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Explaining slow economic growth and poor social development indicators: The case of Morocco

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MAIN POINTS

Morocco's disappointing development results from problems of political representation, government coordination and policy commitment. These weaknesses have dominated economic imperatives with damaging impacts (for poverty reduction especially) across the range of expenditure policies.

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Executive summary

Drawing on elements of a political economy framework, this paper addresses two inter-related questions with regard to economic growth and public expenditure patterns in Morocco. The main factors that help explain Morocco's relatively slow economic growth for the last few decades have to do with problems of

- representation (policy makers mainly represented their own and family/clan interests rather than the public at large);
- coordination (coordination among ministries is constrained by the centralized nature of information and power); and
- commitment (to the trade and economic liberalization as well as privatization policies, linked to rent seeking activities by certain interests groups).

An overarching trend is the disproportionate influence of political considerations on economic decisions. The paper illustrates this point with numerous examples, including the tax exemption of the agricultural sector.

The second part of the paper identifies the main causes of Morocco's disappointing social development indicators compared to other middle-income countries. These causes are mainly linked to unsatisfactory outcomes in the education sector, and weak pro-poor targeting of government programs, which can in turn be explained by political economy imperatives discussed in the first part of the paper.

The policy recommendations put forward by this paper to further pro-poor economic growth emphasize the need for a reform of the tax system and greater redistribution of tax revenues to benefit the poor, as well as easier access to credit. Further, the possibilities for a selective decentralization of decision-making in public expenditure and greater coordination among development actors are presented. Lastly, the paper highlights the need for continued public sector reform, job creation through increased investment and improved human capital development.

The paper concludes that to advance the implementation of the many promising government strategies, it is above all necessary to reframe these reforms in political rather than management terms.

Introduction

The main objective of this paper is to use Morocco - a key EU MEDA partner - as a case study to illustrate some of the points made in the other papers in this series (e.g. Román-Zozaya, 2005). In particular, drawing on elements of a political economy framework, this paper will address two inter-related questions. First, the factors that explain Morocco's relatively slow economic growth since independence (1956) are examined. Following an introductory section on the economic and political context of Morocco's development achievements and challenges, this discussion will be structured around the concepts of representation, coordination and commitment. The second question relates to the causes of Morocco's disappointing social development indicators. This section draws primarily on recent findings regarding the extent of pro-poor targeting of a number of government programs. The paper concludes with some recommendations for enhanced policy effectiveness.

Román-Zozaya (2005) draws on Gilpin and Nelson and the political economy approach to explain why some economies are performing better than others. He refers to the possibility that entire systems stagnate because of power groups and institutional and economic practices, which were key in achieving success yesterday but are not suited for today's needs.[1] Similarly, Cherkaoui and Ben Ali (2003) use the political economy of growth theory developed in Castanheira and Esfahani (2001) to explain why Morocco's growth rates and overall performance have been very low since independence in 1956 both in absolute terms and when compared to those countries which started in the 1960's with relatively similar initial conditions.[2] They also note the continued high dependence on agriculture (employing around 55 percent of the workforce in 2000 and accounting for 18.3 percent of GDP[3]) and the limited change in the overall structure of the economy despite the reforms that have taken place in the last decades.

It is therefore useful to reformulate the first question above in this way: first, why was the system unable to foster incentives for economic agents to invest and improve productivity in the long run and second, why were resources not directed toward growth enhancing activities? The core idea in the political economy of growth theory is that sub-optimal growth outcomes are the result of contracting problems among players in the economy. The contracting problems may arise due to weaknesses in the representation, commitment and coordination capabilities of the policy makers.

These three institutional features are linked one to the other and a subtle combination of the three is required for growth inducing reforms. Each will reinforce the other, as for example the development of effective representation may heighten the value of government's commitment to policy The severity of these problems is related to the institutions that structure interactions among individuals and groups (Cherkaoui and Ben Ali, 2003). Before examining each of these issues in the Moroccan case, the next section will provide some background on the economic and political context of Morocco's development achievements and challenges.

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[1] Douglas North states that '[institutions] evolve incrementally, connecting the past to the present, and the future; history in consequence is largely a story of institutional evolution in which the historical performance of economies can only be understood as a part of a sequential story. Institutions provide the incentive structure of an economy; as that structure evolves, it shapes the direction of economic change towards growth, stagnation, or decline.' (cited in Addison and Baliamoune-Lutz, 2003).

[2] During the 1990s Morocco's GDP expanded by an average 2.7 percent per year. (Cherkaoui, 2001)

[3] Agénor, P.-R. and K. El Aynaoui (2003) and World Bank (2004)

I. Economic and political context: development achievements and challenges

It has been noted that GDP per capita and overall economic conditions were not significantly different between Morocco and some East Asian countries in the 1960's but that divergence in the growth rates in the following decades made Morocco lag behind (its average growth rate in the period 1960-2004 was 3.7 percent (Kably, 2005)). Further, it has been argued that population growth,[4] weather conditions and mismanagement of economic policy had a negative impact on growth over the 1960 to 1998 period (Cherkaoui and Ben Ali, 2003).

