PROGRAM INFORMATION DOCUMENT (PID)
APPRAISAL STAGE

October 11, 2015
Report No.: 100295

Operation Name	Second Morocco Inclusive Green Growth Development Policy Loan
Region	Middle East and North Africa
Country	Morocco
Sector	Irrigation and drainage (20%); Energy efficiency in Heat and Power (20%); Urban Transport (20%); Forestry (20%); Crops (20%)
Operation ID	P149747
Lending Instrument	Development Policy Lending (DPL)
Borrower(s)	Kingdom of Morocco
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Date PID Prepared	October 11, 2015
Estimated Date of Appraisal	October 15, 2015
Estimated Date of Board Approval	December 18, 2015
Corporate Review Decision	Following the ROC meeting on October 6, 2015, the decision was taken to proceed with the appraisal of the operation.

I. Country and Sector Background

Country Context. Morocco recently achieved a consolidation of its macroeconomic framework. Public finances continued to improve in 2014 thanks to reduced recurrent expenditures and particularly a substantial cut to the fuel subsidy envelope - a reform supported by the present DPL series. The external position benefited from an improved current account deficit and consolidation of foreign reserves. Morocco's medium-term prospects will continue to depend on a) the continuation of sound macroeconomic management, including a robust fiscal consolidation and acceleration of the pension and tax reforms, but also on b) growth dynamics, which remain dependent on climatic variability due to the continued relevance of the agricultural sector's share of GDP (15 percent) – an area addressed by some of the policy actions supported by the present DPL series.

Further progress in reducing poverty (currently at 9 percent) and vulnerability (17.5 percent) will require higher rates of growth as well as increased attention to the equity dimension of Morocco's development model. The social and political implications of disparities in wealth and social outcomes continue to be of concern to the Government. The bulk of those living under two dollars/day live in rural areas, where the incidence of poverty is three times as high as in urban areas (14.4 percent versus 4.8 percent), and 23.6 percent of rural people live just above the poverty line. This DPL series supported actions contribute to address the limited revenue-generating opportunities and pervasive underemployment characterizing rural areas, and economic effects of natural resource depletion and degradation which the rural poor and vulnerable are notably more exposed to.

Green Growth and Environmental Sustainability. Continued high level of ownership of the Green Growth agenda reflects the continued awareness of the sustainability challenges facing Morocco. Over the last decade Morocco made remarkable progress in achieving poverty-reducing growth whilst taking steps to consolidate the sustainability of its growth model. Since the late 1990s, the environmental sustainability agenda has moved from fringe policy item to national priority. In his 2009 and 2010 Throne Speeches, King Mohammed VI called for comprehensive legislation on environment management, and explicitly set "Green Growth" as a priority for government action. In addition to reinforcing the principles of good governance and protection of individual freedoms and rights, the new 2011 Constitution, through its Art 31, compels the state and its agencies to work towards ensuring equal access to a healthy environment and sustainable development. In May 2012, Morocco signed the *OECD's Declaration on Green Growth* for a socially inclusive and environmentally sound growth, highlighting Morocco's positioning as the MENA country with the firmest commitments to the sustainable development agenda.

The Government is strengthening key aspects of its environmental sustainability framework. In addition to the parliamentary approval of the *Framework Law on Environment and Sustainable Development* in March 2014 (Law 99-12) ─ which sets the rights and obligations of the State for the protection and preservation of the environment and the sustainable use of domestic natural resources ─ the Government finalized its *National Sustainable Development Strategy* (NSDS). The NSDS articulates the country's Green Growth goals – including policy reforms supported by this DPL series – with a view to aligning sectoral strategies along common long-term sustainability objectives. Legislation is underway to regulate investments in sensitive areas such as coastal zones, and to improve existing legislation on critical sectors such as water. Work on natural capital accounting is ongoing in sectors including water and fisheries, following the Palace's call for an assessment of Morocco's total wealth based on the WB *Wealth of Nations* methodology. Impressive progress was achieved in the implementation of the energy subsidy reform agenda, with the full elimination of gasoline, diesel and Heavy Fuel Oil subsidies. The Government is also making important strides towards the emergence and expansion of sectors such as aquaculture and ecotourism in order to support growth and job creation in rural areas. On the natural resource management side, a new *National Plan for the Water Sector* has been finalized with the aim to articulate the vision for sustainable water management currently enshrined in the legislative tools supported by the DPL series. Progress can also be noted within the coastal zone management and fisheries sectors, where ambitious legislation has moved through parliamentary approval.

