ERF Policy Brief

Morocco — Beyond Debt: Sustainable Pathways to Higher Growth

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In a nutshell

- *A rising debt scenario poses significant dangers to the Moroccan economy's long-term stability. This materializes in a situation where growth revenues will be doomed to finance the interest bill rather than productive investments, further reducing growth prospects and leaving future generations to bear the consequences of unsustainable fiscal policies.*
- *As a primary measure, the government should capitalize on the significant potential for "efficient tax collection" to restore fiscal adjustment. Despite relatively high tax pressure, the actual revenue mobilization falls short of its full potential, mainly because of a limited fiscal base. It is crucial, however, that any reform adheres to the principles of equity, as the burden of taxation does not weigh evenly on economic agents. The equity dimension of the reform can yield potential benefits for the economy and enhance growth in the long term.*
- *To create a favorable budgetary environment and strengthen fiscal management, adopting a fiscal rule may be an essential prerequisite for Morocco in the medium term. Such a reform will enhance the credibility of the fiscal framework, limit deviations from a sustainable debt path, and anchor economic agents' expectations, paving the way for more effective fiscal policies and sustainable economic growth.*
- *The prevailing belief is that achieving debt reduction objectives primarily stems from fostering economic growth. The Moroccan government should not rely solely on fiscal management measures; rather, it should focus on comprehensive growth-enhancing reforms, as outlined in the New Development Model Report. This national program could be the country's main development roadmap to reach a higher growth path that would enable the country to grow out of debt.*

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Introduction

Like many emerging and developing economies, Morocco has experienced a significant increase in public debt since the COVID-19 pandemic. Central government debt reached 69.6 percent of GDP in 2022, up from 60.3 percent in 2019, and overall public debt increased to 82.5 percent of GDP in 2022, well above the presumed critical threshold of 60 percent. Therefore, it becomes crucial to conduct a comprehensive debt sustainability analysis (DSA) that extends beyond a simplistic rule-of-thumb assessment to consider several factors, such as the level and structure of debt, the GDP growth rate, the primary fiscal balance, the real interest rate, and the exchange rate.

In the realm of debt management, the conventional approach of bringing debt to sustainable levels has been shown to be insufficient or rather counterproductive. The "trivial solutions" of manipulating financial records, either by expanding revenues or rationalizing expenditures without careful consideration or scrutiny, often produce adverse consequences, thereby undermining economic growth. Ultimately, the paramount concern lies in fostering growth and ensuring that the economic structure generates the necessary resources to repay debts and bolster overall economic well-being. This policy brief delves into these dimensions and draws from the Moroccan experience of surmounting debt burdens and steering the economy toward a path of fiscal stability and prosperity. This policy brief proposes recommendations to address the challenges of public debt sustainability in Morocco. It also draws from the results of an analysis of the debt and its sensitivity through scenarios and simulations. [1]The policy brief is divided into three sections. The first examines the main trends in the Moroccan economy over the past two decades, the second presents a summary of the simulation model results, and the third proposes policy recommendations to address Morocco's debt sustainability challenges.

The Growing Significance of Debt as A Challenge in the Moroccan Economy

The Moroccan economy has experienced contrasting trends over the last two decades, marked by periods of sustained growth and slowdown, as well as internal and external shocks. Despite these difficulties, Morocco has been able to capitalize on its strengths and reforms to position itself as one of the most resilient economies in the North African region.