A recent survey on policy mistakes that account for this slow economic growth concludes that the main reason is the disproportionate influence of political considerations on economic decisions (La Vie économique 18.2.05). An example is the Moroccan capitalist private sector whose legitimacy depended on the *makhzen* (royal palace and central power network) which was largely responsible for its creation in the 1970s (see below). Another example of the primacy of political over economic considerations is the recruitment of 100,000 young unemployed graduates into government jobs in the early 90s, at a time when the budget had only envisaged hiring 10,000 new recruits, opening the door to continuing claims to the right of government jobs by the ever-increasing numbers of unemployed graduates.

A further important factor explaining the lack of significant growth in the agricultural sector is the incomplete land reform after independence: while 1 million hectares of land were in the hands of French settlers at the time, the redistribution operation in 1963 officially only dealt with 300,000 hectares. Hence, it seems quite plausible that the remaining 700,000 hectares were given to the already rich and privileged Moroccans. Furthermore, the decision to exonerate the agricultural sector from taxation in 1980 seems to have been taken more due to political considerations than to give an incentive to modern production systems which are still very few. And even if the tax on agricultural revenue were reintroduced today, most farmers would not be affected since their revenues are below the minimum taxable income tranche, while the big landowners would have to pay (ibid citing Najib Akesbi, and see below).

With regard to the industrial sector, the government tried to attract private sector investment by applying investment codes. However, they were soon abandoned since the incentives were not limited to specific sectors or time periods, but generalized to all sectors (ibid citing Mohamed Berrada). A further example of political influence in decision making is the policy to address the problem of urban slums; since the government promised the right to adequate housing to all those living in slums, even people who were not living in slums to begin with moved there in order to benefit from this promise (ibid citing Abdelali Benamor).

However, following a structural adjustment program in the 1980s, other macroeconomic indicators besides GDP growth have been brought under control. The government has restrained inflation (under 3 percent between 1996–1998, and about 2 percent in 2000), has kept the external current account deficit below 1

[4] The total population in Morocco increased from 11.5 millions in 1960 to 28.7 millions in 2000. The population living in urban centers increased from 25 percent in 1960 to 55 percent in 2000. The population is still young. The proportion of the population under 15 represents 32 percent of the population despite a sharp reduction when compared to the 1960's (Cherkaoui, Douidich and Touhami, 2002). However, a demographic transition is under way, with important implications for pension schemes. While currently just 7 per cent of the total population is aged 60 and over, by the year 2020 that proportion is forecast to exceed 8 per cent (Boudahrain, 2003).

percent of GDP until the recent drought and decline of phosphate prices (it is now 1.5 percent of GDP), and shored up official reserves, mainly thanks to tourism and remittance receipts (Cohen, 2003).[5] Nevertheless, there is not much scope for a big push on social sector spending, since 80 percent of the government's budget goes to recurrent expenditures, compensation (e.g. subsidizing the petrol price for consumers) and public debt payments (Tritki, 2005).

Moreover, the effects of integration into the global market economy, whether through foreign investment, trade, or privatization, have been very apparent. For young entrepreneurs searching for low-risk investment opportunities that require little start-up capital, the rise in the importation and domestic production of consumer goods has created demand for services like market research and advertising. On the other hand, annual growth in services (the sector most university and secondary school graduates enter) averaged only 2.8 percent during 1990 – 1995. Accordingly, overall unemployment rates averaged around 20 percent in the late 1990s (19.0 percent in 1998) (Cohen, 2003). In particular, unemployed 15-24 year olds account for around 37 percent and individuals with a higher level of education for more than 18 percent of the number of job seekers in 2000 (Agénor and El Aynaoui, 2003).

According to a World Bank Report (2000), the incidence of poverty increased between 1990 and 1998 from 13 percent to 19 percent of the population, i.e. an increase in the number of poor from 3.4 to 5.3 millions. This was attributed in part to the slow growth in the non-manufacturing GDP which was insufficient to compensate for the drop in agriculture production following many years of drought. Poverty is mainly prevalent in rural areas. If one person out of ten is poor in urban areas, this becomes one out of three in rural areas.[6] Moreover, income inequality is still very important. A survey quoted by the Groupe Agence Française de Development (2000, cited in Cherkaoui and Ben Ali, 2003) shows that the richest 10 percent of households consume around 30 percent of total consumption, whereas the poorest 10 percent only consume 2.6 percent of total consumption. This consumption difference has increased during the 1990s. Similarly, a person in the urban sector consumes twice as much as a person living in a rural area.

In addition, while the increase in poverty in the 1990s was accompanied with an improvement in social indicators (such as an increase in enrolment rate in primary education, life expectancy, access to basic infrastructure services and a decrease in adult illiteracy), Morocco has poor social indicators given its per capita income levels. It occupied the 123rd position (out of 178) on the UNDP's Human Development Index (Bougroum and Ibourk, 2003).

