POLICY BRIEF

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THE NATIONAL AUTOMOTIVE INDUSTRY FACED WITH THE COVID-19: SHOULD WE BE WORRIED ABOUT THE IMPACT ON THE CURRENT ACCOUNT?

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The national automotive industry faced with the Covid-19: Should we be worried about the impact on the current account?

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The year 2020 is one of the most difficult years for the global automotive industry. The pandemic first appeared in a region of China known for its developed automotive sector. Initially, it was the South Asian manufacturers who first felt the impact of the shutdown in China before the pandemic shifted to Europe and the United States and before the disruption of value chains took on a global dimension. In Morocco, the sector has not remained immune to this turbulent context and its export performance shows a decline of nearly 40% in turnover over the first half of the year. However, the net effect of this contraction on foreign exchange inflows is not expected to be as significant, for two main reasons: The first is linked to the sector's heavy dependence on imported inputs, which would reduce the sector's demand for intermediate goods, and the second relates to the predominance of foreign capital in the sector, which will see the repatriation of its earnings dwindle. It is therefore essential to broaden the scope of analysis of the spillover effects of the automotive sector and, by the same token, of Morocco's global trades beyond the notion of domestic value added achieved in exports. Indeed, it is useful to take account of the distribution of value added between the factors of production, which suggests the predominance of the capital earnings factor - foreign capital in the case of the motor vehicle sector - prone to repatriate all or part of its profits. In parallel to promoting Morocco's attractiveness - a policy crucial for technology transfer and integration into global value chains - decision-makers should work to consolidate the presence of national capital in the industrial ecosystem and place it at the center of any industrial policy capable of leading industry to a new path of development.[1]

I. The global automotive sector in the light of the Covid-19 crisis

The Covid-19 wave spared no sector of activity on its way and inflicted massive damage to the global and national productive apparatus. Entire industries were directly affected by social distancing measures decided by governments, while others had to grapple with particularly sluggish global economic conditions, and even some disruptions in supply chains that forced operators to temporarily suspend their activities, simply because of a lack of inputs (Baldwin and Freeman, 2020).

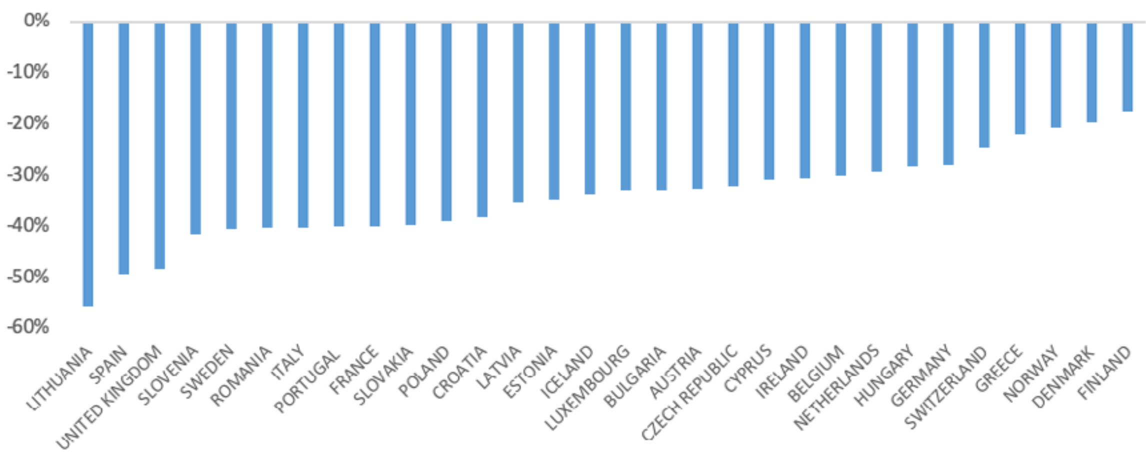
Thus, industries that are highly integrated into global value chains were the first to feel the impact of the crisis. We are referring here to the automotive sector in particular. It should be remembered that the province of Wuhan, the first epicenter of the pandemic

1. My thanks go to Mr. Larabi Jaidi, Senior Fellow at the Policy Center for the New South, and Mr. Badr Mandri, Economist at the Policy Center for the New South, for their valuable comments. I also thank Mr. Abbas El Akari for his excellent assistance in preparing the data and graphs.

at the time, is home to an entire automotive industry ecosystem and accounts for nearly 10% of China's total production capacity. The region is a first-rate supplier for European, American and especially South Asian manufacturers. With the implementation of containment measures in this region, the production flow has suffered major disruptions. In South Korea, for example, some manufacturers temporarily suspended their production lines as early as the first two weeks of February due to stock shortages, even before the pandemic spread across the country on a large scale. Some Japanese operators who suffered the same experience decided to freeze their production for the same reason in the wake of the production shutdown in the province of Wuhan (World Economic Forum, 2020). The shift of the pandemic focus to Europe and the USA this time exposed the ecosystems of this industry in the two economic powers to the effects of the crisis.