II. Operation Objectives

A. Proposed Objective

The proposed DPL2 is the second in a programmatic series of two operations which supports the Government's green growth agenda. The Program Development Objectives are: (i) improving the management of natural capital; (ii) greening physical capital and (iii) strengthening and diversifying the rural economy by leveraging human capital.

B. Description

- Based on internal government consultations, the Bank and the Government have defined prior actions for each Program Development Objective.

- ***Program Development Objective 1:*** **Improving the management of natural capital.** This development objective supports the Government's effort to improve the management of natural resources. Natural assets make up a significant portion of Morocco's total wealth but could underpin growth in key sectors. A strengthened management of natural capital can yield more than positive environmental benefits: it will also ensure that sectors that intensively use natural resources ─ agriculture, fisheries, but also economic activities in coastal zones such as tourism ─ will be able to sustain and increase their growth potential. Therefore measures supported under this DPL series aim at improving management of <u>coastal and marine assets</u> and <u>water sector governance</u>.

- ***Program Development Objective 2:*** **Greening physical capital.** This objective supports the Government's program of reducing adverse environmental impacts of infrastructure investments and promoting low carbon growth. Investing now in an infrastructure base that puts Morocco on sustainable growth involves trade-offs in terms of extra-costs to economic agents, particularly in the short term. Energy is a major challenge in this respect: the country is currently too heavily dependent on fossil fuels and the projected increase in demand across different sectors (particularly transport, housing, industry and tourism) require significant additional investment in power generation capacity. The reforms carried out in this objective can yield global environmental benefits ─ renewable energy deployment contributing to climate change mitigation ─ but also more local, shorter-term benefits linked to improved health outcomes ─ stemming from reduced coal burning and decreased industrial pollution, as well as energy security. Providing the right price signals is a prerequisite to eliminate existing distortions in consumer's and producers' behavior, but needs to be accompanied with interventions to smoothen the transition for economic actors. Objective 2 is composed of two policy areas: <u>low carbon growth</u> and <u>pollution management.</u>

- ***Program Development Objective 3:*** **Strengthening and diversifying the rural economy by leveraging human capital.** This objective supports the Government program to: (i) strengthen the adoption of new technologies to increase agriculture's productivity and resilience and (ii) support the growth of new sectors in rural areas. Morocco has the largest inequalities in living standards between urban and rural areas in MENA. Although Morocco's rural population strives to participate in economic activity (in 2012 labor force participation rate in rural areas was 57 percent against 42.8 percent in urban areas) full economic participation faces serious constraints. Around 75 percent of rural labor force works in the primary sector (agriculture, fishing and forestry), a share increasing to 90% for working rural women. The concentration in low productivity agricultural activities entails significant risks of fluctuations in rural revenues due to weather variability. This contributes to creating vast pockets of vulnerability. Environmental constraints combined with these labor dynamics call for (i) technological innovations to increase the resilience and productivity of the agricultural sector (by ensuring producers' access to adequate agricultural services and by supporting institutions, including those related to direct seeding and agro-meteorological services) and (ii) the diversification of rural revenues through the establishment of sectors able to turn constraints into job creation opportunities, such as aquaculture and eco-tourism. In this context, Objective 3 includes two policy areas: <u>green technologies in the agricultural sector</u> and <u>diversification of rural revenues</u>.