For example, despite a clear improvement when compared to the 1960's, Morocco's illiteracy rate in 1998 was still very high at 49 percent (compared to and average of 31 percent in the MENA region and 10 percent in the lower middle income country group (World Bank, 2004)). Female illiteracy was at almost 62 percent. In the rural areas the illiteracy rate was 67 percent overall and 83 percent for women. In the urban areas these rates are 34 and 45.5 percent respectively (Cherkaoui and Ben Ali, 2003). Concerns have also focused on severely unequal education outcomes as reflected in large urban/rural differentials and a substantial gender gap (Van de

[5] According to data from the IMFs *Balance of Payments Yearbook*, Morocco is the world's fourth largest recipient of official remittances, totalling $3.3 billions in 2002 (Sorensen, 2004).
[6] Teto (2001) finds that without transfers from resident households, public and private administrations, NGOs, Moroccans resident abroad, social transfers and family donations, the poverty incidence would be considerably higher.

Walle, 2005). Results obtained at national examinations show that the knowledge acquired is weak especially for students in the rural sector. This is attributed to the predominance given to memorization and the absence of an efficient evaluation system (Cherkaoui and Ben Ali, 2003).

Special attention should be given to the role of the monarchy in this discussion of the political and economic context of Morocco's social development.[7] As Al-Arkoubi and McCourt (2004) point out, power in Morocco centers on the palace.[8] In formal terms, the 1996 constitution envisages a multiparty system of democracy, but also allows the king a lot of executive leeway. The King continues to chair the meetings of his 'inner cabinet' of appointed ministers, at which all the big decisions are taken, and he personally appoints the Prime Minister, key central ministers and regional governors. In addition, one should not underestimate the king's *baraka* (roughly charisma), a quasi-religious quality that derives from the monarch's important religious role.[9]

Some commentators have been very optimistic about the extent of changes introduced by King Mohammed VI, saying that 'It appears that he is attempting to transform subjects into citizens and to replace a culture of personal allegiance with a culture of civic responsibility' (Denoeux, 2001). However, in light of the following discussion, it seems more accurate to say that 'the palace has played groups off against each other by the well-judged use of patronage, albeit the modernizing bent of both the present king and his father means that recent recipients of patronage have often been highly qualified technocrats' (Al-Arkoubi and McCourt, 2004). As will be seen in the following sections, the role of the monarchy is crucial in explaining many of the issues to do with representation, coordination and commitment.

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[7] Due to the limited scope of this paper, the other main political actors cannot be discussed here in detail, but see Cherkaoui and Ben Ali (2003) for an analysis of the political parties, the administration and the civil society.

[8] See Cherkaoui and Ben Ali (2003:6) for more details.

[9] With an annual budget of 2.28bn Dirham per year, the Palace is also an important economic actor (Ksikes and Tritki, 2004).

II. Issues for Moroccan fiscal policy

Representation

Effectiveness in representation refers to the capability of the public to align the incentives of policy makers with its broad interests (Castanheira and Esfahani, 2001). As Cherkaoui and Ben Ali (2003) observe, in that sense it can be discussed in terms of electoral rules in developed democratic societies but it might not have the same meaning in the developing world. Even in the Moroccan case where multiparty system has a long history it is difficult to see that the change in the electoral rule would in and by itself change significantly the degree of competition among political parties. This is because after independence, the electoral process was designed in such a way as to insure control by the central power. Political parties faced very limited competition and this restricted their willingness and ability to respond to the public broad interests. Furthermore, the alliances of a relatively limited number of families and tribes have for the most part dominated the political landscape in Morocco (see Douichi, 2005b). In addition, the lack of transparency in government decisions and the monopoly it maintained on information meant that no real counter power emerged. The press did not enjoy full freedom and was hampered by high levels of illiteracy in the population.

All these factors significantly limited representation effectiveness. While the new 1996 constitution led to the participation of the *Koutla* (opposition parties' grouping) in government, the hegemony of the Ministry of the Interior was preserved. For the September 2002 elections, 26 parties presented candidates. Of these, 11 were created in 2001 and 2002. The large number of parties can be attributed to the neutralization strategy of the monarchy, but also to a lack of internal promotion, and regional and generational considerations. However, it is likely that the growing strength of civil society, the reduction of the voting age and the transparency of the 2002 elections will increase representation effectiveness by the wider public (Cherkaoui and Ben Ali, 2003).

This does not mean that other interests were not represented. Indeed, associations and interest groups have played an important role in shaping the Moroccan economic policies in the last decades. The policies adopted were often biased toward the interests of large landowners because these have been more organized and better able to defend their interests when compared to small land owners - even though they are an overwhelming majority in terms of numbers.[10] The divergence between the representation of small and large landowners may explain in part some agricultural policy choices of the last decades in favor of irrigated agriculture when dry agriculture has not received as much attention. It may also in part explain the tax amnesty in favor of agricultural production and the subsidies given to this sector, as noted above. It is only recently in the 2000-2004 social and economic development plan that a more global approach to rural development including the reduction of poverty, the improvement of the living conditions of the rural population, the diversification of economic activity, the preservation of natural resources, and the improvement of competitiveness has been developed (Cherkaoui and Ben Ali, 2003).