It is not just a question of disruptions to production lines or production standstills; in fact, the automotive sector soon found itself in a deeper crisis following the collapse of global demand (ILO, 2020). The number of car registrations on the European continent is indicative of the damage suffered by the automotive industry. Over the first 5 months of the year, this number has fallen by almost 40% on average compared to 2019 and by around 50% in the countries most affected by the pandemic, notably Spain and the United Kingdom. Over the whole year 2020, projections expect a drop in vehicle demand of between 14% and 22%, in a pessimistic scenario (BCG, 2020). However, given the prevalence of exceptionally high uncertainty, the automotive sector could end the year with a more pronounced underperformance.

Graph (1): Variations in vehicle registrations in European countries in the first 5 months of 2020 compared to 2019, in %.



Source: European Automobile Manufacturers' Association

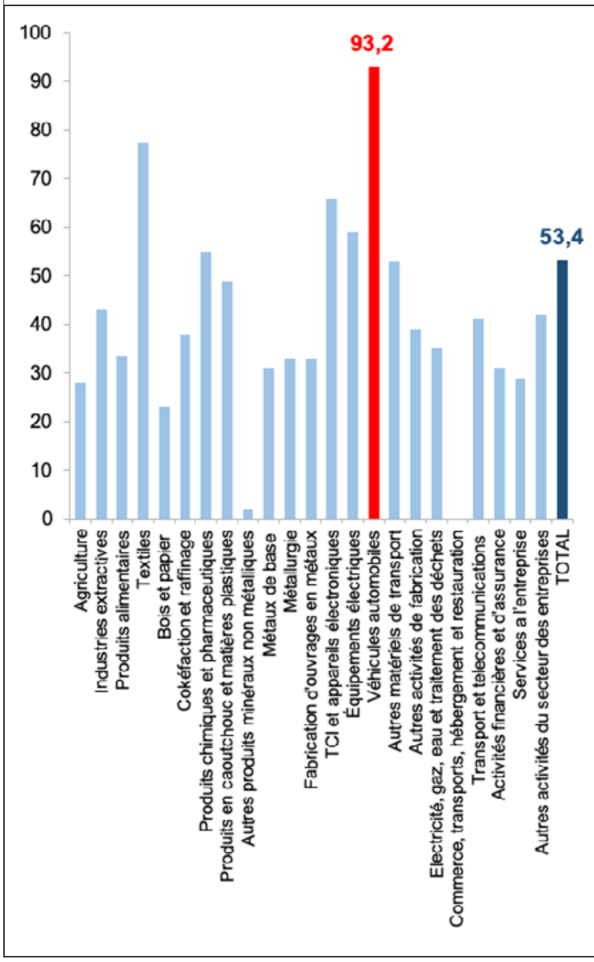
II. Domestic automotive industry: What about net foreign currency inflows in the light of the drastic decline in exports?

Unsurprisingly, in this gloomy context, the domestic automotive industry has shrunk, as evidenced by its export performance. During the first three months of the year, car exports fell by almost a quarter compared to the same period in 2019, even before the state of emergency and containment measures were declared in the Kingdom. The decline concerned finished products, particularly assembly products, down 36%, followed by semi-finished products (26% for wiring and 13% for « vehicle interiors and seats ») components. As the months went by, the situation rapidly worsened. At the end of May, the sluggishness of the automotive sector became more pronounced and exports fell to nearly 40%, this time more sharply for intermediate products. In absolute terms, such a significant decline is estimated at MAD 13.9 billion over the five months of the year. If at the end of the financial year 2020 the sector records the same counter-performance, the loss of earnings for the automotive sector would exceed MAD 33 billion, or the equivalent of 3% of the GDP.[2]