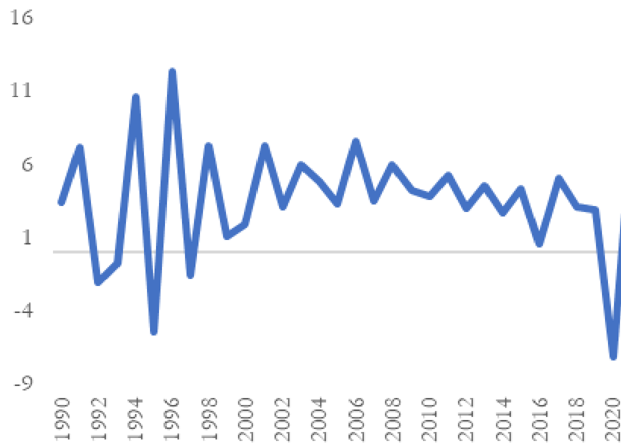
Growth has been driven by various sectors, such as industry and services, which have contributed to the creation of jobs, higher incomes, and improved living conditions. The Moroccan government has implemented sound economic policies aimed at attracting foreign investment, strengthening the country's infrastructure, and promoting innovation and competitiveness (El Aynaoui and Agénor, 2015). These efforts enabled Morocco to undergo a remarkable transformation since the 2000s. The average annual growth was higher (at around five percent) and less volatile between 2000 and 2008 (Figure 1). However, Morocco has faced several shocks that affected its economic growth and social cohesion. The global financial crisis of 2008-09 led to a decline in external demand and a slowdown in economic activity. As a result, the average annual growth rate fell permanently to a lower path, averaging 3.6 percent between 2009 and 2019.

At the same time, political and social upheavals in the Middle East and North Africa (MENA) region have led to social tensions. Although Morocco successfully preserved its political stability, the macroeconomic situation was under severe strain. After two decades of fiscal consolidation bringing fiscal balance to a surplus in 2007 and 2008, the fiscal situation deteriorated again, raising concerns about the trajectory of public finances. The Treasury's financing needs have increased significantly, with the government needing to mobilize financing equivalent to 5.7 percent of GDP on average, peaking at 7.2 percent in 2012 (Figure 2). The good news was the accommodative stance adopted by domestic and global monetary policies, which resulted in a decline in the cost of domestic public debt and easy access to domestic and foreign markets for funding. Nonetheless, real interest rates have remained above the growth rate of the Moroccan economy, particularly in the initial years, therefore requiring additional measures to bring the fiscal deficit under control (Figure 3). The primary deficit, which serves as an indicator of fiscal policy orientation, was brought down from 4.8 percent of GDP in 2012 to 1.4 percent in 2019 thanks to the restructuring of the price subsidy system, marked by the initiation of oil price liberalization and the cuts in the investment budget.

As a result, debt kept rising during the period before stabilizing in 2018. Most of it remains domestic, but there has been an increase in the external share (Figure 4). This is due to the affordable liquidity in the foreign market that enabled the Moroccan economy to strengthen foreign exchange reserves and hedge against the potential collapse of the fixed-exchange regime (Figure 3).

[1] PCNS (2023). Stabilization and Adjustment in MENA region: Proposition for the Moroccan Case Study ERF-FDL project, forthcoming report.

Figure 1. Economic growth rates, 1990-2021 (in %)