[10] The agriculture census conducted in 1996 identifies 1.5 million farms of which 71% have less than 5 hectares and 0.2% have more than 100 hectares. The farms of more than 100 hectares represent 8.7% of the useful agricultural land. Of the 1.5 million farmers, 81% are illiterate. Only 50% use fertilizers, 16% selected seeds and 33% pesticides (Annuaire Statistique du Maroc, 1999 cited in Cherkaoui and Ben Ali (2003)).

At the level of industrial sector, Cherkaoui and Ben Ali (2003) also find a predominance of large enterprise in terms of their ability to influence policy makers.[11] There is an association of small and medium enterprises in Morocco but it is not as influential as the one comprised of large companies.[12] The historical development of the Moroccan bourgeoisie influenced the ability of large companies to defend their interests and influence policy makers. After independence the participation of Moroccan firms in the manufacturing sector was very small. This led in 1973 to the Moroccanization program, which required that at least Moroccan nationals own at least 50 percent of the Moroccan firms. A minority of capitalist families gained control over more than 60 percent of the capital involved. This fostered an economic and financial concentration of private capital in the hand of a small number of Moroccan families.[13] While this capital may today be distributed among more actors, it is clear that the connection of interests between a private sector oligarchy and the administration in the past led to the adoption of policies often in favor of large enterprises. Today, it could be argued that banking reforms are producing private banking oligopolies and autonomous business groups that will demand political pluralism (Clement Henry cited in Dillman, 2001).

Coordination

As Castanheira and Esfahani (2001) point out, the efficiency and growth capability of a given economy depends in part on its ability to coordinate various activities in order to maximize the value of its resources and on its strength in motivating economic agents to achieve this potential outcome. In Morocco, coordination regarding specific issues among different parties is done through the establishment of large committees where a number of representatives of associations and unions are represented.[14] At this level, problems in coordination result from the fact that the role and functions of each body are not clearly identified which often leads to struggle among them as to who should take the lead dealing with a specific issue. For example, until 2002, the question of coordination has for a long time delayed the establishment of a “one-stop shops” for investors (Cherkaoui and Ben Ali, 2003).

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[11] Mateus’s study (1988, cited in Al-Arkoubi and McCourt, 2004) shows that representation does not necessarily imply taxation (see Cobham, 2005: 2): In his examination of the tax files for ninety large firms, Mateus found that they used a blend of three techniques to minimize their exposure to high nominal tax rates. Mateus estimated that companies successfully reduced their tax liabilities by DH3.8 billion in 1986, or approximately 14 percent of total revenue. Moreover, while officials carried out few audits, they did, however, reveal the existence of massive fraud: for the 129 audits carried out in 1984, the audited tax base was nearly three times as large as the declared base. Finally, enforcement was extremely weak in Morocco. While as much as 80 percent of total labor income was included in the income tax net, as much as 80 percent of total capital income had managed to elude that net. He concludes that large chunks of business-related capital income and the incomes earned by self-employed professionals effectively escaped income taxation because of weak tax administration.

[12] The business associations are organized along industry lines and brought together under large associations. They are able to defend their interests through various channels. First the important business organizations publish a bulletin and use the local newspapers. They also meet regularly with the ministers in charge of economic affairs and industry, e.g. ASMEX (the exporters association) would meet with the Ministry of trade to express the views of the exporters. Finally they have access to high officials through social and familial connections (Cherkaoui and Ben Ali, 2003).

[13] Indeed, a study in 1978 showed that the 58 richest families controlled a quarter of all the private capital invested in the Moroccan industry (Clément 1986).

[14] As indicated above, recent governments have been coalitions drawn from the plethora of political parties, with all the problems of agreeing a common program that bedevil coalitions everywhere (Al-Arkoubi and McCourt, 2004).

Coordination problems are most apparent during budget preparations. Apart from a host of other problems,[15] coordination problems arise from the fact that line agencies do not participate in the planning process. Instead, to achieve coordination, the Moroccan budget uses both ex-ante agreements among cabinet ministers and delegation of responsibility to the Ministry of Finance (MoF) for the design and implementation of the budget. The MoF holds bilateral negotiations with other ministries but usually its view dominates. This is reinforced by the fact that information is most often lacking, and that the legislature cannot make changes that would either increase or decrease the deficit (Cherkaoui, 2001). Hence, coordination among ministries is constrained by the centralized nature of information and power (notably in the MoF and the Ministry of the Interior), and the large number of ministries (34), many of which are 'empty shells' and created to satisfy the political demands of the many new parties (Douichi, 2005). A related issue is the deep-seated inclination of political actors to hold the ring between opposing factions rather than to initiate actions, with the related clientelistic preference for keeping every option open without committing oneself irrevocably to any one (Al-Arkoubi and McCourt, 2004).

