered tariffs to 5 percent on about 500 goods which are not produced locally. However, since the remaining taxes (15 percent PFI and 19 percent VAT) on these products will not be lowered, this is unlikely to divert trade substantially to formal channels, while leading to an immediate loss of about 203 million DH in tariff revenue. The elimination of the PFI on equipment imports under the Code d'Investissement is estimated to result in a 500 million DH revenue loss.[31] This is in addition to the 8.5 billion DH revenue loss from the proposed FTA, which represents 68 percent and 17 percent of total 1993 customs and tax revenue respectively. The best strategy may be for Morocco to first lower dispersion in trade taxes in the context of revenue-neutral reform and, as a next step, lower average tariffs further.

Allow employment and relative price flexibility

Many of the benefits of trade liberalization are predicated upon freely-functioning factor markets which permit ready resource reallocation. The high levels of urban unemployment and underemployment in Morocco, however, indicate that significant labor market rigidities exist.[32] Further import liberalization in such a context could increase unemployment rather than exports and would therefore raise adjustment costs.[33, 34]

Chapter 3
Factor markets

The labor market

Conclusion. Significant rigidities exist in the way the labor market functions primarily because of the enforcement of stringent labor regulations, which can hinder growth in output, exacerbate urban unemployment, weaken Morocco's ability to compete in international markets, and increase the informalization of employment (which has regressive effects on income distribution). While improvements in the education and training system are absolutely necessary to develop human capital efficiently and to raise employment, they need to be accompanied by changes in the regulatory framework for labor to maximize gains in employment. Trade liberalization and the changing international marketplace will have stronger positive effects on employment creation, wages, and export growth if labor market rigidities are removed. Greater labor market flexibility can also reduce the adjustment costs associated with privatization and public enterprise reform. By reducing entry and exit costs for enterprises in the formal sector in Morocco, labor market reform can promote investment. High entry and exit costs provide strong incentives for the informalization of production and put large formal sector firms at a disadvantage in a competitive environment.[35] Labor market reform, by encouraging the formalization of production and employment, will also raise the tax base. This will be an important element of the high growth scenario: it will help to maintain budget revenues as a proportion of GDP as trade liberalization proceeds. Formalization of the labor market will also encourage firm-level (or on-the-job) provision of training and a better allocation of financial capital.

Key objectives. (a) Increase the differential between the non-agricultural minimum wage (SMIG) and the average urban wage, and reduce the differential between the SMIG and the agricultural minimum wage (SMAG) by, for example, allowing the SMIG to remain constant. This will encourage employment creation in the formal sector, possibly reduce the rate of rural-urban migration, raise Morocco's competitiveness in international markets, and encourage the formalization of employment. (b) Make the current system of social security more efficient by separating the distributional component of the high social charges on labor from the savings component. Non-wage costs of labor are high. Lower total labor costs will reduce disincentive effects in the labor market and encourage formalization of the economy. (c) Relax the regulations governing dismissals to allow firms to change the skill mix of labor employed, as well as the total number employed. (d) Develop an unemployment compensation system over the longer run and ensure more rational implementation of the current severance payment scheme. (e) Increase the efficiency of the educational and training systems to produce the "right" skill mix for growth and raise the overall productivity of the labor force. In particular, take active measures to remove the gender bias from the education sphere.

The labor force

Of the total population of just over 26 million, 48.6 percent live in rural areas and 51.4 percent in urban areas. Overall population growth continues to be high at just over 2 percent; urban areas have had average annual growth rates of about 3.7 percent, and rural areas of 0.79 percent during 1987–92, putting enormous pressure on the urban labor market. The gross labor force participation rate is 39 percent, with 44 percent in rural areas and 33 percent in urban areas, the difference stemming from variations in the labor force participation of women (33 percent in the rural sector and 17 percent in the urban sector).

The rate of unemployment is very high at 16 percent in urban areas; those in the age group 15–24 years and with no education have the highest rates of unemployment (see tables 4 and 5). Though rural unemployment is low at around 5 percent the evidence indicates the existence of substantial underemployment. In urban areas, 62 percent of the labor force is classified as wage earners, while only 17 percent of the rural labor force work for a wage (only 5.2

TABLE 4

The unemployed by educational achievement and age

Educational achievement	Age 15–24	25–34	35–44	45–59	60 and over	Total	Percentages
No education	109,868	92,318	32,242	18,650	2,467	255,545	37.5
Certificate of primary education	78,220	43,701	9,093	1,988	–	133,002	19.5
Certificate of secondary education or equivalent	35,303	54,539	3,089	601	–	93,532	13.7
Baccalaureates or equivalent diplomas	8,998	25,373	1,197	172	–	35,740	5.2
Degrees of higher education except medicine	6,679	32,095	2,382		–	41,156	6.0
Degrees of higher education—medicine only	633	1,830	370	–	–	2,833	4.0
Technical diplomas	9,799	29,685	1,713	538	–	41,735	6.1
Other professional diplomas	31,622	41,760	3,600	276	–	77,258	11.3
Total	281,122	321,301	53,686	22,225	2,467	680,801	
Percentages	41.3	47	8	3.3	0.4		

Source: Urban Labor Force Survey, 1993.

percent of rural women work for a wage, versus 25.4 percent of men). The figures for rural areas probably underestimate the fraction of the labor force working for a wage since many earn a large part of their income from more than one occupation and are classified only according to their main activity. Hence, labor market conditions in rural sectors affect a substantial proportion of the population.

As is widely recognized within Morocco, the quality of the Moroccan labor force needs substantial improvement: the adult literacy rate at 49 percent (38 percent for women) is very low compared with other middle-income countries and particularly the fast growers. Moreover, employers face shortages of certain skills, particularly management and technical skills. However, public expenditures on education at over 5 percent of GDP are relatively high. In addition, the government is intensively involved in vocational training. This indicates that significant inefficiencies exist in the manner in which public expenditures are currently utilized for the development of human capital. One striking example is the fact that the government currently allocates a very high proportion of its expenditures on education in the provision of higher education; it would probably have a greater impact on raising literacy by concentrating its resources on promoting basic education.[36]

TABLE 5

Labor force participation and unemployment rates
(Percent)

Age	Participation rate	Unemployment rate
15–24 years	32.2	30.0
25–34 years	63.1	20.3
35–44 years	63.6	5.5
45–59 years	50.0	3.4
60+ years	20.6	1.9

Source: Urban Labor Force Survey, 1993.

The regulatory framework

Morocco has fairly well enforced labor regulations. The administrative framework is strong with a very active enforcement department, and labor unions play an important role. The three main aspects of the regulatory system that have contributed to the rigidity of the labor market are the minimum wage policy, mandated non-wage labor costs, and regulations governing hiring and dismissals.

Minimum wage policy

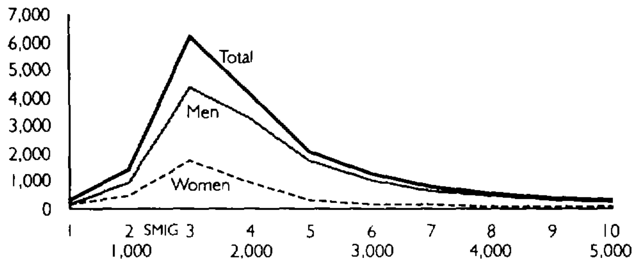
The SMIG, which has been rising in real terms, has a strong impact on the formal urban private sector and appears to be one of the reasons for the high rate of unemployment in urban areas. By raising total labor costs in formal sector firms, it also encourages the informalization of production, and the use of relatively more capital-intensive techniques, and lowers Morocco's competitiveness in international markets. It may also play a role in accelerating rural-urban migration and thus in affecting urban unemployment. This policy is also regressive in its effects. International comparisons show that Morocco's unit labor costs in its main manufactured exports (textiles and clothing) are much higher than in competitor countries; over the last decade, they have declined much less than in these countries. This can be seen in table 6 below.