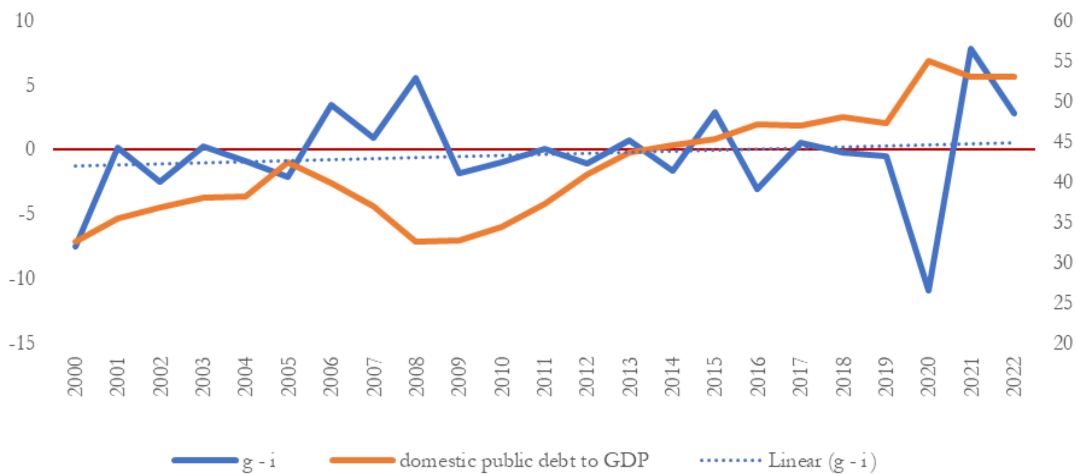


Source: World Bank.

Figure 2. Fiscal balance in % of GDP, 2000-22

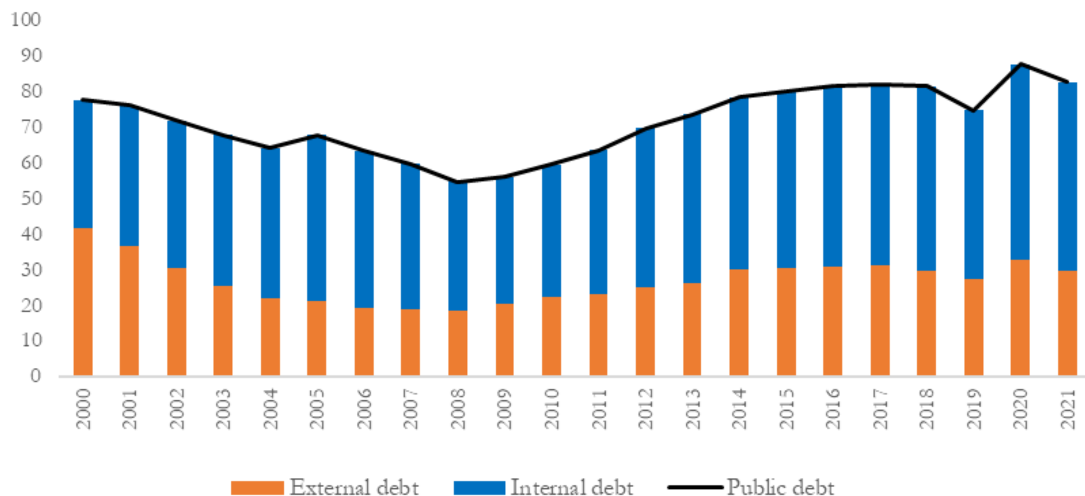
Source: Ministry of Economy and Finance.

Figure 3. GDP growth and real interest rate on domestic debt differential (g – r), 2000-22, in percentage point



Source: Ministry of Economy and Finance.

Figure 4. Public debt, 2000-21, in % of GDP



Source: Bank Al-Maghrib, World Bank, and the International Monetary Fund.

The advent of the COVID-19 pandemic significantly exacerbated the macroeconomic disequilibrium. Economic activity contracted by over 7.2 percent despite the substantial fiscal and monetary stimulus. While tax revenues considerably fell, the public spending lever was activated to cushion the adverse shock. Direct transfers to the poor and vulnerable population have been temporarily allowed on a large scale. The budget deficit deteriorated to 7.1 percent of GDP and the total public debt rose to over 87.5 percent of GDP. On the monetary side, the central bank, Bank Al-Maghrib (BAM), slashed policy rates by 75 basis points between March and June 2020. In addition, the bank fully liberalized reserve requirements, supporting the economy and preserving the country's financial stability. In 2021, the economy managed to revert to the pre-COVID-19 level (World Bank, 2022), as it recorded a growth rate of eight percent. Still, the most prominent legacy was a historically higher level of debt. To cope with the fiscal impact of the pandemic, Morocco implemented a fiscal consolidation strategy aimed at reducing the budget deficit and avoiding an explosion in debt. The triennial budget planning envisaged a scenario where the central government debt is projected to stabilize at around 70 percent and initiate a process of deleveraging by 2024. The importance of restoring the macroeconomic equilibrium by the public authorities is clear, as debt seems to be testing the boundaries of the region of stability.

