MOROCCO 2000

Trade Reform and Economic Efficiency: Policies for Trade Promotion

COUNTRY SUMMARY

This summary was prepared under the Trade Expansion Program of the United Nations Development Program and the World Bank, at the request of the Moroccan Ministry of Trade and Commerce. The study team was led by Oli Havrylyshyn, (Consultant) and included Giorgio Basevi, Riccardo Faini, Dominique Hachette, Brian Hindley, André Sapir, (Consultants), and Mona Haddad, Donald Keesing, (World Bank). Jean Waelbroeck acted as general advisor. A separate annex study on agricultural trade policy not included in this report, but available from the World Bank CECTP Division was prepared by Agroconcepts of Rabat.

The work is based on several missions to Morocco by team members: September 15-30, 1989; November 18-21, 1989; December 6-12, 1989. An earlier draft of the Report was discussed with Moroccan authorities on April 19-20, 1990.

Main findings

Trade liberalization was an important component of Morocco's Structural Adjustment Program. The reforms included reducing import licensing, trimming tariffs to a ceiling of 25 percent, and eliminating the anti-export bias of the economy through various export-preference mechanisms.

The report concludes that:

- Morocco's export performance improved particularly in clothing, until about 1988. At the same time the *deficit* recorded an improvement. But recent data show a serious deterioration of both trade and adjustment programs.
- The failure to achieve the goals of trade liberalization has contributed importantly to the recent slowdown. Morocco's major accomplishment was its success in modernizing policy instruments and replacing quantitative controls with tariffs.
- The positive effect of liberalization may have reached a limit because the original goals failed to emphasize liberalization in agriculture, services, and the financial sector. The government should move to
- Reduce the deficit and avoid the unfavorable effects of an unstable macroeconomic environment, such as excess demand, high financing costs, and a decline in credibility.
- Complete the trade liberalization program to achieve 25 percent maximum tariffs, eliminate other controls and work toward an eventual uniform tariff below 25 percent.
- Liberalize the agriculture, service, and financial sectors.

Trade policy liberalization in the eighties

Trade policy liberalization included the reduction of tariff ceilings to 45 percent (excluding the Special Import Tax), the elimination of import licenses, currency devaluation and measures to lift import duties and restrictions. The result was a reduction in but not an elimination of the anti-export bias, and an improvement in the export performance of manufactured goods. The export-to-GDP ratio rose from 12 percent in the late seventies to 16 percent a decade later (figure A). The share of nontraditional manufactures rose from 15.1 percent in 1983 to 22.5 percent in 1988. (The data understate the export performance of nontraditional manufactures, as they exclude the increase in subcontracting exports.)

There was a marked improvement until 1988 in the budget deficit, which was 11.2 percent of GDP in 1984 and 4.2 percent in 1988, the current account, which was 7.8 percent of GDP in 1984 and recorded a small surplus in 1987-88), and a substantial increase in GDP growth, from 2.4 percent during 1980-84 to 5.6 percent for 1985-88. Finally, the ICOR declined from 6.1 in 1978-83 to 3.6 in 1984-88.

But there are strong reasons for concern. First the deterioration in 1988-90 in the two key performance indicators: the deficit and manufactured exports. Second, the Moroccan economy remains highly protected and inward-oriented. Lowering maximum tariffs from more than 100 percent to 45 percent, and reducing import licensing coverage from more than 60 percent of imports to less than 10 percent appears to be a very substantial liberalization. But these two indicators overstate the degree of liberalization for the following reasons:

- The application of the 12.5 percent Special Import Tax (PFI) on top of a structure with other exemptions increases the distortions of the tariff system.
- Even without the PFI, the 45 percent ceiling provides a range of effective protection from -130 percent to +185 percent.
- The potential application of reference prices and administrative restrictions can result in an even greater range of effective protection.
- Protection is still concentrated on import-substituting industries.
- Despite the widespread application of exemptions for exporters, the protection of import-substituting industries means the import tax puts a tax on exports. An econometric estimate of this import-tax burden suggests 85 percent is transferred to exports.
- While exports are recognized as providing some benefits, they are still viewed by many as a necessary evil to gain foreign exchange and international financial credibility.