A large share of the labor employed in the urban sector is paid at or just above the SMIG, as can be seen in figure 1. The wage distribution is unimodal around the SMIG,

FIGURE 1

Urban private sector wage distribution, 1992

(Number of hours)



Note: In the horizontal axis label, the top line refers to wage classes and the bottom to dinhars.
Source: Caisse Nationale de Securité Sociale, Government of Morocco.

suggesting that the latter is well enforced. Empirical evidence shows that SMIG revisions have followed the average wage more than proportionately; in fact, revisions have overcompensated for changes in the average wage.[37] This has led to a shrinking margin between the two and a compression of the lower tail of the wage distribution, as well as the upper tail.[38] This shrinking margin has contributed to the high urban unemployment rate and further changes in the SMIG should not occur until unemployment is restored to an acceptable level. The wages of the lowest paid workers and their employment opportunities are adversely affected by a high SMIG.[39] As table 3 shows, the unemployment rate is highest for those with no or little education, precisely the category for which the minimum wage would be binding.[40]

The SMAG is about 36 percent lower than the SMIG, and is well enforced; labor unions seem to be active in rural areas as well. The large differential between the agricultural and non-agricultural minimum wages has probably accelerated the rural-urban migration that would normally occur with increasing industrialization, raised urban unemployment, and put pressure on urban services.[41] Such a large differential is not warranted for cost-of-living reasons.[42] Further ad hoc real wage increases could have negative effects on employment in the rural sectors. By making future increases in the SMAG conditional on improvements in labor productivity, further aggravation of unemployment in rural areas would be avoided. In conjunction with the above SMIG policy, this should have the desirable effect of compressing the gap between the two.

Non-wage costs

The social charges levied by the main (mandatory) social security organization for the urban private sector, the Caisse Nationale de Sécurite Sociale (CNSS) amount to 18.6 percent of the take-home pay. Firms must also pay a 1.6 percent levy for vocational training. In addition, firms pay for various types of insurance (such as accident insurance), which are not compulsory. These charges drive a wedge between the cost of labor and the net take-home pay that varies between 20.2 percent and 35 percent. This, particularly in conjunction with the minimum wage policy, has negative effects on formal sector employment that could be significant. For example, with a 60 percent elasticity of the demand for labor with respect to the cost of labor, it is estimated that the wedge results in a level of employment (for the lower tail of the wage distribution, i.e. for those for whom the minimum wage is binding) that could be lower by 18 percent. Many countries with high social charges have non-binding minimum wages, keeping the total costs of labor low.[43, 44]

International comparisons show that the ratio of non-wage costs to per capita income is very high in Morocco though the ratio of non-wage to wage costs is not.[45] While it may not be possible to find less distortionary tax revenues to achieve necessary social objectives, the operations of the CNSS could be made more efficient to

TABLE 6

Cost competitiveness in textile, clothing, and footwear, 1991

	Real wages in ECU[a]	Value added per worker[a]	Unit labor cost in ECU[a]	Share of EU imports 1985	1991
Morocco	58	89	88	0.9	1.6
Tunisia	62	105	76	1.0	1.6
Turkey	92	145	82	2.6	4.2
Malaysia	55	142	50	0.3	0.7
Indonesia	51	154	43	0.2	1.6
China	53	126	55	2.3	4.9

a. As percent of 1985 values.
Source: Kingdom of Morocco, Republic of Tunisia—Export Growth: Determinants and Prospects. World Bank, 1994. Annex III.

reduce the disincentive effects in the labor market. The current social security system does not link contributions directly to benefits and may be an important cause behind the informalization of much of the economy. Given the necessity of raising the tax base for more efficient forms of taxation, the underprovision of training by the private sector (and the potential fall in labor productivity) and negative consequences for growth, greater formalization is desirable.

Hiring and firing

The Moroccan system penalizes worker dismissal and this reduces labor mobility and employment; more flexible laws governing dismissals and layoffs would raise mobility and labor market efficiency. Individual firing for economic or technological reasons is forbidden by law.[46] Collective layoffs are permitted for economic reasons with prior approval by the regional authorities.[47] In addition, rather than providing for appropriately designed unemployment compensation the labor code emphasizes severance pay and judicial recourse.[48] These two elements together ensure that severance payments are very large, or their magnitude is uncertain, or both. (Trade unions seem to be very active in ensuring that these regulations are enforced.) These rigidities have negative incentive effects, lower productivity, and, by raising exit costs, make it harder for firms in need of restructuring or filing for bankruptcy, to adjust. The new draft labor code proposes changing the laws relating to collective dismissals by making the process of prior approval somewhat more flexible.[49]

Labor market intermediation was forbidden by the old labor code: the new code is supposed to remove this constraint on hiring. Though this restriction was not binding in the sense that firms relied on "consulting" firms for information, legalizing employment agencies will probably increase the free flow of information that is important for hiring decisions.

As a consequence of the rigidity of the labor market, employers need to be more cautious than they would otherwise be before hiring. The irreversibility of hiring decisions, combined with uncertainty regarding the future, probably causes firms to delay hiring and to hire less than they would in the absence of these restrictions, thus encouraging the use of capital-intensive techniques. This could reduce the rate of job creation. The system also protects those who are employed at the expense of new entrants and encourages informalization of production. The segmentation of the economy generally penalizes the poorest in urban areas. In a country like Morocco, with a rapidly increasing and young population, greater flexibility would mean gains in both economic and social terms. Moreover experience worldwide seems to indicate that labor is best protected by market flexibility that allows economic growth, and growth in employment (which is either followed or accompanied by growth in real wages), rather than the by premature creation of a welfare state.

Another probable consequence of this system is the particularly archaic matching between job seekers and employers in Morocco. The data show that job seekers rely on personal contacts with potential employers, friends, and relatives for finding jobs, rather than on marketing their qualifications successfully. In a system where a worker cannot be dismissed for economic reasons, and employment agencies are not well-developed, employers need more information than they otherwise would before making hiring decisions.

To mitigate the possible increase in unemployment associated with the stringent regulations, the authorities have allowed the use of "temporary" workers (those who have worked less than a year) and "apprentices" (young people with secondary school degrees who can be hired for eighteen months) who can be dismissed at the end of their contract period.[50] There has been a dramatic increase in the use of temporary workers recently, especially in the export-oriented sectors and among the unskilled. While these provisions may reduce the costs associated with the rigidities in the labor law, particularly for the unskilled, it is only a partial solution. The recourse to temporary labor to avoid labor market rigidities can encourage underinvestment in training, lower long-run productivity, and enhance disincentive effects on labor. In addition, these solutions penalize outsiders (who are generally poorer) and favor incumbents, who know that adjustments in the work-force will come from the temporary work-force. These solutions therefore not only have negative incentive effects but are also regressive.

As a result of the high cost of labor caused by the conjunction of the minimum wage, high social charges, high and uncertain severance payments, and recourse to the judicial system, the incidence of long-term unemployment in Morocco is very high in the urban sector. More than 50 percent of the unemployed stay so for more than a year.[51]

Efficiency of the educational and training systems

The literacy rate in Morocco is 49 percent, very low compared to other middle-income countries and particularly the fast growers. Both supply and demand factors are important in affecting literacy. Raising the literacy rate is important since this is positively related to labor productivity. Key elements necessary to raise literacy will be improving the allocation of public resources spent on education (to favor basic education) and encouraging extensive private sector provision of training and higher education. In particular, the 1.6 percent payroll tax on employers which is used to finance publicly provided training needs to be revised. Payroll tax credits could be introduced against enterprises' training-related expenditures and eventually the tax could be eliminated, as enterprises should ideally be allowed to choose not only the type of training provided to their employees but also the magnitude of overall expenditures devoted to training.[52] In addition, public and private training institutes could be put on an equal footing in terms of fiscal incentives, recognition, and standardization of certification procedures.