Two new interrelated dynamics were added to the current context, further complicating the situation. The first one is the soaring inflation worldwide and domestically that brought new challenges for the Moroccan economy. Though eroding debt and the cost of borrowing, it has required the reallocation of additional resources to stabilize the local prices of some basic products, resulting in a surge of total subsidies to three percent of GDP in 2022 instead of 1.7 percent a year earlier. The second one is the monetary response to the soaring inflation, which triggered synchronized worldwide policy monetary tightening, posing new difficulties to the fiscal authorities. Access to foreign markets was constrained, while the domestic cost of borrowing started to rise as BAM tightened monetary policy.

Meanwhile, in the post-COVID-19 era, there appears to be an increasing demand from the population. Citizens are becoming more demanding, particularly when it comes to public services, especially in education and healthcare. The public authorities also must tackle the underlying implications of COVID-19 on social cohesion, poverty, and overall well-being. All these factors necessitate the mobilization of financial resources, which may conflict with the required adjustments.

Is Debt Sustainable? The Results of the Model

In light of these developments, it becomes imperative to address the following question as a primary step: Is the current level of debt sustainable? Additionally, amidst this confluence of challenges, other crucial considerations arise. The most pressing one relates to the so-called arbitrage that fiscal authorities must make between supporting economic growth and restoring macroeconomic stability.

To do so, we run a simple DSA model that borrows from the commonly used framework at international institutions. The Policy Center for the New South (PCNS) has built an accounting framework that captures the key identities of the economy. The model is used to produce projections of debt sustainability based on multiple scenarios. More precisely, we have relied on three different trajectories for the Moroccan economy to assess how public debt would react when financial and macroeconomic undergo a sudden change.

The first trajectory is the baseline and relies on the World Economic Outlook (WEO) October 2022 projections of the International Monetary Fund (IMF) for the main exogenous variables as well as the realized growth and inflation rates, as roughly estimated by the High Commission for Planning (HCP) for 2022. This status quo situation assumes that Morocco will fully recover from the trough of the COVID-19 crisis, as the economy is expected to get back to its decadal growth level, averaging around three percent. Inflation would converge back to two percent in the long and medium term (Table 1). The primary deficit would improve over the next 10 years as a result of a reduction on the expenditure side, triggered by a possible overhaul of food subsidies and an improvement of tax collection that would increase fiscal revenues. The second and third trajectories deliver alternative scenarios, where the Moroccan economy fails to speedily recover from the current slowdown. In one scenario, the recovery to the historical trends is ultimately achieved, albeit at a very sluggish pace, owing to a slow adjustment of prices and the recurrence of droughts over the next five years. In the other scenario, the hypothetical case of a permanent one percentage point, the drop in potential growth is considered as well as the persistence of inflation over the medium term. In both cases, however, we suppose that the primary deficit would decrease.