The percentage of restricted imports in total imports understates the protectionist effect of licensing. Protected goods (those on what is called the B List) also enjoy the highest levels of tariff protection, hence the effective protection is even more concentrated. A better indicator (though difficult to measure precisely) is the share of production covered by restrictions. Most analysts agree on a figure of about 40 percent, but for import substitutes coverage is more than 70 percent.

The protective impact of the restrictions will tend to ease as foreign exchange becomes more available. In 1988-89, as foreign exchange difficulties loomed, there were signs of tightening. The percentage of licensing requests denied rose for most sectors, but most importantly in import-substituting categories. For consumer goods generally the denial rate rose from 5.4 percent in 1987 to 7.2 percent in 1989; for textiles, from 10.6 percent to 23.2 percent;agro-industry, from 3.4 percent to 6.6 percent; and leather and clothing, from 6.3 percent to 15.6 percent. It is important to underline the paradox that administrative tightening (as opposed to regulatory increases in coverage) reduces the proportion of imports under restrictions. This makes it difficult to interpret such a proportion as a measure of liberalization, for while a regulatory shift of products from restricted to unrestricted did increase the openness of the economy, an administrative tightening of remaining products may have offset this. One result, as noted by many analysts, is that the import-to-GDP ratio has not risen (and may have fallen) during a period of apparent liberalization.

In spite of a very timid trade liberalization program and a high degree of protection, how was export performance achieved? Compensatory export incentives played a role in stimulating exports, just as their limitations plus the slowdown in import liberalization played a role in the slowdown. But the trade regime was not the only factor. Devaluation and its eventual erosion also contributed. So too did the ease of access to EEC (and in particular French) markets for clothing -- and its tightening by 1989. Chapter 1 reviews the shock effect of hitting quota ceilings in France, and demonstrates that relative competitiveness (trade regime incentives plus exchange rate policy) also matters. While one cannot show that 1988-89 manufactured exports would have been higher with more liberalization, one can certainly conclude that given the external limitations in one market and in one category of products, policy changes that increase competitiveness and diversification will be essential to regain the momentum of export growth. The analysis reveals that external balance was improved, first by a compression of imports (1983-85) and then by an expansion (1980-88). This explains the improvements in Morocco's external credibility. The reversion in 1989-90 to import compression is not desirable and has contributed to some loss in credibility.

By 1989, despite incomplete achievement of the original goals, the trade regime had moved slightly toward an outward orientation. It can at best be regarded as a mixed regime with strong elements of inward orientation offset by compensatory mechanisms to promote exports. The challenge for the next phase of policy

reform is to move toward an outward-oriented economy to exploit Morocco's low labor costs, enterprising business class, and proximity to the dynamic European market.

A strategy for the nineties

Several key government documents imply that Morocco intends to build an economy open to the world market based on freedom of initiative and the discipline of the marketplace. These goals will be complemented by the following government actions:

- A stable, clear, and credible legal framework enforcing commercial and contractual obligations in a system of justice with recourse and access by all parties.
- A stable macroeconomic environment.
- Safety-net mechanisms of temporary assistance to those seriously hurt by changes in policy during the transition.
- Direct government actions to develop the physical, human, and social infrastructure needed for economic growth.

The economic logic of outward orientation

The next phase of trade policy liberalization must be based on a *view that imports not only satisfy essential needs* (as inputs to permit exports) *but also serve as a force of competition and discipline in production efficiency.* Export growth and import competition are critical in stimulating increased productivity and improved quality -- the essential ingredients in achieving *competitiveness at world standards.*

Protection expands production, but does not provide enough stimulus to increase productivity. The competitive force of imports in a more open environment stimulates productivity and the attainment of internationally competitive standards in sectors of potential comparative advantage. Even export promotion that does not reduce the protection against imports but relies on exemptions for exporters will not be sustainable. Yugoslavia and Brazil promoted exports much earlier than Korea, but they did not remove the high protection against imports for the domestic market. Thus an anti-export bias remained and economic performance faltered in the debt crisis. In sum, the key is not simply to promote exports but to promote open trade, recognizing that exports and imports, provide the necessary stimulus to achieve competitiveness.

It is important to emphasize that a liberalized, open, outward-oriented economy need not mean complete free trade, as in Hong Kong. Tariffs may remain as high as 25 percent for sometime, but gradualism should not be used as a screen for continued protection. The anti-export bias should be kept low and the process of liberalization should continue.