Gender issues

Education. While literacy rates in urban areas are similar for males and females, there is a large disparity in rural areas: only 10 percent of rural girls are literate as compared with 38 percent of boys. A concerted effort to educate women in rural areas will raise the productivity of this generation's and the next's labor force through higher overall literacy and improvements in family health, and finally, it will help reduce poverty.[53]

Labor force participation. Biases in the employment of women persist. Though women in the labor force have a greater tendency to acquire higher education, women find it much harder to access first employment, and in fact the probability of being unemployed is much higher for women.[54]

Public versus private

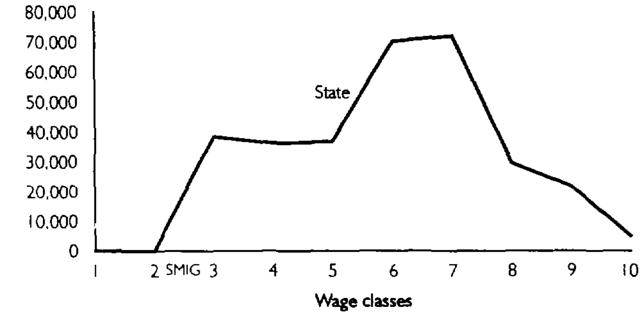
Certain differences in labor market characteristics stand out:

• The government's wage distribution is very different from that of the private sector, which is unimodal around the minimum wage: there are proportionately more people with much higher wages in the central government so that the government's wage distribution is bimodal as shown in figure 2.

FIGURE 2

State wage distribution, 1993

(Number of persons)



Source: Data from the government of Morocco.

• The average wage is higher in all sectors where the state is the dominant employer (gas, electricity).

• The probability of being unemployed is much lower in the sectors where the state is predominant.

• Seniority and education have stronger effects on earnings and employment in the public sector. The reason for the higher pay and the higher premium on education in the public enterprise sector does not seem to be justified on economic grounds.

The financial sector

Conclusion. Accelerated financial sector development is essential to raise both the magnitude and the efficiency of investment. It will do this by mobilizing resources, lowering the cost of transactions (for example by bringing small savers and investors together), and providing information on alternative investments for savers. With a diversity of investment instruments and competitive pricing, businesses and investors will be better able to manage the risks associated with doing business (for example, riskier projects can be rewarded with relatively higher returns). A developed financial sector can also improve corporate governance in Morocco through the provision of both information (to investors and savers) and credit. In the longer run, better financial intermediation will lower the cost of credit to the government. Though past reforms have led to a relaxation of controls on the pricing and allocation of credit, the establishment of a solid regulatory framework for the banking sector, and the development of a stock market invigorated by recent privatizations, much remains to be done. The financial sector in Morocco does not provide the necessary services to the extent required for higher sustained growth.

This is partly reflected in the low domestic savings and investment rates. Empirical evidence indicates that there is no unique structure of the financial system that is necessary for the efficient provision of the above services; thus, financial policy in Morocco should be directed toward facilitating the provision of these services by creating the enabling environment and developing the existing structures.[55] Financial sector development is also closely tied to the successful reform of public enterprises including privatization (as Morocco is demonstrating), newly privatized firms must go to financial markets and institutions to raise capital. It enhances the resource re-allocation effects of trade reform; as capital moves to where it is most needed, other resources will also be attracted to these activities.

Key objectives. (a) Liberalize interest rates to allow interest rates to allocate and mobilize financial (and therefore other) resources for their best economic use and to permit risk-reward management. (b) Accelerate the use of indirect instruments for the efficient conduct of monetary policy, to allow better allocation of resources and to encourage capital market development. (c) Eliminate the government's preferential access to credit. This will help mobilize resources for more productive purposes. (d) Accelerate regulatory reform of the securities market and strengthen institutions: capital market development facilitates the management of risk, provides market information, allows ownership changes without disruption of productive activities, and helps mobilize resources. (e) Take measures to increase domestic savings by reform of the contractual savings system. (f) Open the financial system to the international market by establishing a foreign exchange market; this will allow better risk management and allocation of resources. (g) Strengthen bank supervision and prudential regulations to maintain the soundness of the banking system in a more open and competitive economy.

Structure of the financial system

Morocco's financial sector includes thirteen commercial banks (including the central bank, BAM) and three foreign off-shore commercial banks in Tangiers' off-shore commercial banking sector, a financial holding company which was recently privatized (SNI), six leasing companies, twenty-two insurance companies, and a few recently created brokerage houses operating on the stock exchange. All except one of the thirteen have significant but minority foreign bank participation.[56] There are five state-owned specialized financial institutions,[57] including the Caisse de Dépôt et de Gestion (CDG), which is used as a conduit to channel a large part of the economy's savings to the public sector, the national savings bank (CEN), some pension funds, and the Casablanca stock exchange. Recent reforms in the banking sector have led to the establishment of a relatively solid prudential and supervisory framework. Institutional savers still play a modest role in the Moroccan financial system. In 1993, total assets managed by institutional investors amounted to about 20 percent of GDP compared with, for instance, about 150 percent in the US, 50 percent in Malaysia, and 30 percent in Chile. The insurance industry is growing rapidly but remains financially weak and underdeveloped.

Size of the financial system

The size of a financial system is a good indicator of its relative importance in economic activities and of the diversity of services that it provides. Table 7 presents some indicators for Morocco. Some interesting features of the financial system are evident: a large share of bank credit still goes to the public rather than private sector, and stock market capitalization is increasing rapidly. As a percentage of GDP, it has doubled since 1992 largely because of the privatizations that

TABLE 7

The financial system in Morocco: some indicators, 1993

	Millions of dirhams	Percent of GDP
Deposit-taking banks		
Deposits	112,720	45.5
Domestic credit	111,005	44.8
without government	44,657	18.0
Private sector	65,840	26.6
without medium/long-term	15,771	6.4
Specialized financial institutions		
Deposits	53,938	21.8
Credit		
without government	7,980	3.2
without private sector	35,542	14.3
without medium/long-term	30,265	12.2
Stock market capitalization	25,623	14.0[a]
	1980–93	**1993**
M2/GDP	49.4	62.3

a. This figure is for 1994.
Source: Bank Al-Maghrib, Government of Morocco.

have taken place. M2/GDP compares favorably with other middle-income countries.[58]

Interest rate liberalization

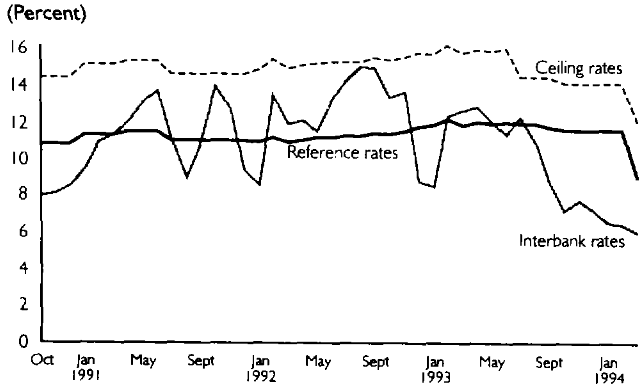
Real interest rates in Morocco, though positive, are not market-determined. Figure 3 shows the evolution of interest rates in Morocco. The BAM sets the maximum lending rates for loans of varying maturity based on an estimate of the cost of resources to the banks. These calculations lack transparency and the differences between rates for long and short term loans were set arbitrarily. The ceiling rate was to be adjusted periodically, but this has not been done on a regular basis; nearly all bank lending takes place close to the maximum rate. Deposit rates are set within the guidelines provided by the Groupement Professionel des Banques Marocaines (GPBM). Legal restrictions exist to prevent remuneration of most sight deposits. Interest rates on savings accounts are set at 7 percent for commercial banks and 9 percent for the Caisse d'Epargne Nationale (CEN), the national savings bank. The CNSS and CEN deposit their resources at the CDG, for which the CDG must compensate them at 9 percent. This restriction sets the cost of resources to a major player in the financial market at 9 percent thus establishing a lower bound for its lending rates.