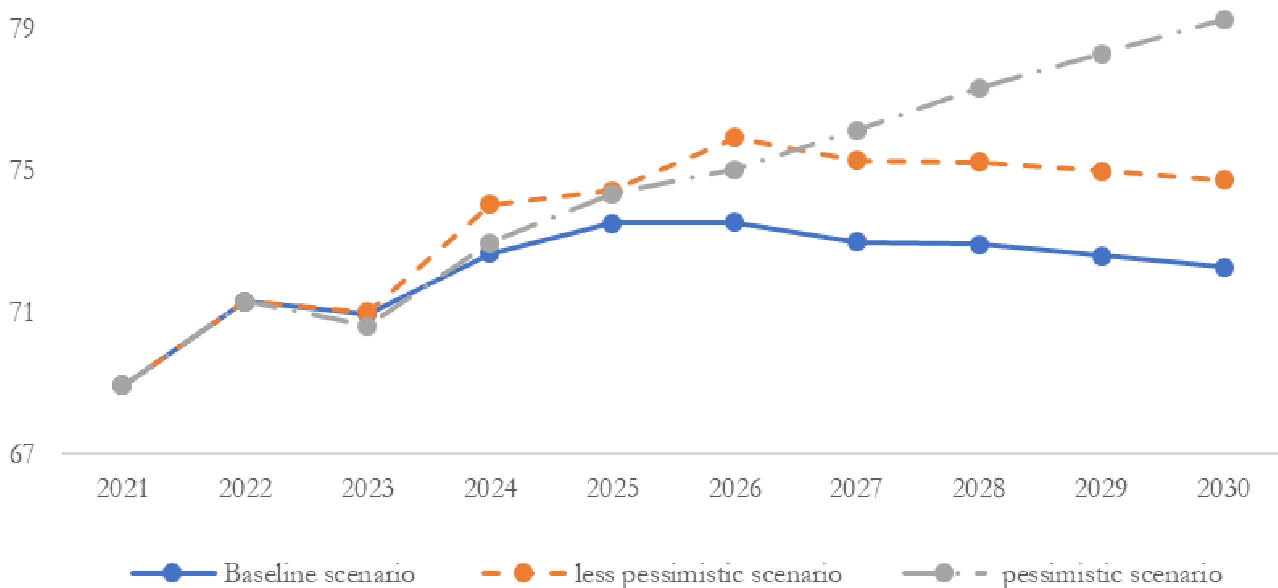
Figure 5 provides the projection of the public debt-to-GDP ratio based on the different trajectories described above. Based on the scenarios described earlier, it can

Table 1. DSA assumptions

	Basic scenario	Less pessimistic scenario	Pessimistic scenario
Real GDP (in %)	Rebound in 2023 and then stabilize at around 3.5 percent.	Deterioration in economic activity to 0.7 percent for two years due to unfavorable weather conditions.	A permanent decline of one percentage point.
Inflation (Morocco)	A fall from around four percent in 2023 to two percent afterward.	Temporary rise by 0.5 percentage points, but back to normal starting from 2024.	Persistently high above three percent.
Interest rates on domestic debt	Gradual increase from 3.7 percent in 2021 to 4.1 percent in 2027.	Increase by 50 basis points in 2023 and 20 basis points on average in the next four years before reverting back to normal.	Rise by an average of 100 basis points over the next two years and stay permanently high.
Interest rates on external debt	The monetary policy tightening will partially and progressively affect the cost of borrowing.	An increase of 75 basis points in 2023, followed by a gradual decrease in 2026.	An increase of 100 basis points is expected over the next two years.
Public expenditure (Interest not included) % GDP*	A gradual fall from 29 percent of GDP in 2021 to 27.2 percent in 2027.	–	–
Budget receipts in % GDP	Gradual increase from 25.1 percent in 2021 to 26.5 percent in 2027.	–	–
Inflation (US)	High inflation with a gradual decline to around two percent from 2024.	–	–
Bilateral nominal exchange rate (US/Morocco)	Depreciation in nominal terms.	–	–

Source: PCNS (2023).
*Notes: * Optimistic forecasts by the IMF and other international institutions support Morocco's MEF baseline scenario for public expenditure and budget receipt. The IMF forecasts a reduction in the budget deficit from 7.1 percent of GDP in 2020 to 4.9 percent of GDP in 2023 and 4.4 percent in 2024. Other international institutions are also positive about the Moroccan economy. Fitch, for example, forecasts that the budget deficit will fall from 5.1 percent of GDP in 2022 to 4.9 percent of GDP in 2023 and 4.4 percent in 2024.*

*Figure 5. Central government debt in % of GDP, in three scenarios**



*Notes: * For an extensive discussion of the scenarios, please refer to PCNS (2023).*

be observed that the model projects a stabilization and consolidation of debt over the chosen time horizon, regardless of whether the economy continues its current trajectory with implemented or imminent reforms (baseline scenario) or faces some challenges due to volatility in the agricultural sector (less pessimistic scenario). This is in line with the result of the IMF's DSA as part of the Article IV consultations and other studies that focused on the Moroccan case. However, under the pessimistic scenario, debt is expected to increase steadily, mostly explained by the permanent fall in GDP growth and tighter financial conditions that lead to higher interest payments (Figure 6).