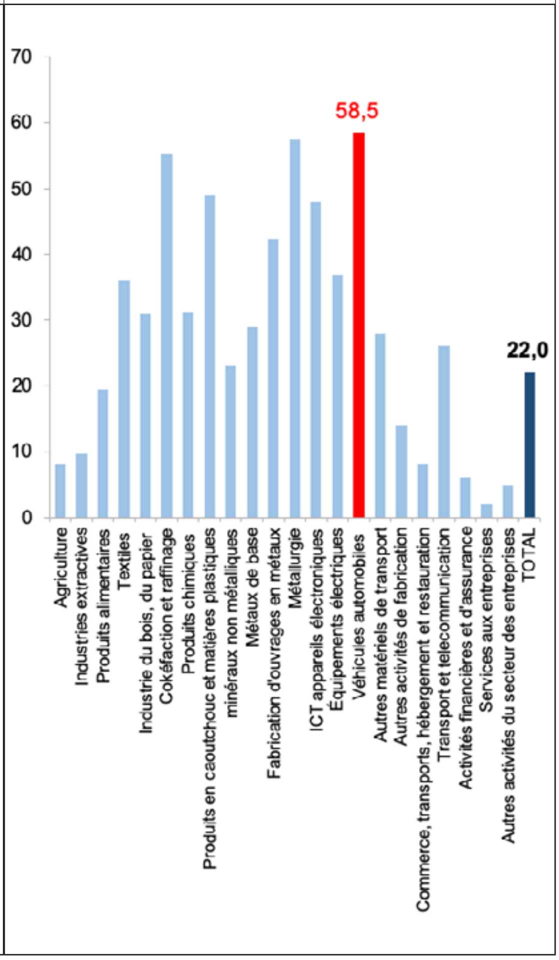
At first sight, the trade balance, and the current account in general, should suffer a major shock and face a substantial loss of export earnings, especially since the automotive sector has become a driver of export growth over the last six years and has also positioned itself at the forefront of exporting sectors, ahead of the traditional activities of agro-industry, and phosphates and derivatives. Nevertheless, it is important to stress that the net effect of the sector's poor performance on external accounts is to be put into perspective and may be less pronounced, for two main reasons: the first relates to Morocco's positioning at the top of the production chain, making it an importer of intermediate products, especially for assembly activities; Thus, any downward adjustment to the export turnover would result in a proportional reduction of the imported inputs. The second reason is linked to the predominance of foreign capital in the ecosystem of the automotive industry, which means that the sluggishness of export activity would inevitably affect the profitability of the companies and ultimately their ability to repatriate profits.

2. The decline in exports is estimated at MAD 13.9 billion over the first months of the year. Annually, this poor performance could amount to 33.4 billion dirhams. The objective of this Policy Brief is not to provide a forecast of export performance over the year, but to draw attention to the risks of the sector's integration into global production chains and its ensuing impact on the current account balance in Morocco, in this exceptional context.

Graph (2): Share, in %, of imported and re-exported intermediate products by sector, 2014.



Graph (3): Share, in %, of foreign value added in Morocco's gross exports, 2014.



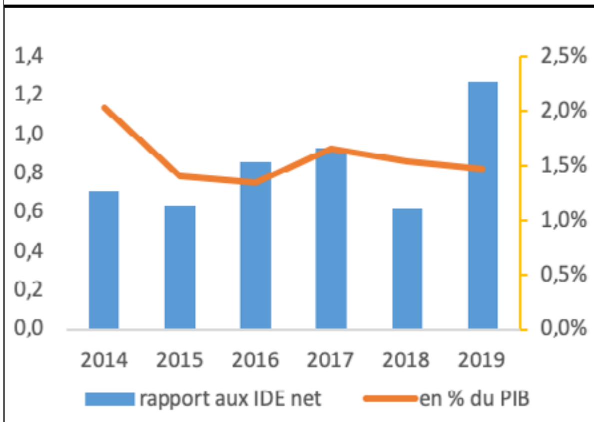
Source: OECD TiVA Database.

With the commissioning of the Renault plant in 2012, Morocco had established itself as a platform for the automotive industry on the world stage. Annual installed car production capacity has jumped substantially to nearly 530,000 units, compared with almost a sixth in the pre-2012 period (DEPF, 2020). Since then, the structure of exports has thus evolved in favor of finished products, particularly passenger cars, representing in 2019 more than 42.5% of the sector's total exports, against 12% in 2011. This repositioning of the industry at the top of the value chain has led to the redeployment of satellite activities around major operators, initially Renault and then PSA, and the development of a real ecosystem revolving around them. The target integration rates for public authorities are around 65% for Renault and 80% for the PSA Group.