Since interest rates have not reflected the true cost of resources in the economy, they have not been able to play their role in resource allocation effectively. As a result, small- and medium-sized enterprises, relatively more risky ventures, and those on which information may be hard to obtain have had difficulty in accessing credit. In addition, banks' incentives to be aggressive mobilizers of savings have been dampened.

FIGURE 3

Morocco—interest rates, 1990–94

(Percent)



Source: Bank Al-Maghrib.

Within the context of a continuing stable and sustainable macroeconomic framework, and given the progress made in the area of bank regulation and supervision, the authorities recognize that interest rates should be liberalized and plan to implement liberalization in the near future.

Regulatory reform of securities and bonds markets

At present there is no market for private bonds in Morocco, the capitalization of the stock market has risen rapidly but remains low at 14 percent of GDP, on-floor trading remains low with off-floor transactions being three times greater, and there is no active money market. Reform of the securities, bond, and money markets will help achieve an important objective. These markets are essential for efficient risk management through portfolio diversification and better liquidity management.[59] Stock market development is closely tied to the privatization process. Those firms which have been sold on the stock market have been several times oversubscribed: not only has stock market activity increased as a result of the privatization process, but the privatization process can benefit substantially from capital market development. Moreover, securities markets also reveal information about firms and thereby facilitate the monitoring of managers and investments. In addition, securities market development encourages the establishment of capital market intermediaries such as rating agencies, investment banks, and auditing firms, which enhance the flow of information about firms and thus improve resource allocation. Capital market development will aid in the mobilization of resources for the private financing of infrastructure. It also lowers transactions costs in another important manner: stock markets allow the exchange of ownership to take place without disrupting productive activity, increasing firm productivity and encouraging investment.[60] The development of the money market is important for the conduct of monetary policy in a context of liberalized interest rates and free credit flows.

The securities, debt, and money markets could play a much larger role in the economy than they currently do. Though the legal framework is in place for their development, some implementing decrees remain to be put in place. Specific actions to promote development of these markets include the following:

- Making the Comité Déontoligue des Valeurs Mobilières (CDVM—the equivalent of the Securities and Exchange Commission of the United States) operational.

• Eliminating government guarantees for bonds issued by public enterprises, as these distort the market. This action will level the playing field for private sector borrowers.
• Implementing measures to enable effective open market operations to be carried out as swiftly as possible. These include the development of the institutional environment and training of BAM staff.
• Strengthening the regulatory and institutional framework of the securities market on the basis of the recommendations of the G-30, in particular the implementation of a central depository system and a trade settlement and delivery system.
• Modifying the regulatory framework so as to permit banks and other financial institutions to issue mortgage-backed bonds.

Increase the use of indirect instruments for monetary policy

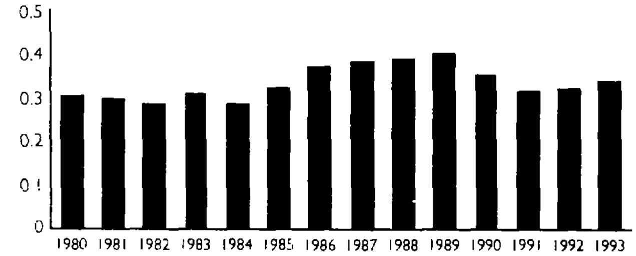
The monetary policy instruments available to the BAM consist of non-remunerated reserve requirements with the banks, rediscounting of commercial paper, auction, and repurchase agreements (established in 1995), in addition to the controls on interest rates mentioned above. The secondary market in short-term debt needs to be developed so that the government can efficiently affect liquidity (and thereby interest rates). Monetary policy reform will allow more efficient financing of government budget deficits at lower costs and improve the allocation of financial resources by removing possible distortionary and implicit taxes on the financial system and the private sector. The government will be able to move away from direct controls on credit and prices to the use of indirect instruments to influence these variables. Some policy measures that would need to be implemented are:
• Allowing remuneration of reserve requirements, currently required to be maintained at 10 percent of sight deposits.
• Strengthening the technical capacity of the BAM staff to implement open market policy and providing the necessary infrastructure (computers, for example).

Reduce the government's preferential access to credit

Figure 4 shows domestic credit to government as a proportion of total credit during 1980–93. Under the current regime, the Treasury has preferential access to financial resources through a variety of mechanisms:
• Banks are required to hold 20 percent of their sight deposits in public paper that pays 4.25 percent (Plancher des Effets Publics, or PEP). The implicit tax on the financial sector from these below market interest rates would have amounted to 0.35 percent of GDP. Note that because of the other distortions in the economy (few alternative investments, controlled interest rates), banks currently hold an additional 18 percent of their deposits in Treasury paper, though at higher interest rates.
• The Treasury has interest-free access to funds from the BAM up to a limit on the stock of around DH 5.5 billion plus the equivalent of 10 percent of the previous year's tax revenue. Interest payments on these funds could cost the government an additional 0.4 percent of GDP, assuming interest rates of 10.5 percent.
• All the reserves of the postal savings bank and the main social security organization (CNSS) are required to be deposited, at a fixed interest rate of 9 percent, with the Caisse de Dépôt et de Gestion (CDG).
• Insurance companies are required to invest 40 percent of their reserves in Treasury paper.[61]

The above mechanisms direct credit to the public sector (much of it at preferential rates), tax the financial sector, and impede the efficient mobilization and allocation of financial resources. Financial managers have little incentive to acquire and market information and, in some cases, are prevented from playing any role in capital markets. Private sector firms lose twice: first, from the reduction in the availability of long-term funds and from the implicit tax on the financial sector,[62] and second, from the other benefits that come from capital market development. As is widely recognized, the above restrictions on the use of the funds of finan-

FIGURE 4
Morocco—credit to government, 1980–93
(Fraction of total)



Source: Data provided by Moroccan authorities.

cial institutions need to be abolished in the context of appropriate accompanying regulatory reform. The role of CDG in a changing financial system needs to be redefined with a view to converting its function (perhaps to a commercial bank) over the medium term.

Reform of the contractual savings system

Apart from the commercial banks, the other major mobilizers of savings in Morocco are the postal savings system (CEN) and the institutional savers such as the pension funds and the insurance companies. The law allowing the creation of mutual funds has been passed.

Reform of the savings institutions is important for mobilizing savings (the domestic savings rate of around 16 percent is very low) and for boosting capital market development, as the experience of many countries has shown. The CEN could play an important role in Morocco by making use of its extensive infrastructure to reach small savers, especially in rural areas. Utilizing such systems for savings mobilization in many East Asian and European countries has worked well. In Japan and Italy for example, the postal system still collects around 30 percent of total personal savings. Efficient functioning of institutional savers is important for capital market development since these institutions can become important players in capital markets. Moreover, the present pay-as-you-go pension system will be running large deficits over the longer run. The budgetary implications of the financial situation of the pension system could be significant. Well-designed pension systems that are fully funded and privately managed (within a suitable regulatory framework) have generally proven to be financially sustainable, to boost capital market development, and to reduce labor market distortions.[63] In addition, an appropriately designed multipillar system (public and private) allows the functions of redistribution that a social security system provides to be separated from the savings and insurance functions. This separation will minimize the labor market distortions that accompany many pension systems (causing informalization of production and employment) and will promote growth, while still allowing coverage of the (targeted) poor. Reform of the current system will lower the public sector's fiscal burden in the long run and ensure the financial viability of the social security system.