Commitment

As Castanheira and Esfahani (2001) state, we should expect to observe sub-optimally low growth in countries where the government cannot commit to follow its announced policies. In Morocco, the support of late King Hassan II to the trade and economic liberalization of the early 1980's played an important role in insuring commitment to these reforms despite the reluctance of various interest groups (Cherkaoui and Ben Ali, 2003). The January 1984 riots were triggered by rumours that the official proposals (made at the end of December 1983) to increase the price of basic commodities, including food, were going to be implemented. The social unrest was a response to the fact that reforms ignored some basic realities, namely that food items, particularly bread, do not only have an economic (consumption) value but they play a cultural role as well, especially for the low-income groups (Addison and Baliamoune-Lutz, 2003). Nevertheless, in the face of IMF pressure to adopt a rapid approach to reform, the Moroccan side entertained a wide range of opinions across government, and even the IMF came to admit that the gradual pace of the reform program that emerged and the care taken to address the public's anxieties contributed to its success (Al-Arkoubi and McCourt, 2004).

Commitment problems can be addressed by fixing major elements of reforms into laws (e.g. trade and privatization law), international agreements (e.g. free trade association agreement with Europe) and constitutional clauses. This significantly reduces the risk of policy reversal and time inconsistency. However, within this framework it is still sometimes possible to delay or circumvent the reforms by not putting sufficient efforts in their efficient implementation (Cherkaoui and Ben Ali, 2003).

[15] To do with fiscal discipline, accountability and the lack of sanctions, which make the budget sensitive to political pressures to overspend, especially on the wage expenditure front. This is in turn due to the power of Morocco's three trade unions who in 2001 were able to negotiate a 10 percent increase in the minimum wage and a significant boost in remunerations in the public sector, despite low inflation and tight budget constraints (Agénor and El Aynaoui, 2003). As in other countries, the budget is also very sensitive to fluctuations in the price of oil and to variations in international interest rates. Moreover, in Morocco, the use of cost benefit analysis in programs assessment is very rare, and the national development plan decisions are only indicative (Cherkaoui, 2001).

This point is well illustrated by the adoption of the new trade policy. While it was detrimental to the industries based on import substitution, a large number of industries were hindered in their growth because of the unavailability of imported inputs. Furthermore, exporting firms and large land owners exporting citrus fruits and other agricultural products wanted to take advantage of the proximity to Europe. The latter were also interested in getting inputs (such as tractors and seeds) at lower prices. More importantly, their professional association informed the large enterprises of the new policies and they probably had sufficient time to adjust their portfolio to take upcoming changes into account (Cherkaoui and Ben Ali, 2003).

Nevertheless, the new trade policy went against the interest of many employees of the administration who perceived their position as an important source of rents coming from the granting of licenses and "special" exemptions from import duties. This was thanks to the fact that the Moroccan economy is relatively well endowed with natural resources. There is a good agricultural land, important phosphate reserves and minerals, a great tourism potential as well as significant fisheries resources.[16] At the same time it was easy to justify their positions against free trade on the basis of the possible decline of tariff revenues (representing some 25 percent of current expenditures in the early 1980s) and the need for reducing the budget deficit (Cherkaoui and Ben Ali, 2003).[17]

Herein lies a strong explanation for Morocco's slow growth - rent seeking activities by interests groups arguably leads to a lack of competition for some major domestic industries. In other words, the existence of these rents tends to direct the public resources to these sectors and divert them away from more growth inducing sectors. The profit expectations of rent seekers are slow to adjust as they adopt a defensive attitude to keep their privilege for as long as possible. Since rent seekers includes politicians who distribute rents to secure their power, the most desirable economic policies become those that are susceptible to allow rent extraction (Cherkaoui and Ben Ali, 2003).

However, liberalization of the economy does not necessarily result in the reduction or suppression of rents as the state can continue to control the polity through rent distribution despite liberalization (Cherkaoui and Ben Ali, 2003).[18] Apart from the

[16] Sewell and Thirsk (1997) note that in the mid-1970s, the price of phosphate rock, a major export that accounted for roughly one-third of export revenues, more than tripled. As a result, the economy grew unusually rapidly in 1975 and 1976. Government revenue, especially transfers from the state-owned phosphate monopoly, also grew quickly and allowed the government to embark on an ambitious new expenditure program that involved higher levels of both investment and current spending. Concurrently, the Saharan War brought about a large buildup in military spending. Unfortunately, the export boom did not last long. Even if it had continued for longer, it could not have sustained the enormous concurrent increase in government expenditure and debt.

[17] Interestingly, the reduction in trade tariffs did not affect revenues significantly. Indeed, not only did it force the government to undertake a long-overdue customs administration reform, but revenue from import taxes and duties has remained stable since 1998 despite progressive tariff reductions (particularly on imports from the EU). The revenue reduction was offset by a rise in value added tax revenue from imports thanks to increased commercial activity, so that customs revenue remained a constant proportion of overall budget resources, around 46 percent or slightly more, from 1998 through 2002 (Steenlandt, and De Wulf (2004). However, Martín (2004) points out that each additional year of tariff dismantling until 2012 will cause an extra Euro 50 million of tariff revenue loss for Morocco. He calculates that in order to compensate for this loss with an increase in VAT receipts, the latter should grow at a rate of 2.9% each year up to 2012.