III. Rational for Bank Involvement

The sustainability challenge facing Morocco is threefold: (i) *A dwindling natural capital resource base*. The economy remains reliant on a natural capital base which is rapidly being eroded. Agriculture accounts for 13 percent of GDP and 23 percent of total exports; but future growth will be affected by water and land constraints. The gap between water supply and demand is estimated at 2 billion m^3. Land degradation translates in a reduction in crop production translating into an estimated annual cost of US$134 million per year. Shrinking natural capital is expected to impact additional productive sectors such as fisheries, which accounts for 2.3 percent of GDP and employs nearly half a million people, and suffers from persisting trend towards overexploitation of key species menacing its medium term prospects; (ii) *The long-lived impacts of physical investments*. Annual damage costs of environmental degradation are estimated at 3.7 percent of GDP. Heavy dependency on energy imports (97 percent) entail energy supply and macro risks; (iii) *Limited leveraging of green technologies and investments.* Recent growth gains have not eradicated widespread vulnerability and income disparities. Labor market and education shortcomings only partly explain the persistently large reservoir of low productivity jobs and pervasive underemployment affecting particularly rural areas.

The proposed DPL2 will contribute to the World Bank's vision of reducing poverty and boosting shared prosperity. Bank support to environmental sustainability in Morocco is among the core activities of the Bank's Country Partnership Strategy (CPS) for Morocco (2014-17). This DPL series is a key vehicle towards the achievement of the CPS Results Area 1 (Promoting Competitive and Inclusive Growth) and Results Area 2 (Building a Green and Resilient Future). Additionally, in supporting policy measures aimed at cleaner, more efficient, resilient and socially inclusive growth, the DPL series operationalizes the World Bank's conceptual framework for *Inclusive Green Growth*. Furthermore, the proposed operation complements and leverages several ongoing policy and investment engagement in Morocco.

IV. Tentative financing

Source:	International Bank for Reconstruction and Development
Borrower:	Kingdom of Morocco
Amount:	Euro xxx (US$ 300 million equivalent)

V. Institutional and Implementation Arrangements

The institutional setting to monitor the results of the operations reflects the one used for implementation, based on the tripartite steering committee and the Ministers and Departments involved. Results indicators have been discussed with each concerned counterpart together with the availability and quality of data. Due to the relatively short timeframe of the proposed program and the expected medium-long term impacts of the reforms supported, part of the selected monitoring indicators and associated target values focus on measuring intermediate outcomes, rather than development gains on the ground.

VI. Risks and Risk Mitigation

The overall risk to PDOs achievement is rated as substantial based on the following risk categories.

- **Political and governance risks are moderate**. Although the implementation of specific policy reforms is subject to political economy factors that may delay or derail progress, the risk of a lack of commitment to the overall reform efforts remains moderate. Commitment to the *Green Growth* agenda is high and is likely to remain a priority beyond the current government. Mitigation options to be deployed by the team revolve around close ministerial-level and technical collaboration during implementation.

- **Macroeconomic risks are moderate.** Morocco recently demonstrated its willingness and capability to adjust policies and introduce corrective measures to overcome the adverse effects of shocks. The phasing out of energy subsidies has already positively impacted the fiscal deficit. In the medium term, Morocco will however continue to face three macroeconomic risks: (i) the slow or delayed implementation of key fiscal and structural reforms; (ii) limited capacity to resist strong social demands for public sector employment, new subsidies, and untargeted transfers; (iii) continued unfavorable external conditions in its main trading partners. To mitigate these risks, Morocco needs to deepen on-going structural reforms and launch planned ones to improve the competitiveness of the economy, including a more flexible exchange regime, in addition to pension and other fiscal reforms aimed at maintaining Morocco's macroeconomic sustainability.
- **Sectors Strategies and Policies risks are substantial.** The operation's design has tried to combine ambition and realism in line with the value added sought by the Government from the DPL series. Policy measures address a number of particularly sensitive reform areas such as integrated coastal zone management, the revision of the water law, and energy sector regulation.
- **The risks related to the technical design of the program are assessed as substantial.** The operation's design was informed by the need to mitigate against exogenous (political, stakeholder, institutional) risks. To address political fluctuations, only actions and triggers which are fully country owned and grounded in solid dialogue were selected. The substantial risk rating is called for by the multi-sector nature of the program.
- **The risks originating from institutional capacity for implementation and sustainability are substantial.** The prospects for implementation progress of the reform areas supported by the DPL are strong, given the deep degree of ownership by the Government, as witnessed by the satisfactory progress made since DPL1 approval. However, the multi-sectoral and multi-stakeholder nature of the reform program entails the risk of variable and uneven implementation progress. Risk mitigation revolves around the sustained activity and close monitoring of progress by the multi-departmental steering committee supporting the operation, which is chaired by the MAGG, the MEF, and the Ministry of Environment, with clear sector focal point and constant engagement at senior management level.
- **Fiduciary risks are low.** The Moroccan public administration operates in a structured and reliable control environment. It presents low fiduciary risk, even though efficiency and effectiveness can be enhanced notably at the sub-national level.
- **Environmental and social risks are substantial.** The measures supported by the DPL series will have overall very positive environmental impacts. Regarding aquaculture sector development, the Government is fully aware of related risks and is taking action to address them in coordination with the Ministry of Environment. DPL-supported measures are also likely to lead to net positive social effects, including for poor and vulnerable groups.
- **Stakeholders' risks are also assessed as substantial**. Capacity risks can affect the implementation of reforms beyond the specific measures supported in the series. This will be addressed through complementary operations and technical assistance, with a view to further enabling the articulation of reforms and continue policy dialogue over the various sectors during and beyond the current operation.