External environment: opportunity and challenge

Until recently, the external environment has -- if anything -- favored Moroccan exports, which were granted privileged access to EEC markets. This favorable treatment is reaching its limits. The post-1992 environment in the EEC suggests more opportunities than impediments. The community's integration will have the following effects on Morocco: (1) economic growth will mean increased demand for Moroccan products, both raw materials and manufactures; (2) indications point to lower barriers against labor-intensive imports and agricultural goods; (3) a tendency to diversify imports of textiles, clothing, and other manufactures is likely, which will benefit Morocco; (4) the integration of Spain and Portugal will have a positive effect. Although the removal of barriers against Spanish and Portuguese exports in the EEC may cause some substitution for Moroccan exports, those countries will move away from labor-intensive goods and will require Moroccan exports. And finally, the geographical and historical proximity of Spain makes it a natural partner and a source of foreign investment.

Diversification from Europe is of course desirable as well, but it should not be pursued at high cost and great risk. In other markets, institutional support for marketing without discrimination as to destination is the best

policy to follow. The opportunities for the Maghreb Economic Union development, while not to be ignored, must be viewed as both relatively limited and distant.

Trade policy to 2000

The following changes are essential to achieve an outward-oriented policy regime:

In trade

- The objectives of the 1985 program, including a maximum tariff of 25 percent, the abolition of licensing restrictions, and a uniform tariff should be completed.
- Trade in agriculture should be liberalized.
- It is essential to liberalize foreign investment procedures and the investment codes.
- The government should support international commercial activities by providing a safety net to ease the effects of transition, assisting in the development of physical and human infrastructure, and supporting activities such as testing laboratories, textile-engineering education, and so on.

In other areas

- The fiscal deficit should be reduced to allow the government to eliminate the PFI, avoid excess domestic demand, and keep interest rate low.
- It is crucial to reduce the debt overhang. This can best be achieved by closing the trade gap and attracting foreign investment.
- A stable and credible exchange rate policy encourages investment. One option would be to include the dirham in the EMS and tie it to the ECU.
- The liberalization of the banking and financial sectors will increase the availability and lower the cost of financing export activities. This should also constrain the public sector's access to funds.

Policy recommendations

Since macroeconomic disequilibrium may overwhelm the effects of any trade policy, these distortions must be addressed in concert with trade policy changes. The most important issue is the fiscal deficit. Trade policy alone can do little to solve the balance of payments gap as long as the fiscal deficit remains too large to be covered by domestic savings alone. Expenditure discipline is required, but increased revenues from two sources are essential: new taxes (VAT and income taxes), and rationalization of tariffs.

Efforts to stabilize exchange rate and liberalize financial markets are essential. Four categories of policies affect trade directly:

The import regime

- Import licensing of manufactures should be eliminated by 1992; licensing for agricultural products by 1995.
- Within three years tariffs should be at the original 25 percent tariff ceiling goal. By 1995 a uniform 20 percent should be in effect. Exemptions should be eliminated except for exporters. The reduction of exemptions and the increase in some tariffs to the minimum 15 percent will permit the elimination of the PFI.
- The new commercial code should (1) define "prejudice" and stipulate how it is to be calculated; (2) balance the calculation of injury to producers with the calculations of costs of protection to consumers and other users; (3) reassess the use of Article 19 as an alternative to the difficulties of estimating dumping margins under Article 6 (perhaps in the context of the small technical assistance project). If Article 6 is followed, the law must be more explicit about how to calculate dumping-subsidy margins.

Export regime

- Duty exemptions for exporters should be simplified under one regime and removed by 2000.
- The Centre Morocain de Promotion de Exportations should be rationalized. This would require a)changing it to an autonomous agency and allowing remuneration at the private sector level; b)encouraging the private sector to compete with the agency; and c)increasing its budget.
- An export committee should be established at the highest level of government to review policies, award export merit prizes, and so on.
- A commercial representative service should be set up in the Ministry of Foreign Trade.
- A limited exporter's fund should be available that combines grant and loan monies for exporters to cover first-time marketing, product design or adaptation, and export consulting services.