How to Address Debt Challenges: Focus on Growth-Enhancing Reforms

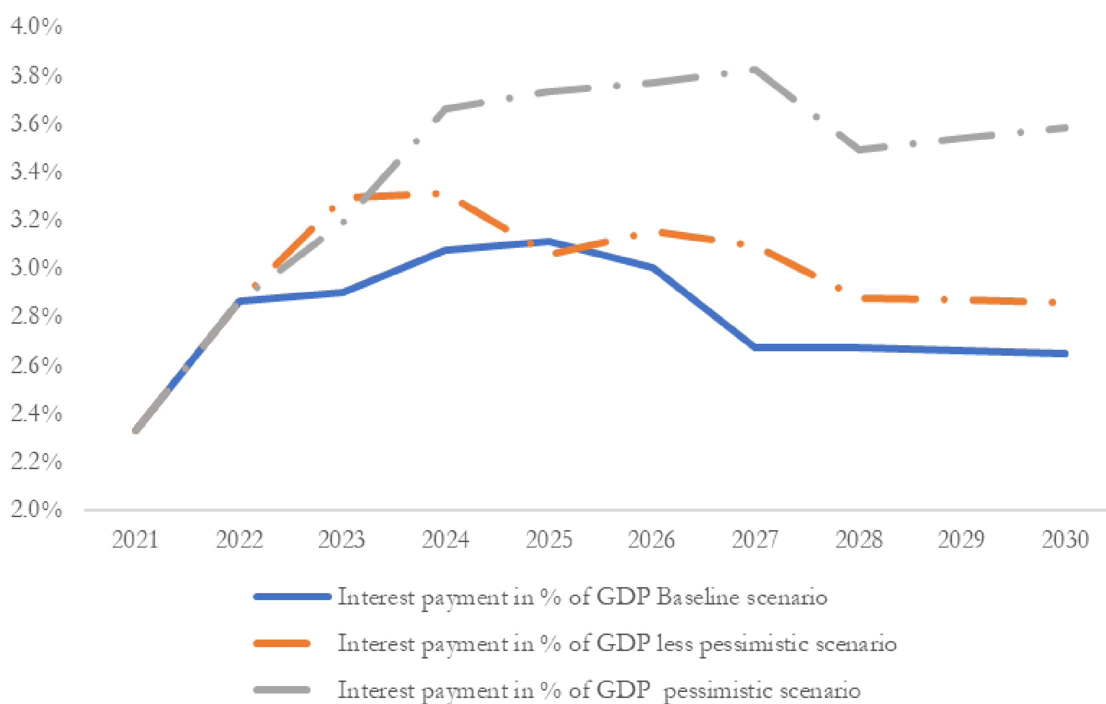
The conducted analysis on debt sustainability reveals that in two out of three scenarios, the debt burden is projected to stabilize, but at elevated levels. Considering this situation, policymakers possess a repertoire of response mechanisms encompassing three distinct elements. Firstly, the simplest (and often the most controversial) way is implementing adjustment measures. Such an approach can exert detrimental consequences on an already sluggish growth, posing significant threats to social stability. Empirical evidence shows that relying solely on rationalizing expenditure for fiscal consolidation results in a negligible effect on debt ratios, while significantly slowing economic growth (IMF, 2023). Secondly, the approach known as the "growing out of debt" strategy encompasses the implementation of a series of structural reforms aimed at enhancing economic growth. This approach serves to effectively tackle debt challenges while fostering long-term fiscal sustainability. It is the most appealing approach as it sets growth and prosperity as the final aim, while the system automatically manages to pay back its debt.