VII. Poverty and Social Impacts and Environment Aspects

The reforms supported by the proposed operation are expected to generate positive and generalized social impacts, including for poor and vulnerable groups. In relative terms, poor and vulnerable groups are known to be more impacted by common pool problems and environmental externalities. Measures supported by the DPL aimed at improving the sustainability of natural assets and environmental stewardship are key to ensuring equity and shared prosperity, including from an inter-generational perspective. Additionally, several reform areas target directly rural areas, where most of Morocco's poverty and underemployment lie. To ascertain potentially adverse impacts on specific groups of the DPL series, the Bank carried out a framework poverty and social impact assessment of selected reform areas supported by the operation, including: energy subsidy reform; the introduction of environmental taxes/regulations on specific polluting goods; control of illicit fishing practices; groundwater management; industrial wastewater control; and coastal zone management. Additionally, the Bank has supported the Government in assessing and addressing the potential negative impacts of future reductions of energy subsidies through dedicated technical assistance. Supported measures also have a clear gender dimension. The poverty and social impact assessment included a gender assessment of supported reforms, which highlighted the opportunities for women's empowerment.

As per its policy, the World Bank assessed whether specific country policies supported by the DPL series are likely to cause significant effects on the country's environment, forests, and other natural resources. The assessment concluded that the policies supported by the proposed DPL are not likely to have negative impacts on the country's natural assets.:

- The implementation of the coastal zone law lays the regulatory framework protecting areas that harbor fragile ecosystems and are critical to the country's economy for their tourism and fisheries potential. The development of the *National and Regional Coastal Zone Management Plans* will provide further tools to strengthen the impact management framework for sector investments along the coast.
- Water sector-related measures, including for groundwater, aim to address critical aspects of resource management needs for a country that expects its water stress condition to deteriorate even further in the coming years. Existing analytical work demonstrates the positive environmental effects of leveraging participatory process to plan groundwater abstraction to levels agreed with consumers, with no negative environmental impacts
- Energy-related measures support a decrease in energy intensity of the economy and related pollution and emission impacts. The types of renewable investments enabled by the legislation in this sectors entail negligible environmental risks, as they essentially concern residential and small scale photovoltaic development, which in the case of the former are impact neutral, and in the case of the latter will be subject to the provisions of the EIA Law.
- Reforms related to the provision of agro-meteorological services will contribute to enhancing the resilience of the agricultural sector to climate change impacts.
- The development of the ecotourism sector based on robust environmental norms and standards for investments will ensure that the sought-after development of economic activities in rural and remote areas will not come at the detriment of natural assets.
- Environmental risks arising from aquaculture sector development are being mitigated by measures supported by the proposed DPL2 (Strategic Environmental Assessment of the Aquaculture Sector and National Directive for Impact Assessment of Aquaculture Investments), which aim squarely at endowing the Ministry of Environment, the National Aquaculture Development Agency and private investors with the tools to ensure the environmental soundness of the sector.

VIII. Contact point

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