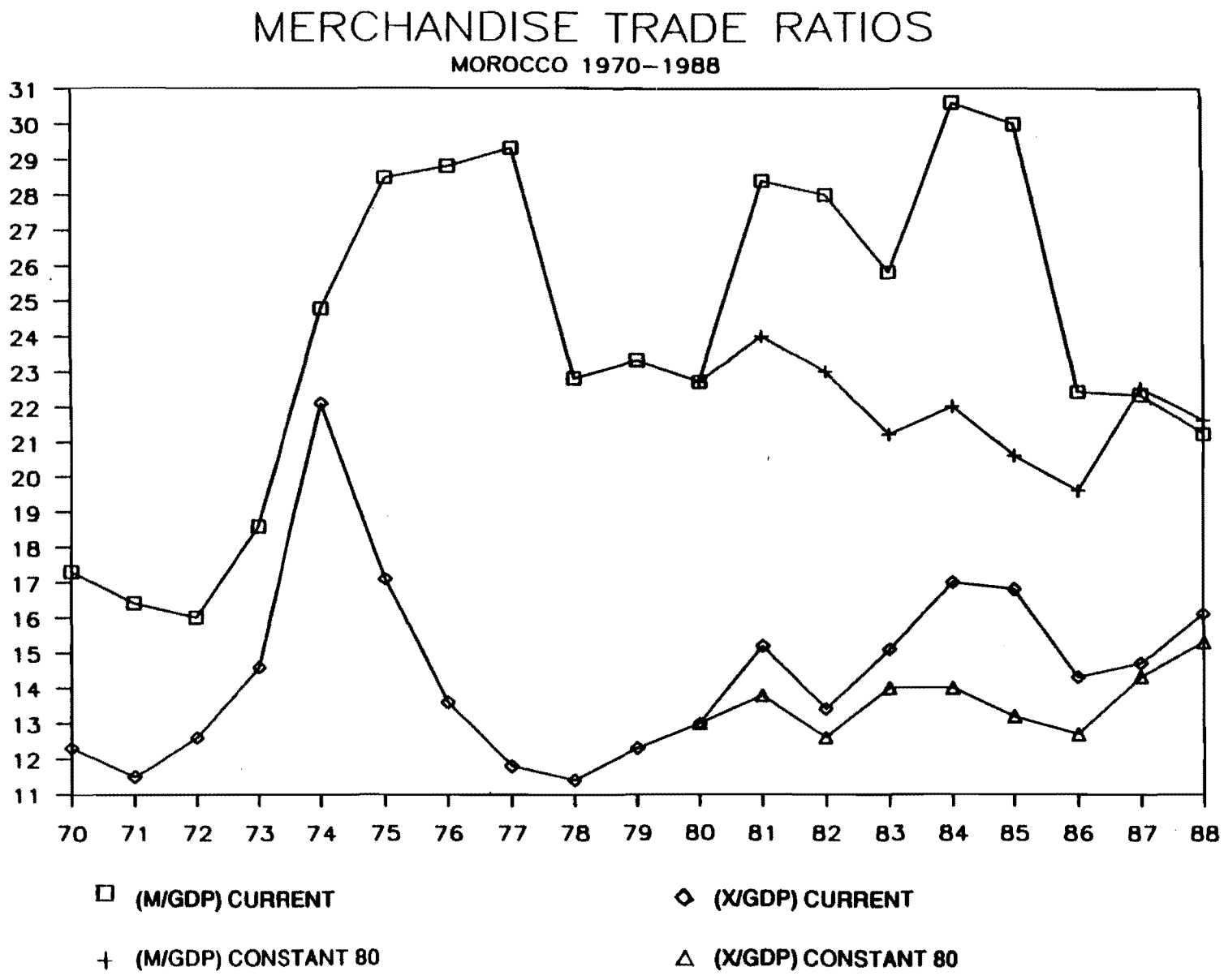
Foreign investment

- Foreign investment restrictions should be simplified by reducing them to a short negative list (that is, any industry not listed is eligible).
- The preferential incentives for foreign investors should be reduced and eliminated by 1992.

Institutional support

- The Simplification Project should be completed by 1993.
- Additional support should be provided for training and education in such areas as textile engineering.
- Private sector initiatives to establish quality-control laboratories and testing services are urgently required. This would require subsidies to such laboratories, or export funds, or both, for such purposes. The subsidies should be consistently reduced to zero over five to ten years.

Figure A


MERCHANDISE TRADE RATIOS
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