[18] Schlumberger (2000) states that 'since material gains and rewards are more likely to be achieved by loyalty and personal contacts or friendship than by productivity, rational micro economic behavior

gains from privatization, which will be discussed in a moment, this can also take the form of tax exemptions (see above on agriculture). As Mateus (cited in Al-Arkoubi and McCourt, 2004) concludes, while acknowledging how far the tax system has moved toward simplification and more uniform treatment of all taxpayers since passage of the 1984 Framework Law, perhaps the tax system's most striking feature remains the number of instances in which it singles out particular sectors of the economy for special treatment.[19] Yet another form of rent extraction happens on an individual basis: A recent survey concluded that there are 80,000 'phantom' civil servants in the Moroccan administration, i.e. persons who do not appear to be working but are receiving government salaries (Chaoui, 2005).

In terms of the liberalization of the private sector, Dillman (2001) found that incumbent elites in North Africa can forestall democratisation by a selective engagement with global markets that maintains distributional coalitions and co-opts a largely dependent domestic private sector. Furthermore, he notes that the more regimes 'deregulate', the more they 're-regulate' by determining precisely who can most easily benefit from change and join distributional coalitions to tap profits in the market. For example, in Morocco, some 30 large families tied personally to King Hassan were said to be the chief beneficiaries of liberalization in the late 1980s. Moreover, cannabis and hashish have become the country's most valuable export items, bringing in an estimated $3 billion a year. It is ironic to note that this important 'private sector' activity in which high public officials are accused of being involved has thrived in the free market environment into which Morocco has thrown itself.

At the same time, privatisation does not necessarily increase competition; in most North African countries, privatised assets have often been sold below market value to small groups of investors, increasing their oligarchic control of markets.[20] Engaging the market this ways has less to do with generating efficiency than picking winners and loosers. However, Dillman notes that Morocco has been one of most successful privatizers in the region.[21] The extent to which liberalization has had the impact of reducing control over the rent and inducing a greater reliance on a merit-based system still needs to be fully evaluated (Cherkaoui and Ben Ali, 2003).

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does include the principle of maximizing gains as is assumed in classical economics, but gains are not necessarily, and not even primarily, realized through successful competition in an open market'.

[19] See Cobham (2005:11) for trends in Morocco's taxation levels up to 1999. According to Ageniou (2004) since 1999, direct taxes such as the taxes on revenues and companies are progressing the most. Citing estimates by the Ministry of Finance, in 2004, direct taxes amounted to 36bn Dirhams while indirect taxes contributed 34bn Dirham whereof 25bn of VAT (domestic and those on imports).

[20] Speaking of the Arab state in general, Ayubi (cited in Younis, 1996) notes that actual privatizations remain rather limited and the Arab state is not about to withdraw from the economy. Privatization is still basically a public policy that is pursued by the state with reluctance and for its own purposes; it has not yet become a dynamic process whose initiative is taken by the private sector itself. If the private sector is gaining it is not because of its initiative, drive and organization; rather, it is mainly because the state can no longer continue with its étatiste and welfare policies at the same time. In other words, the private sector may end up growing "by default" so to speak.

[21] From 1993 to 1998, privatisation had garnered $1.9 billion for the government (Dillman, 2001). Cohen (2003) notes that , foreign investment - responding in part to the privatization of state-owned enterprises (SOEs) in utilities, infrastructure, telecommunications, and derivative industries of natural resources - has risen dramatically over recent years, reaching $1.2 billion in 1997, four times the 1996 figure, and 3.5 percent of GDP. However, foreign direct investment dropped in 1998 to 1.6 percent of GDP, but jumped again in 1999 to 5.4 percent, probably reflecting the large one-off sales of the most profitable SOEs.

III. Explaining Morocco's poor social development indicators

This paper now turns to the second question stated at the beginning, i.e. the causes behind Morocco's disappointing social development indicators compared to other middle-income countries. The situation can partly be explained by referring to the issues of representation, co-ordination and commitment (and especially the discussion on rents within the latter) discussed above, all of which mean that available resources are distributed overwhelmingly in favor of the privileged classes.

A second factor is the investment in human capital (see Román-Zozaya, 2005). Indeed, this element might also in part explain the sources of differences between the growth experiences of South Asia and Morocco. The former, having invested heavily and efficiently in building its human capital, was able to enter the virtuous circle of more human capital inducing stronger institutions, themselves calling for more investment in human capital. In contrast, Morocco's investment in education was always important as a share of GDP but was not efficient enough. [22] Moreover, while education reforms often called for the use of Arabic instead of French based on nationalistic rhetoric, they were not successful in improving the quality of education. In fact the elimination in 1983 of compulsory French instruction led to an important decrease in the returns to schooling (Cherkaoui and Ben Ali, 2003).