In this endeavor, we advocate for the second approach, which centers around the concept of growing out of debt. In this regard, we draw on the extensive literature addressing public finance reforms in Morocco.

Fiscal management reforms

Fiscal consolidation reforms can be viewed as the prerequisites for creating a favorable budgetary environment that facilitates structural reforms aimed at enabling the Moroccan economy to grow out of debt. This entails enhancing the credibility of the fiscal framework to anchor economic agents' anticipations regarding the evolution of the fiscal and tax policies. A complementary and necessary step is to adopt a numeric objective in the form of fiscal rule (Agénor, 2015). Under such rule, the

Figure 6. Interest payment in % of GDP, in three scenarios



Source: Authors' calculations based on the DSA.

government commits to a path for the evolution of its budget, which limits the margins to deviate away from the sustainable path of public debt.

Moreover, there is an imperative need for implementing fiscal reforms to improve efficiency and promote equity. Morocco needs to accelerate the implementation of a new fiscal framework that will allow for more efficient tax collection. In fact, fiscal revenue mobilization in Morocco remains far from its potential despite relatively high tax pressure due to a narrow fiscal base (Agénor and El Aynaoui, 2015) (Table 2). Revenue mobilization stood at 21.6 percent of GDP according to the IMF, while the tax gap is around 10 percent of GDP.

Table 2. Fiscal revenues potential, 2016

	Tax Revenues Collected (% of GDP)	Tax Revenue Potential (% of GDP)
Corporate Taxes	4.2	5.2
Income Taxes	3.8	4.5
Value-Added Tax	7.4	8.8
Domestic Consumption Tax	2.4	3.1
Customs Duties	0.9	1.1
Tax Revenues	20.8	25

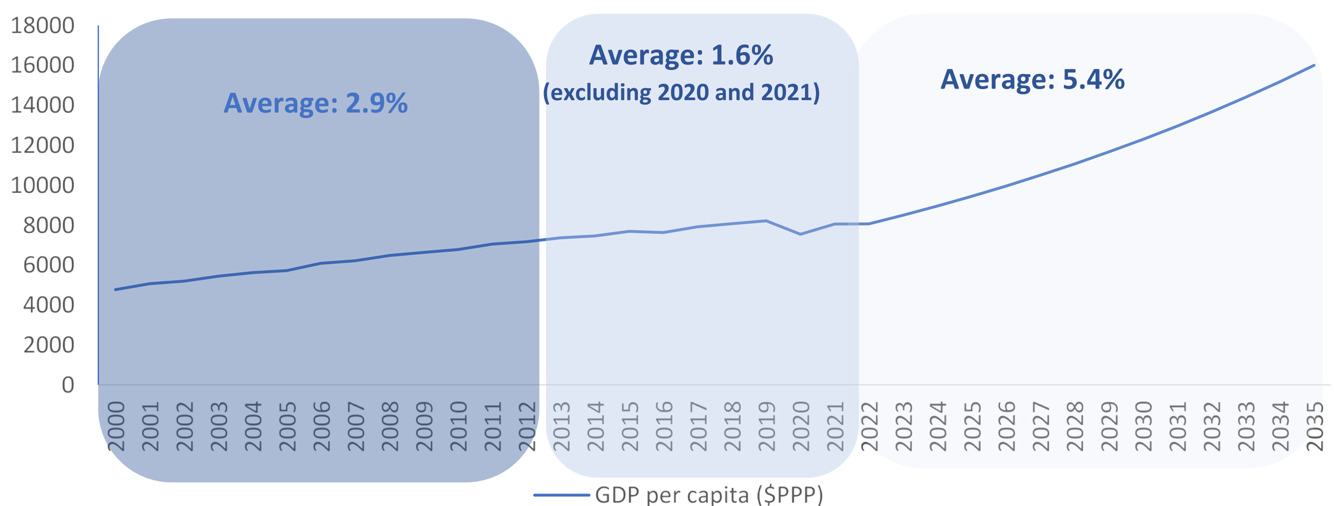
Source: Ministry of Finance (2018).