Additional measures would need to be taken with regard to the major institutional savers. A greater effort could be made to increase CEN's savings mobilization, especially in rural areas.[64] The CEN pays a fixed return to savers and deposits everything with the CDG. The investment operations of CEN as well as deposit rates will need to be liberalized, and perhaps the management of the savings system should be separated from that of the post office.[65]

The Moroccan pension system is dominated by a few large entities. To ensure the financial viability of the system, reforms will be needed. In the short run they consist of (a) allowing investment of reserve funds at market interest rates, (b) full price indexation of pension benefits, and (c) the use of a lifetime average wage as the base for pension calculation rather than the most recent salary, and (d) raising the retirement age. Over the medium term, the pension system would need to be reformed from the current predominantly pay-as-you-go, publicly managed system to a predominantly fully funded, suitably regulated, privately managed one. There should also be a complete separation of the social programs (health, family allowances, etc.) from the pension system. The public side of the system should be reserved mostly for well-targeted redistributive functions.

The overall situation of the insurance industry and the controls on premiums should be reviewed with the goal of improving the financial condition of the insurance companies, and if need be, prudentials regulations should be modified to allow greater flexibility in investment decisions once the financial system develops and high-grade investment instruments become available.

Opening the financial system

Morocco achieved current account convertibility in 1993. It has also established virtually full capital account convertibility for foreign investors. The relaxation of surrender requirements for export revenues and of foreign borrowing restrictions, as well as the authorization of outward investments by certain export firms and banks, represent a first move towards capital mobility for resident Moroccans. Currently there is no foreign exchange market in Morocco. Since 1993 exporters have been permitted to retain a small share of their export earnings (10 percent for exporters of goods and 5 percent for exporters of services). Banks are allowed to trade the foreign exchange they own amongst themselves, but not against dirhams. Full convertibility of the dirham can play an important role in Morocco by signalling the irreversibility of reform and the commitment of the government to maintaining a sound macroeconomic framework. Such signals can have substantial positive effects on the magnitude of private investment and on foreign capital inflows. It will also allow investors much greater risk-hedging opportunities and thus improve the efficiency of investment.

In light of the relatively favorable macroeconomic performance, the strong reserve position (around 5–6 months of imports recently), and the additional reforms that could be implemented (discussed above), the establishment of full capital account convertibility is desirable over the next few years in Morocco. The authorities intend to establish a foreign exchange market in Morocco as a first step towards an open foreign exchange regime. Some key elements need to be put in place in preparation:

- BAM must establish the regulatory framework, strengthen supervision, and set prudential ratios for foreign exchange positions taken by dealers.
- Banks should be allowed to exchange their foreign exchange holdings into dirhams and exporters should be allowed to retain 100 percent of their foreign exchange earnings.
- Regulations pertaining to foreign exchange accounts held by individuals should be liberalized.
- BAM will need to acquire the necessary staff and equipment to implement the desired exchange rate policy.

Bank supervision

As the financial system is liberalized and developed, it will increase the opportunities for bank lending and risk-taking. Further strengthening of bank supervision will ensure the stability of the financial system in a competitive environment. The following measures will need to be implemented swiftly:

- Issuance by the central bank of prudential regulations for the newly established interbank foreign exchange market.
- Harmonization of prudential regulations for banks and specialized financial institutions.
- More frequent on- and off-site supervision of banks.[66]

The water constraint

Conclusion. A sustainable growth strategy for Morocco must take into account the water resource problem: by 2020 the per capita renewable water supply is expected to fall by 50 percent, and Morocco will be a "chronically water stressed" economy. It is crucial that a national water plan that will treat water issues in a centralized manner (and on the basis of strategic priorities) be developed quickly as part of Morocco's overall development strategy. Future investments aimed at increasing water supply will have to consider the net additional benefit from investment in water mobilization and distribution in each economic activity before being implemented.

The principal challenges include (in addition to the decline in per capita water supply): (a) the degradation of water quality; (b) providing the remaining 86 percent of the rural population with potable water supplies; (c) the rapidly rising marginal cost of water and sharp increases in investment costs, which are not matched by cost recovery; (d) the deterioration of existing infrastructure and the silting of dams; (e) inadequate demand management as reflected in losses of irrigation and potable water; (f) the relative absence of efficiency and equity criteria in water allocation; (g) the expected 30 percent decline in water available per hectare by 2020 and the implications for irrigated agriculture; and (h) the need for institutional, legal and regulatory reform to address the challenges. The main policy measures the government will need to take can be grouped broadly around demand and supply management issues.

Key objectives. (a) Better demand management through the use of rational water tariffs designed to cover costs (plus a mark-up). The prices of other inputs and outputs of productive activities must also reflect market levels. Higher water charges are expected to increase efficiency in water use. (b) Improved supply management: through reform of the legal and regulatory system that will encourage innovation, efficiency gains, and water conservation, quality improvements in the institutional system that will encourage charging for actual use of water, and the setting of national priorities for water use in various economic activities (industry, services, agriculture, and household).

The land market

Conclusion. The major constraints to efficient land use and development generally vary from urban to rural areas. In rural areas the main problem is the lack of an integrated market for land, due to the fact that property rights are not well defined because much of the land is collectively owned or not registered. In urban areas the main problem is the incentive structure and lack of transparency in the real estate market, including land reserved for industrial zones. This leads to holding of land by insiders (often referred to as speculation) in expectation of capital gains, and higher land prices. In addition, land reserved for industrial uses is often not suitably equipped. There is also crowding out of the private sector by public developers of urban lots.

Key objectives. (a) Increase the pace of land registration in rural areas to allow the transfer and consolidation of land as desired by farmers, and to allow its use as collateral to obtain credit; simplify the process of transferring land titles in both rural and urban areas. (b) Increase transparency of the real estate market by publishing zoning plans and sales prices, and consider increasing the availability of publicly held land to the private sector. (c) Change the favorable taxation of land relative to other assets. (d) Equip industrial zones appropriately, tax unused land, ensure that supporting services for industry are available (such as improved telecommunications), and let development be demand-driven. Reorient public developers towards installing only primary infrastructure; this will enable private developers to develop lots fully.

Chapter 4
Privatization and promoting the private sector

Conclusion. A much bolder and faster program of privatization, more aggressive promotion of private sector investment in all economic sectors through regulatory and incentive framework reform (designed to promote competition and prevent the abuse of monopoly power), and overhaul of the supervisory and regulatory framework for remaining PEs will be necessary to support an acceleration of growth. These actions will contribute to higher growth by raising the overall efficiency and magnitude of investment, by enabling the financing of much-needed (large) investments in areas such as infrastructure, and by contributing to a strategy of public sector deficit management through debt reduction. Privatization (with regulatory reform) can provide a significant boost to capital market development (as it already has begun to do), and can play a significant role in signalling the commitment of the government to continued reform and thus increasing investor confidence. The first phase of privatization in Morocco was launched in response to the general dissatisfaction with the performance of Morocco's relatively large PE sector. This program was an encouraging beginning: investor interest has been high, significant revenues have been generated for the government (totalling around DH 7 billion or US$ 857 million to May 1995), and the process has been transparent and has had public support. The second phase should now be extended to previously untouched areas. While some of the remaining firms may require more complicated transactions due to their poor financial condition, the diversity of economic activities they are engaged in, or overstaffing, for example, these should not be reasons for delaying action. To prevent the process from losing momentum, and given the limits on public finances, privatization prior to restructuring could be encouraged.

Key objectives. (a) Completing the privatization of industrial and commercial firms operating in competitive markets. (b) Increasing the participation of the private sector in the management, financing, and especially the ownership of infrastructure firms while simultaneously providing a liberal and competitive and adequate regulatory framework. The approach that has been initiated in energy and water distribution should be extended to the telecommunications, mining, port, and transport sectors, for example. (c) Overhauling the conceptual and supervisory framework for those PEs, or parts of PEs, that will temporarily or indefinitely remain subject to state control.

The PE sector

For a middle-income country, Morocco possesses a large, economically important PE sector accounting for 20 percent of GDP, 21 percent of gross domestic investment, 27 percent of wages and salaries, and 10 percent of the urban, formal sector labor force (or about 200,000 jobs). Moroccan PEs have a modest impact in agriculture, construction and retail commerce, but account for one fourth of value added in industry as a whole, and more than half of value added in mining, water supply, energy, transport, and communications.