Thirdly, the big urban/rural divide that was noted at the beginning can be explained by the nature of past public provision of services, which was uneven and long focused on urban areas. This is because along with other functions, responsibility for rural infrastructure was decentralized to *communes* (municipalities) in 1976, yet no provision for financing was made at the time. Richer *communes* are likely to have better provided for their populations. As communes generally lack investment budgets, little investment occurred until the 1990s when the state woke up to the extent of the rural infrastructure problem. Since then, there has been a concerted effort to remedy the situation through new national programs to more widely provide electricity (PERG), water (PAGER), and rural roads (PNCRR). A poor area development program begun in 1996— BAJ1 — has focused on basic health, education and infrastructure investments in 14 targeted poor provinces. However, practically nothing is known about the impact of these programs, let alone their incidence or even their beneficiaries. Much of the data necessary to assess these issues at the household level are simply not available (Van de Walle, 2005).

A recent World Bank Working Paper on Morocco (Van de Walle, 2005)[23] has used a new technique to overcome these data constraints, and examines to what extent public policy programs have been pro-poor in their targeting.[24] Using a province-level

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[22] See also Laframboise and Trumbic (2003:24-25), who conclude that the weak performance in female social indicators in the MENA region, particularly in the area of education, is not explained by the amount of government spending, but rather must be attributed to the effectiveness of existing spending, including issues such as access, availability, efficiency, allocation, and targeting.
[23] For which the author was involved in the data collection.
[24] The findings in Van de Walle (2005) are based on a methodology developed by Ravallion, measuring targeting performance by exploiting the spatial variances in both program spending and poverty incidence across regions. The inter-regional targeting differential is estimated by regressing program allocations across regions on the regional poverty measure. Van de Walle (2005) stresses that the results reported in her paper must be seen as preliminary and only indicative of likely targeting performance. They need to be rigorously investigated and assessed using household level information on program participation.

database,[25] it shows that of all the spending programs reviewed, a majority are estimated to significantly benefit both the rural poor and the urban non-poor, i.e. neglecting the urban poor. For example, the results suggest that the health ministry's 1997/98 (net of salaries) allocations across provinces were biased against poorer areas. Equally, the PAGER rural potable water investment program for which two years of data (1995 and 2002) are available reveals a lack of pro-poor targeting and there are no signs of improvements in targeting over time. Similarly, the budgets allocated to NGO literacy or poverty programs do not appear to be targeted to the poor.[26] However, the inter-provincial distribution of the total Ministry of Education budget of 2001 (also net of salaries) show considerable signs of pro-poor targeting. The analysis also revealed evidence of impressive progress in primary and secondary school enrolments for the poor as well as for poor girls since 1994. However, here too, the gains are found to have been concentrated on the rural poor while the urban poor appear not to have particularly benefited. Of course, the paper is unable to say whether increases in school enrolments have translated into improved school outcomes such as test scores, grade completion, literacy and skills. There are also hints that the newly implemented demand-driven Social Development Agency (ADS) is successfully targeting poor people, though the statistical evidence is not conclusive.

Van de Walle (2005) explains her main finding, i.e. that while targeting is pro-poor in rural provinces, it is often pro-non-poor in urban areas for the same programs, by referring – among other factors – to a political economy imperative of leaking some benefits to urban elites whose taxes most likely fund many programs in order to concentrate the rest of the benefits on the poorest of the poor - those in rural Morocco. The discussion in the first part of the paper seems to support this view.

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[25] The database includes public expenditure data to measure differences in service provisioning, but it also includes other factors which play a role in the geographic disparities in living standards, such as local characteristics including terrain, isolation, soil quality, access to water, agricultural and growth potential, and vulnerability to drought and other climatic shocks. Population characteristics such as cultural norms, the status of women, the degree of community solidarity and whether households are spread out or live clustered together will also play a role (Van de Walle, 2005).

[26] However, it is important to note that allocations are influenced by considerations other than a province's incidence of poverty. For example, literacy programs may put more weight on the illiteracy rate in deciding where to distribute their resources. Programs may spend more in more urbanized areas where access and implementation is easier. Rural poverty in Morocco is related to rainfall and the risk of drought. Thus the average amount of rainfall in a province may well affect the distribution of spending on poverty programs. Indeed, consistently across programs, one finds that higher rainfall reduced the amounts going the non-poor. A high province level literacy rate tends to positively affect the amount of the 2001 Education budget allocated to the poor while reducing that going to the non-poor. This is consistent with a possible political response to demand on the part of more educated poor (Van de Walle, 2005).

IV. Policy recommendations and conclusions

Reform of the tax system: As noted above, mainly for political reasons, tax exemptions for important sectors of the economy continue to be applied. In addition, Ageniou (2004) points out that the tax base is very narrow, given that company taxes are levied on only 88 375 companies and income taxes on 2.66 million taxpayers, mainly government-wage earners (more than half of all formal sector jobs are in the public sector). This is combined with a growing informal sector. According to the Statistics Directorate, the informal sector (not including the agricultural sector) in 1999-2000 had a turnover of 166bn Dirham by 1,2 million enterprises, sustaining 18 percent of the total number of households in Morocco. Apart from the need to bring these businesses into the formal economy, Ageniou and others have emphasized the need to increase the efficiency of VAT collection. Citing a recent IMF study, 49 percent of final household consumption is exonerated from VAT. This means a loss of a tax base of 130bn Dirhams, and 26bn Dirhams in lost tax revenue, if applying the most frequently applied VAT rate of 20 percent. Another reason for the inefficiency of VAT collection are its multiple rates of 20, 14, 10 and 7 percent. Following Lebanon's policy (since 2002) of applying a single VAT rate of 10 percent, for example, would be more efficient.

