Morocco's Growth Strategy in an Evolving International Environment

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Key Messages

- The goal of a more developed macroeconomic strategy would be for Morocco to accelerate the transition to the top of the world technology frontier, in order to better position itself in global value chains.

- Morocco's strategy should aim to promote growth and employment, as this could lead to better leverage in the new international environment

- Morocco is at a crucial stage in its evolution, as it is in a position to adapt, and to become a leader in economic transformation

Introduction

Morocco's GDP growth has increased over the past three decades, mainly as a direct consequence of the expansion of domestic demand, triggered by an increase in both government-initiated public investment and minimum wage. However, this growth strategy has its limitations, leading to a push for an integrated approach to economic growth and employment that incorporates a quantitative macroeconomic model. The Moroccan economy's resilience in light of the global financial crisis and its resulting international difficulties should be highlighted. Nonetheless a more developed macroeconomic policy framework is needed to address several issues related to the process of financial globalization and more open trade. Morocco should aim to accelerate its transition to the top of the global technology frontier in order to better position itself in global value chains.

Growth Strategy Rationale

The Moroccan economy is at a crucial stage in its evolution for three reasons. The first looks at the shifting international division of labor due to changing power dynamics. This includes the possibility of a moderate growth trap, where Morocco would be caught between rapidly-growing low income countries and middle-income countries, potentially proving problematic for the country's role in the region. Strategically, Morocco's goal would be to use the new international division of labor to overcome the growth trap. Furthermore, in light of a series of structural problems with unfavorable medium-term growth prospects, close trade and financial ties between Morocco and Europe are an important strategic drawback. This, in addition to China's heavy investment in Sub-Saharan Africa, contributes to a redirection of Morocco's attention towards the South, which may help the country eliminate the growth trap.

The second impetus for a new economic strategy is the fact that growth has been decelerating since 2010 due to increasing macroeconomic imbalances, overvaluation of the real exchange rate, rising labor costs, and limited improvement in workface quality. This, coupled with the fact that private investment has not increased as expected, may have led to a decreased incentive to invest in activities that would facilitate Morocco's ascension to the top of the technological landscape. The growth strategy's limitations combined with changing real exchange rates have contributed to the deterioration of Morocco's competitiveness and have curbed its ability to diversify

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its exports, while encouraging imports. This leads to account deficits in the short-term and possible deindustrialization in the long-term.

Thirdly, the economic growth was insufficient to absorb the growing labor force, leading to a high unemployment rate. The supply of educated individuals does not correspond to the labor market's demands and as such amplifies the problem.

Transition Strategy

Morocco's strategy should be aimed at promoting growth and employment, as this could lead to better leverage in the new international environment. The strategy has three pillars. First, boosting competitiveness by adopting measures to reduce production costs in labor intensive sectors and improving the labor pool. Second, promoting private investment in productive sectors that would help accelerate the country's transition to the top of the global technology frontier, compete in international markets and better integrate into the global value chain. Lastly, rethinking the role the Government should play in facilitating this transition, particularly in terms of incentivizing private investment.

Quantitative Macroeconomic Model

This integrated strategy for economic growth and employment has been evaluated from a quantitative macroeconomic model, calibrated for Morocco. It takes the following into account: sectors that produce intermediate and final goods; imitation and innovation activities; transformation of unskilled labor into skilled labor; distortions in the labor market; the quality of public investment; the distinction between basic infrastructure and advanced infrastructure; the bidirectional relationship between FDI, economic and quality of human capital; and the degree of enforcement of intellectual property rights associated with innovation. This strategy would help accelerate Morocco's annual trend growth rate from its current rate of about 4% to about 6.2%, creating a net increase of 160.000 to 200.000 jobs a year. The end result would be a near doubling of per capita income over a ten year period.

To achieve these aims, the new framework for economic growth stipulates:

1) A more appropriate composition of public investment spending and a better distribution of capital between the country's regions. This reallocation of infrastructure investment is essential to adjusting production structures.
2) Strengthening policies to promote high-quality education at all levels, with an emphasis on national innovation and rule of law with a focus on key economic areas.
3) Labor market reforms to reduce the cost of labor, eliminate knowledge disparities, and enable the country to better capitalize on the opportunities created by rapid changes in global markets.
4) Specific policies favoring strategic productive sectors, namely agriculture,

manufacturing, phosphates, and renewable energies, that would promote research and innovation, allow more favorable position on the world's technological landscape, and maximize benefits from projected demand growth in these areas.

5) Strengthening the role of the domestic financial sector in the financing of SMEs', production, and innovation activities. This would help accelerate the development of market financing, expand savings and finance the economy.
6) Further liberalization of the capital account and the adoption of a more flexible exchange rate regime in order to reduce imports and help rebalance payments, reestablish cost competitiveness, and facilitate absorption of external shocks.
7) Emphasize regional strategy to capitalize on Morocco's geographical position in the context of the new international division of labor. Morocco should work on promoting a regional integration dynamic that would in time lead to the creation of export markets for high-tech products, eventually leading to increased FDI. This would include relocating the unskilled labor-intensive light manufacturing activities that are modeled after Francophone countries, to Sub-Saharan Africa. This would allow Morocco to take advantage of low labor costs, promote the "upgrading" of the country, and benefit from both an established presence in a number of sectors and a common cultural heritage to face competition from China.
8) The adoption of monetary, fiscal, and macroprudential policies that contribute to adapting and strengthening the macroeconomic policy framework's ability to mitigate growth rate fluctuations, keep current and anticipated inflation rates stable, and reduce the procyclicality of the financial system. There should also be closer coordination between monetary and fiscal policies, to foster a more credible framework.

Bottom Line

Morocco is at a crucial stage in its evolution, as it is in a position to adapt and even become a leader in economic transformation. International challenges provide Morocco with the opportunity to reformulate its macroeconomic strategy in order to spur substantial economic growth. This would refocus Morocco's attention southward, enabling it to take advantage of its strategic geographic location and geopolitical stance. The quantitative macroeconomic model illustrates how such a strategy would enable Morocco to pursue economic and human development; improve access to basic infrastructure; increase life expectancy; reduce poverty and vulnerability; and keep inflation at relatively low levels.