Aggregate data on the financial and economic performance of the sector are inadequate; basic time-series information for the PE sector, the number of PEs making losses, the rate of return on total equity, and the breakdown of employment by firm are lacking. Data from the mid-1980s showed that 30 percent of 226 PEs studied had a negative return on equity, and an additional 23 percent had returns of between 0 and 5 percent. Again, in the mid-1980s, in fifty-eight of the PEs owned entirely by the state, 36 percent made losses. In the period 1988–92 the fourteen largest PEs taken together produced an annual average loss equal to 1.7 percent of GDP. In 1992, this rose to 2.1 percent of GDP, or almost half the consolidated public sector deficit. In the 1990s, net financial flows were from the state to the PEs, averaging about 0.3 percent of GDP annually.[67] Problems of interenterprise and enterprise-government arrears abound, despite several efforts to resolve the difficulty.[68] These scattered pieces of information, combined with (a) several qualitative assessments noting weak management and supervisory practices, wastage, overstaffing, and missed opportunities in PEs, and (b) documented instances of increasing financial difficulties (in the state phosphate company, OCP, and the state airline, RAM, for example), lead to the conclusion that while the sector is not yet in crisis, its performance is considerably below the level of what could be achieved. If current conditions continue, the PE sector could be in crisis over the medium term.

First phase of privatization

Recognizing the unsatisfactory financial state of the PEs and the poor quality of services provided by them, a Privatization Law mandating the sale of 112 companies and hotels was passed in 1989. The program took some time to start; sales actually began in February of 1993. However, since then some thirty-four companies and hotels have been sold in a transparent and productive manner, in the sense that core, experienced investors, domestic and foreign, are being brought in; revenues are being generated (7.2 billion DH—$857 million—to May 1995); and the Casablanca stock exchange is being expanded. 40 percent of the proceeds generated have come from non-Moroccan investors in Europe, North America, and the Middle East, revealing an exceptional openness on the part of Moroccan authorities to accept foreign involvement in the economy. The share of privatizables in value added in proportion to total value added of the sector in GDP is shown in table 8. The conclusion on the privatization program to date is that what has been sold has been sold very well, but the program has not yet seriously reduced the economic weight of the public enterprise sector.

TABLE 8

Sectoral distribution of firms to be privatized, 1989

(Excluding hotels)

Sectors	Number of entities	Value added of privatizables /total value added of sector	Employment
Agriculture	3	0.06%	411
Extractive industries	5	6.25%	1,543
Manufactures	41	6.12%	19,837
Financial institutions	10	31.32%	8,751
Commerce	9	4.23%	3,285
Transport and communication	2	0.93%	820
Services	4	0.27%	1,279
Total	74		36,612

Note: This list was established in 1989. Two firms were subsequently merged. Note that only in the financial sector is a substantial portion of value added being divested.
Source: Ministry of Privatisation, Government of Morocco.

It is too early to tell if privatization in Morocco has resulted in more efficient use of these assets and whether the macroeconomic impact of the program will be positive and large. First impressions suggest that most of the privatized firms are doing well, and that the chances for broader economic and financial success are high. Also, privatization has been, to date, a political success. The public seems largely to accept the sales; partly because, in an effort to demonstrate that privatization benefits not just the rich or the foreign, care has been taken to encourage share-holding by first-time investors, workers in the affected firms, and Moroccans working abroad.[69]

Next steps

Much more could be done in the area of privatization and private sector development. Greater efficiency of investment will be required to attain the high-growth scenario. Increasing funds for essential investments in infrastructure, which the government cannot provide, will be needed. Moreover, given the increase in the budget deficit in recent years, the potential loss in trade related revenues, pressing demands in the social sectors, and other public expenditure priorities, the net revenue effect of privatization has become more important. The deadline for sales, set in the Privatization Law of 1989, has been extended from end 1995 to end 1996. This is necessary to complete the sales of the eighty-six firms (at time of writing) that remain on the list of "privatizables". Cabinet has also added to the "for sale" list two oil refineries, SAMIR and SCP; it thus appears that the expansion of the list is a relatively simple matter. The success of the first phase of sales suggests that the remaining industrial, manufacturing, and service enterprises could be put up for sale as soon as possible.

However, a fair number of the profitable, easily divested firms operating in competitive markets have already been, or are now being, sold. This means that some and perhaps many of the upcoming sales are likely to be more complex and difficult transactions (such as traditional natural monopolies). For example, forthcoming sales include five banks, two insurance companies, a steel company, two oil refineries, three sugar companies, and several poorly performing industrial and manufacturing firms. It has already been demonstrated in Morocco that large and complex, or difficult transactions of this nature can be completed; the successful privatization of CIOR (a large cement company), SNI (a holding company with forty-one companies in its portfolio), and MODULEC (a troubled appliance company, sold for one DH) are examples of this. However, as the number of complicated transactions increases, the resources of the understaffed and underfunded Ministry of Privatization will be more severely taxed. The authorities have privatized the privatization process by keeping their own staff small and relying heavily on private consultant services (lawyers, accountants, investment bankers, management specialists, and sector engineers) to bring transactions to the point of sale. This method is fast and results in high quality work. It is also expensive, and will become more so as transactions get larger and more intricate.[70]

Privatization proceeds are handed over to the national budget, where they are being used to finance current budget deficits. Ideally, the government should be using these one-time revenue flows (from selling off assets) to reduce its stock of debt. Countries following that advice (France, Chile, Argentina) have reaped the greatest macroeconomic benefits from their privatization programs.

Infrastructure

The first list of privatizable companies excluded (a) firms fulfilling a public service role, and (b) firms not operating in competitive markets. These limitations should be abolished. The question of selling, or at least involving the private sector in the management and financing, of any public enterprise—from the largest offices to the smallest régies,[71] ORMVAs, and municipal public service agencies—should be considered. The reasons for the change in perspective are numerous: technology has changed, opening to competition previously closed markets (in telecommunications and power, for example). The capability of the Moroccan private sector has increased. The government recognizes the financial limitations on the state, and the need to use private funds for investment in crucial areas. Foreign investment is no longer viewed with the level of suspicion that previously prevailed. All these factors combine and open the door to private participation in areas previously closed.

Several path-breaking activities are underway. The electricity enterprise, ONE, is presently negotiating build-operate-own (BOO) contracts with private firms for the construction and operation of two new thermal generating plants, and is considering using this approach for two others. Thirty percent of the water needs of Casablanca are already distributed by a French private firm, under a fifty-year build-operate-transfer (BOT) contract. Discussions are advanced between ONE, various régies, and private contractors for concession arrangements in electricity and water distribution and sanitation services in a number of municipalities. Efforts of this sort could be dramatically expanded to increase efficiency in the provision of infrastructure services, and to generate revenues for the state. However, a number of negotiations to date have taken place in an ad hoc manner; in the future it would be desirable to negotiate and award such contracts (especially large ones) through a competitive bidding process.

Worldwide, telecommunications have proven to be comparatively easy to open to private involvement. Divestiture in this sector normally yields substantial benefits, in terms of sales proceeds, increased welfare, and the increased provision of services essential to economic and business expansion. In Morocco, the sector remains basically closed. A new telecommunications law is being drafted that calls for the creation of an independent telecommunications company operating on commercial principles. A core portion of this company would be privatized soon after the passage of the law and there would be partial liberalization of the sector. The draft law has some important weaknesses. It envisions granting a seven-year monopoly position to the main privatized operator, at least for the provision of basic services. Such a situation would not promote efficiency in the economy, and it is essential that a more competitive environment be introduced much earlier. In addition, the proposed regulatory framework lacks specificity, and the proposed regulatory agency lacks power. In particular, an effective regulatory agency (with the supporting regulatory framework) will be required to monitor concession obligations, secure a credible and coherent investment environment, and provide arbitration between operators and users and among different operators. To ensure efficiency, the law would need to define the general principles (such as cost-based pricing, non-discriminatory access, and protection against unfair competitive practices) necessary to guide regulation in a competitive environment. It is crucial that Morocco establish a fair and credible regulatory framework, not only for telecommunications, but for every infrastructure field subjected to privatization. Once the competitive and regulatory frameworks are established, private involvement can increase rapidly in subsectors such as railroads, air and land transport, ports, mining, and in both the mining and industrial branches of the phosphates industry. Where privatization of assets is not possible (because of government reticence or investor hesitancy), privatization of management can be considered.