Greater redistribution of tax revenues to benefit the poor and easier access to credit: As Cobham (2005:iii) points out, human poverty in middle-income countries such as Morocco has more to do with income inequality than with low income levels *per se*. Policy makers should therefore consider cash transfers as a means to redistribute incomes and alleviate poverty, especially among the urban poor, but also the rural poor who will be the most affected by increased trade liberalization in agriculture. This presupposes better data at the household level to assess the cost-effectiveness of existing poverty and social programs (such as Entraide Nationale, Promotion Nationale, and the BAJ Social Priorities Programs, see World Bank, 2002 for details) and to feed into policy reform (Van de Walle, 2005). Valuable lessons could be learned from Mexico's rural income support programs such as *Progresa/Oportunidades* and *Alianza para el campo* designed to mitigate the effects of NAFTA. An even more important measure, but politically not very feasible, would be to redistribute agricultural lands (and/or change inheritance laws which lead to ever smaller sizes of plots) so that the small landowners could benefit from economies of scale, modern production systems, and increased collateral for access to credits. Currently, access to financial services for the poor is limited, as micro-finance institutions serve only a small fraction of the demand for services from the low-income population, and cannot offer deposits or savings products – see World Bank (2003), El Khezzari (2005) and Benjamaa (2005).

Selective decentralization of decision-making in public expenditure and greater coordination among development actors: With an expanded tax base and hence greater tax revenues, and a greater commitment to a policy of cash transfers, the main issue then becomes one of clearly defining the responsibilities of the central, regional, provincial, and municipal levels with regard to social development spending. At the moment the important decisions are still taken at the central level, despite recent formal changes (e.g. adoption of a new municipal charter in 2002). The fact that local governments have a very limited visibility in terms of the following year's budget means that it is often not allocated in an efficient way or addressing local needs (Cherkaoui, 2001). Nevertheless, the superior local knowledge of municipalities and communities about local conditions should be used to improve targeting to households.

This implies that communities must be given discretionary power to allocate benefits. But as Pritchett (2005: 24) points out, this discretion could either lead to superior targeting or to elite capture, or to community pressures for more "spreading" of the benefits. Hence, government agencies and donors working on governance issues and local capacity building in Morocco (e.g. USAID) should take into account that social institutions and the political power structure are major conditions that determine the impact of decentralization on poverty reduction (Jütting et al., 2004).

Moreover, the multiplicity of actors on the development arena (not only 'vertically, i.e. from central to local levels, but also 'horizontally', e.g. the new Social Development Agency and the Ministry of Social Development, Family and Solidarity as well as many other Ministries and countless bilateral and multilateral donor projects) requires much stronger coordination and sharing of information to avoid the concentration of resources on specific 'trendy' but not necessarily most needy regions (such as the Souss-Massa-Draa region).

Reform of the public sector: While past attempts at public sector reform have correctly identified problems and solutions (i.e. reduce corruption, rationalize public expenditures, increase transparency and strengthen the rule of law), they have received little application due to the constraints identified above. The recently signed EU-World Bank public administration reform loan is mainly aimed at curbing the expanding wage bill.[27]

Job creation through increased investment… : While the above cited measures are necessary, they should not distract from the fact that incentives for more private domestic and foreign investment are needed to create employment opportunities and hence lead to economic growth. This could be achieved by reinforcing current efforts to elaborate regional growth strategies according to the regions' comparative advantages. This would stimulate competition for private investment among regions.

… and improved human capital development: In terms of human capital development, apart from the difficulties involved in making primary education generally available, the education system also suffers from the lack of a clear policy on language, and this has a very negative effect on the quality of state education. Thus it is both urgent and necessary to start reforming the education system, giving absolute priority to widespread availability of quality basic education equipping each pupil with the same language skills (Bougroum and Ibourk, 2003).

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In light of the above discussion and recommendations, it seems that the first step for policy makers should really be to reframe taxation, public sector, and institutional reforms in political rather than management terms, i.e. as overcoming entrenched positions due to long-standing privileges which present representation and coordination arrangements entail. This would permit the development of (objective) targeting mechanisms that would ensure that public expenditures reach the most needy. Such a reframing of the issues would also start to address more realistically how the big urban-rural inequality divide could be overcome in a socially sustainable way.

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[27] In 2004, the wage bill accounted for 12,5% of GDP and this will grow to 12,8% this year, making it the highest proportion ever.

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This OCGG Economy Analysis is part of a series of publications stemming from the OCGG Economy Section's Development and Fiscal Policy project, by early career-stage researchers currently studying and working at leading universities around the world. The central theme is the reassessment of fiscal policy priorities in development.

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