Growing out of debt reforms

In order for the Moroccan economy to grow out of debt, the primary emphasis should be placed on the implementation of a comprehensive national program that incorporates long-term strategies designed to facilitate economic growth. In the case of Morocco, a thorough examination has been conducted over a period of three years starting from 2019, resulting in the development of a comprehensive solution to address the challenges of a stagnant economy and an economic model that's running out of steam. This solution was presented in the form of a New Development Model, prepared by a multidisciplinary commission of experts, whose mission was to provide a comprehensive roadmap for the country's development in all domains. The commission worked diligently to formulate objective recommendations without any political bias (Table 3).

The different recommendations of the New Development Model are highly applicable within the framework of pursuing public debt reduction objectives. These measures focus on accelerating economic growth to reach an annual rate of more than six percent (Figure 7), enhancing the quality of human capital, strengthening the inclusion and participation of women in the labor market, and improving environmental sustainability. Such ambitious objectives are not meant to be achieved without efficient public expenditure reallocation by

Figure 7. GDP per capita for Morocco, in $PPP, 2000-35



Source: World Bank and NDM projections.

Table 3. Key targeted indicators by the new development model

Economy	2019 or latest available	2035 target	Source
GDP per capita (in $ PPP) (Hypothesis: Average annual growth >6%)	8 062 (2022)	16 000	HCP
GVC participation index (Backward and forward)	43%	60%	OCDE
Medium to high-tech industrial value-added	28%	50%	ONUDI
Human capital			
Human Capital Index	0.5	0.75	WB
Density of healthcare workers per 1,000 population (SDG)	1.65	4.5	MS
Students with basic reading, mathematics, and science skills by age 15	27%	75%	OECD
Inclusiveness			
Female employment rate	22%	45%	HCP
Share of formal employment in total employment	41%	80%	HCP
Gini index	0.395	0.350	HCP
Durability			
Share of desalinated water and treated wastewater in total water consumption	0%	15%	New
Multidimensional Local Development Index (MLDI)	0.7 (national average 2014)	0.85	ONDH
Share of renewable energy in total energy consumption	11%	40%	WB
Governance and administration			
Government Effectiveness Index	-0.12	1	WB
Online Services Index (OSI)	0.52	0.9	UNGS
Citizens' satisfaction with public services	-	80%	New

Source: New Development Model report.

substituting the subsidy system with a targeted transfer system for the lower deciles of the population (World Bank, 2019). The generalized social protection reform is an additional measure aiming at increasing the quality of human capital in Morocco, with significant long-term effects on economic growth and possibly little negative impact on budget balances. The latter is due to the fact that a significant portion of the allocated budget for this reform will consist of absorbing the existing social programs budget, which has demonstrated suboptimal performance, alongside the implementation of a socially cohesive contributory system.

Conclusion

The Moroccan economy has evolved over the last decade under an economic equilibrium that allowed for a sustainable and well-managed trajectory of the public debt. This has concurred to a solid macroeconomic framework. However, in recent years, this model has shown its limits, especially with a multiplicity of shocks, including COVID-19 and the return of inflation as well as the transition toward a lower regime of economic growth. Beyond their long-term impact, these evolutions were also crucial for the sustainability of the macroeconomic balances. An assessment of debt sustainability has shown that public debt is still sustainable but surrounded with potential risks that need to be addressed. Ultimately, avoiding these downsides would require undertaking a series of reforms that go beyond the cosmetic surgeries tackling public finances themselves and set a comprehensive reform agenda with the aim to grow out of debt.

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