The labor issue

There is a concern that labor layoffs brought about by privatization may provoke social tensions. To date, this has not been a problem, since one of the criteria for inclusion on the list of privatizables was lack of surplus labor (and all the buyers have made a commitment to retain the inherited labor force for a period of five years). As larger and, in some cases, poorly performing firms are sold, or market conditions change radically for firms already sold, labor redundancies will become a more apparent problem and some form of targeted compensation will become necessary. International experience offers some guidelines for Morocco:

- It is important to bear in mind that private investment generally creates more jobs than public investment; it is better to concentrate on job creation through private initiative than job preservation in public enterprises.
- The incidence of increased unemployment directly attributable to privatization is often less than anticipated, particularly in infrastructure fields where the PE was starved for investment funds and there is considerable pent-up demand.
- In those areas where large layoffs are common (for example, railroads, steel mills, "old" and capital-intensive industries), dismissals can be handled by severance packages composed of a combination of monetary payments, training, loans, early retirements, outplacing in private firms, and a variety of other mechanisms.

Public enterprise reform

Privatization and private sector involvement should go forward as rapidly as possible; however, international experience indicates that the process will take time, during which the remaining PEs must be monitored and managed. Whether their retention by the state is temporary or indefinite, reform of the PE sector is essential if it is to avoid the continuation of past financial and economic mistakes. This is a particularly pressing issue given the fragility of the medium-term budgetary outlook and the consequences for investment and growth. One example is the state-owned OCP, which retains a monopoly on the extraction, processing, and exports of Morocco's large phosphate reserves. Morocco is a leading world exporter of phosphates. These resources are non-renewable. A large part of any transfers to the state, which are economic rents, would need to be placed in forward-looking investments to optimize their allocation.[72] An incentive and regulatory system to encourage optimal allocation will need to be adopted. Prices of goods provided by PEs need to be adjusted to reflect their true costs and to enable entrepreneurs to make sound investment decisions (for example for water and electricity). Overall, the present approach to PE oversight needs revision. Possible actions are:

- A new code of PE management and governance could be promulgated, eliminating the present system of financial control *a priori,* and assigning to PEs the primary goal of maximizing net worth.
- The PEs would produce and negotiate with the representatives of their owner a medium-term business plan, setting out their strategy and financial relationship with the state, but management's performance would be assessed annually, on the basis of the fulfillment (or not) of readily measured objectives. Good performance would be rewarded under established guidelines and poor performance penalized. Non-commercial objectives imposed by the state would be accounted for separately and paid for in a transparent manner from the budget.
- A majority of the PEs' Boards of Directors would be composed of non-governmental persons; government representatives would be limited to a delegate from the Ministry of Finance and the relevant sector ministry, and no minister nor government employee could chair the Board.
- All PEs would be made subject to the new Moroccan Company Law, once it is passed. This will ensure that regular audits take place; company disclosure requirements will enhance the transparency of PE operations and prepare them for future private participation.

Notes

1. Real growth in manufactured exports was 24.4 percent in 1990 but dropped to 2 percent in 1991 and –8.4 percent in 1992.
2. For example, the growth rate of real GDP was –4.4 percent in 1992, –1.1 percent in 1993, and 11 percent in 1994 due to variability in agricultural output. Growth rates for agriculture were –36 , –6.2, and 65 percent respectively. The share of industry in GDP remains around its level in the early 1980s at about 30 percent.
3. The fast-growing East Asian economies have demonstrated that factor accumulation (both labor and capital) has been an important source of growth and in many cases has been more important (even in the manufacturing sector) than increases in total factor productivity. See Alwyn Young, 1993.
4. See bibliography for various cross-country studies on policies affecting growth.
5. The experience of Latin American countries provides a good example.
6. These issues have been studied in "Kingdom of Morocco—Preparing for the 21st Century—Strengthening the Private Sector in Morocco." Report No. 11894-MOR (PSA), 1994.
7. To complement these reforms, Morocco will need to strengthen its legal and judicial framework. For greater detail, see PSA.
8. In times of high unemployment, many are not counted as unemployed since they have stopped searching for jobs. However, as times improve, they can be expected to re-enter the labor force; this will prevent the unemployment rate from falling as fast as would be expected in the absence of such a reserve labor force. The rural unemployment figures are very low at about 5 percent; however there is a lot of underemployment (estimated at around 20–25 percent on average in a normal year, and more during drought years) and disguised unemployment in rural areas. See "Kingdom of Morocco—Poverty, Adjustment and Growth." Report No. 11918-MOR, 1994 (PA).
9. Current projections of the viability of the financial condition of the two main social security organizations in Morocco indicate insolvency over the medium-term. Chapter 4 deals with the financial condition of public enterprises. It is not possible at this stage to determine the implicit debt of the government resulting from the current pay-as-you go system of social security, though this number should ideally be added to the public sector deficit cited above to get a true picture of the overall deficit.
10. Expenditures on health in Morocco at 1 percent of GDP are low compared to other middle-income countries and are also skewed towards the better-off in society.
11. Trade taxes are very distortionary sources of revenue and should in any case be replaced by less distortionary taxes.
12. A very rough estimate of the possible revenue gains from eliminating the tax exemption for agriculture has been estimated at 1–2 percent of GDP, and similarly for the housing sector at 0.2–0.7 percent of GDP.
13. However, this is one possible option and the tax system should be reviewed before any action is taken.
14. The ratio of public to private investment in Morocco is high relative to other middle-income countries and particularly the fast growers.
15. Many of the issues which are not covered in the CEM in detail, particularly pertaining to legal, administrative and regulatory obstacles to private sector development, have been covered in the PSA.
16. For example, agricultural products (such as oilseeds) that use water intensively may not be profitable to produce once trade reforms are undertaken and price distortions in the economy are corrected.
17. Trade diversion occurs when countries import more from a higher cost producer as a result of preferential tariff reductions; trade creation occurs when the total volume of trade rises as a result of falling prices for imported goods. Tariff revenues can be replaced by increases either in consumer surplus for the importing country or in producer surplus for the exporting country. The net welfare gain to the countries involved depends on the sum of these effects.

18. Under the UR, there is a 40 percent cut in import-weighted average bound tariffs on all industrial products by industrial countries and an increase in tariff bindings to cover 98 percent of all imports.
19. While there are several items of clothing and textiles subject to voluntary export restraints (VERs), these do not appear to have been binding in practice and have been surpassed by 200–300 percent without corrective actions being taken ("Kingdom of Morocco, Republic of Tunisia, Export Growth: Determinants and Prospects." World Bank, 1994).
20. Ibid.
21. Morocco faces tariffs of 11–18 percent for tomatoes and clementines and 4–20 percent for oranges under the EU offer to the GATT.
22. The PFI has been 12.5 percent for medical products and 10 percent for products which fall under the investment code. However, the Loi de Finances 1995 abolished the PFI for investment goods, and also provides exemptions on import taxes for some investments.
23. The fiscal effect of the conversion of agricultural quotas to tariffs is not known at this time.
24. Domestic prices under a VAT imposed on the tariff inclusive price of a good are higher by tv percent (a cascade effect), where t is the tariff rate and v the VAT rate.
25. These reference prices are to be removed in 1998 in accordance with the GATT. The system seems to provide significant protection for specific products. A previous study noted that one in four products subject to reference prices were not imported in 1990 ("The Moroccan Reference Price System." P. Messerlin, 1991).
26. Based on 1990–94 prices, the base plus marginal tariff structure under consideration for soft wheat would have yielded a tariff rate of 126 percent. While lower than the 190 percent tariff binding, it is no lower than the estimated 1994 tariff equivalent of 123 percent.
27. "Incentives and Protection in Morocco's Industrial Sector in 1991." Van de Wetering, H., S. Belghazi, and A. McDermott, 1993. Prepared for USAID. This paper is based upon the same survey and study as Ministère du Commerce, de l'Industrie, et de la Privatization (1993), "Les Incitations et la Protection dans le Secteur Industriel en 1991".
28. It is far better to target and reduce the original source of distortion than to compensate by increasing a countervailing distortion. Tax incentives for exporters, for example, increase the incentive to export but create additional distortions. By raising the after-tax return to capital (profits), they may bias production away from more labor-intensive methods. In any case, new export incentives are not permitted under the UR.
29. Free agricultural access to the EU is available only under full membership
30. A study by T. Rutherford, E.E. Rutstrom, and D. Tarr (1993) using a computable general equilibrium model for Morocco estimates net welfare gains to Morocco of 1.5 percent of GDP. This model has thirty-nine production sectors, is based on a 1980 input-output matrix of the Moroccan economy and assumes, among other things, that there is an accompanying real exchange rate depreciation (to ensure current account sustainability) which boosts exports and that there are no terms of trade effects.
31. The former estimate was calculated by the Ministère du Commerce Extérieur and can be thought of as a lower bound on tariff revenue losses since they assume no response in import demands. The latter figure is from customs (Administration des Douanes), cited in *L'Economiste* (11/17/94).
32. They are too high to be explained simply by frictional or search unemployment, for example.
33. Estimates show that with labor mobility and a non-binding minimum wage, trade liberalization (especially reducing tariff dispersion) can lead to an increase in employment and wages. Studies also show that trade reform in Morocco had a small impact on aggregate wages and employment in the formal manufacturing sector (Currie and Harrison, 1995). This may be partly explained by the rigidity of the labor market.
34. In the absence of labor market reforms, export expansion is better accomplished by a sustained real exchange rate depreciation rather than tariff reduction. However, real exchange rate depreciations are often hard to sustain.
35. The informal sector in Morocco is not well known. There is also a definitional problem: firms that are often referred to as informal may pay taxes and the minimum wage. There are also firms whose activities may in part be considered in the informal sector (due to underinvoicing, for example).
36. This expenditure pattern is also regressive since it is usually the better-off that have access to higher education.
37. Though the process of revising the SMIG is not completely clear, labor unions and employers' associations play an important role.

38. This has been occurring at a time when the gap between the minimum and average wage has been increasing in most countries, due to falling real minimum wages.
39. Note however that compression of the upper end of the distribution also has negative incentive effects.
40. The new draft labor code suggests the possibility of establishing different minimum wages for different types of economic activities: such a move would complicate the existing system and might introduce new rigidities into the labor market.
41. Demographics in Morocco has exacerbated youth unemployment, with a large share of the population in the 15–30 age group.
42. There do not appear to be any systematic price differences between urban and rural areas. See Report No. 11918–MOR, 1994 (PA).
43. One example of this is Singapore, where social charges were very high, falling from 50 percent of costs to 35 percent during the 1980s.
44. As shown in the PA, employment increases in recent years have occurred in export-oriented firms (mainly textiles and clothing firms) where temporary workers have been hired. Though the data do not allow us to distinguish the number of temporary workers and thus their wages, estimates indicate that many of these workers are paid below the SMIG (the average wage for temporary unskilled workers is below that for permanent unskilled workers). Wages lower than the SMIG are legally permitted for workers under eighteen and for apprentices. It seems also that firms find it easier to pay lower wages for temporary workers in some firms.
45. "International differences in wage and non-wage labor costs." WPS 188, L. Riveros, 1989.
46. Though the new labor code was not available at the time of writing, this restriction is apparently to be included.
47. The new labor code due to be published in 1995 may be more flexible in this regard by establishing a deadline for the authorities' response beyond which the approval can be regarded as granted.
48. According to the authorities, the average severance pay granted is substantially greater than that required by law, at two months' pay per year of work. This does not include the uncertainty and other costs associated with frequent recourse to the judicial system.
49. It aims to do this by reducing the waiting time required before approval is obtained and by devolving responsibility to local authorities for granting approvals. How this will affect labor market flexibility remains to be seen.
50. The authorities are addressing the placement of the young unemployed through the development of a network of placement bureaus called the *Centres d'information et d'orientation pour l'emploi* (CIOPE). Employers do not have to pay social charges or the minimum wage for apprentices, though they are legally required to pay both for temporary workers. Perhaps rather than spending scarce resources on centers which may have negligible effects on reducing unemployment given the labor market rigidities, the government could spend these resources elsewhere.
51. Note that a binding minimum wage can encourage firms to adopt more skill- or technology-intensive production techniques. Firing restrictions can have similar effects.
52. Publicly provided vocational training degrees only significantly affect employment opportunities in the public sector.
53. Education for women has also been shown to have beneficial effects on environmental protection.
54. The high investments in education may reflect the higher entry barriers for women. It is interesting to note that gender has a significant relation to earnings in the public sector: women earn much less on average. Since the law does not allow differentiation in salary levels on the basis of gender, the lower average rate probably reflect the restricted nature of the career opportunities available to women.
55. For example in France, Italy and Japan, bank credit provides about 30 percent of the financial resources of enterprises against only 9 percent provided by bonds and stock; the remaining 60 percent are from internally generated sources. In the United States, on the other hand, 45 percent of the financial resources of the enterprise sector are provided through corporate bonds.
56. The banking sector is less competitive than that of countries like Turkey and Chile, but more so than in Colombia or Pakistan.
57. As shown below, the deposit-taking banks extend mainly short-term credit to the private sector; medium- and long-term credit is provided largely by the specialized financial institutions which obtain their resources from issuing and from borrowing abroad, both of which are granted government guarantees.
58. Note that a high M2/GDP ratio could be signalling the lack of alternative investment avenues in Morocco..
59. An important facet of improved risk management is the

ability to diversify the risks associated with innovation and the provision of information on the expected gains from innovative activity. See Levine (1991) and King and Levine (1993).

60. See Levine (1992a, 1994a).

61. Note that this requirement should only be made more flexible over time, as the financial system develops and high-grade financial assets become available along with credit rating agencies.

62. The tax on the financial system is probably (at least partly) passed on to the private sector.

63. This has happened, for example, in Chile.

64. A large proportion of the rural poor do not have financial savings but savings in the form of physical assets alone.

65. Malaysia tried this in the 1970s with success. A study group was created to devise a strategy to revitalize the CEN as its share of savings mobilization fell; the outcome of the study was not made available

66. These measures are expected to be taken by the authorities. See Report No. P-6633-MOR, World Bank, for details.

67. OCP and ONPT (Office Nationale des Postes et Telecommunications)were the only commercial PEs making positive transfers to the government.

68. Some estimates put gross arrears at DH 19 billion.

69. In a few instances when the spirit of the divestiture procedures has been violated—in one transaction, for example, when some purchasers evaded a limit on the number of shares that could be acquired by any one individual—the authorities intervened briskly, identified and annulled improper sales, and distributed the shares to purchasers who had asked for but not received the minimal allowance.

70. The Ministry of Privatization has so far succeeded in financing most of its activities through grant funding.

71. Régies are autonomous public entities charged with the distribution of electricity and water and water production. ORMVAs are non-autonomous public entities (essentially administrative arms of the Ministry of Agriculture) and their activities are divided equally between public services (namely extension services to farmers) and the distribution and sale of irrigation water to farms.

72. There are no data available on the assets of OCP.

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