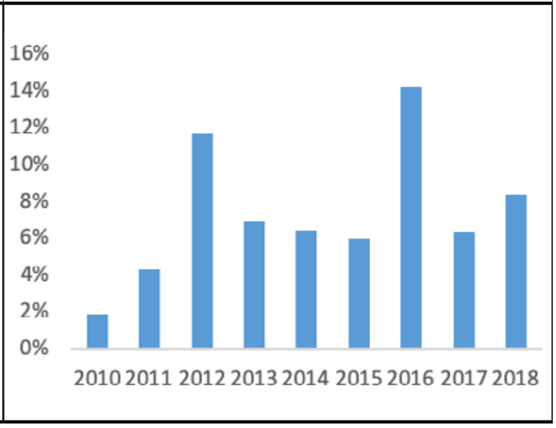
Thus, the automotive sector's dependence on imported inputs would still be significant and will weigh on the import account. Analysis of Morocco's exports in value added is highly instructive of the high import content. The sector is, moreover, at the head of the exporting sectors most dependent on imported inputs, since more than 58% of the export value of the automotive sector[3] actually includes a contained foreign value added, i.e. more than double the proportions observed in other sectors of the economy. In other words, more than 58% of the automotive sector's exports are in fact only initially imported products. In addition, 93% of intermediate products intended for the automotive sector are automatically re-exported and only 7% are intended to supply production for the domestic market.

The implication of this finding on the sector's net contribution to foreign exchange earnings in this pandemic context is crucial. Out of the 13.9 billion dirhams of export revenue decline recorded over the first five months of 2020, only 5.8 billion dirhams are actually to be considered as a net loss of foreign exchange earnings for the Moroccan economy. The rest represents in fact savings in imports.[4]

Graph (4): FDI primary income in Morocco



Graph (5): FDIs in the automotive sector in Morocco, in % of total



Source: Foreign Exchange Office

In addition to the automatic adjustment of imports, another mechanism should help to mitigate the effect of the decline in the sector's exports on the current account, namely profit repatriation. Indeed, the automotive industry has only taken a new step in its development process with the establishment of Renault from 2012 and its positioning at the top of the production chain. Since then, the interest in investing in the sector has become more and more evident and several international operators have preferred to set up and provide assembly services in Morocco (DEPF, 2020). In fact, this was in response to the will of the national authorities to intensify the sector's upstream links with the national productive fabric. Thus, commitments have been negotiated and agreed with the two OEMs to gradually increase the rate of integration. Foreign direct investment (FDI) in the sector reached an average of MAD 3 billion over the post-2012 period, while it amounted to only MAD 900 million between 2010 and 2011. Hence, the predominance of foreign capital in the sector is clear, pending the emergence of a new class of domestic entrepreneurs capable of mastering knowledge and technology and penetrating niche markets in the automotive sector.

3. « Motor Vehicles » according to the classification used by the OECD TiVA Database on trade in value added. The most recent data go back to the year 2014.

4. For the sake of simplicity, the « change in stocks » dimension, be it intermediate products or finished products, is not included in these calculations.

It is in fact through the vector of foreign capital that technology and know-how can be transferred to the local productive fabric. However, the other side of the coin is that the profits made by these foreign companies can be partly or wholly repatriated to the countries of origin. Foreign exchange regulations in Morocco do not impose any restriction in this respect – a quite commendable practice – which guarantees to foreign investors that have financed their foreign currency transactions the freedom to repatriate all the proceeds gained from their investments. (Foreign Exchange Office, General Instructions on Foreign Exchange Transactions, January 2020).

Indeed, current account data confirm that this heading has been growing steadily over the years and affects external balances. (Graph 4). This has resulted in a foreign exchange "leakage" equivalent to 1.6% of GDP on average between 2014 and 2019, and sometimes even the equivalent of net FDI inflows to Morocco. In 2019 alone, for example, this income exceeded the amount of FDIs. As early as 2014, the issuing institution drew attention to the weight of dividends transferred internationally and at the same time called for a detailed assessment of the contribution of FDI, particularly in the automotive sector, in view of the facilities and incentives offered to this sector (Bank Al Maghrib, 2014).

Unlike trade statistics, which now make it possible to measure trade in value added and to identify the contribution of each sector of activity to the generation of foreign exchange, those relating to primary income on investments are only available at an aggregate level. Indeed, the MAD 17 billion of income on FDIs in Morocco concerns all foreign operators in the country, all sectors combined, whose stocks amounted to MAD 589.7 billion until the end of 2017. Nevertheless, considering that the automotive sector has drained nearly 7% of total FDIs between 2010 and 2019 and assuming a uniform return across the different sectors of activity, the return on investment in the sector would be around MAD 1 billion. It is thus relevant to integrate this dimension to supplement the analysis on the net contribution of the sector to foreign exchange earnings so as to have a more exhaustive overview.

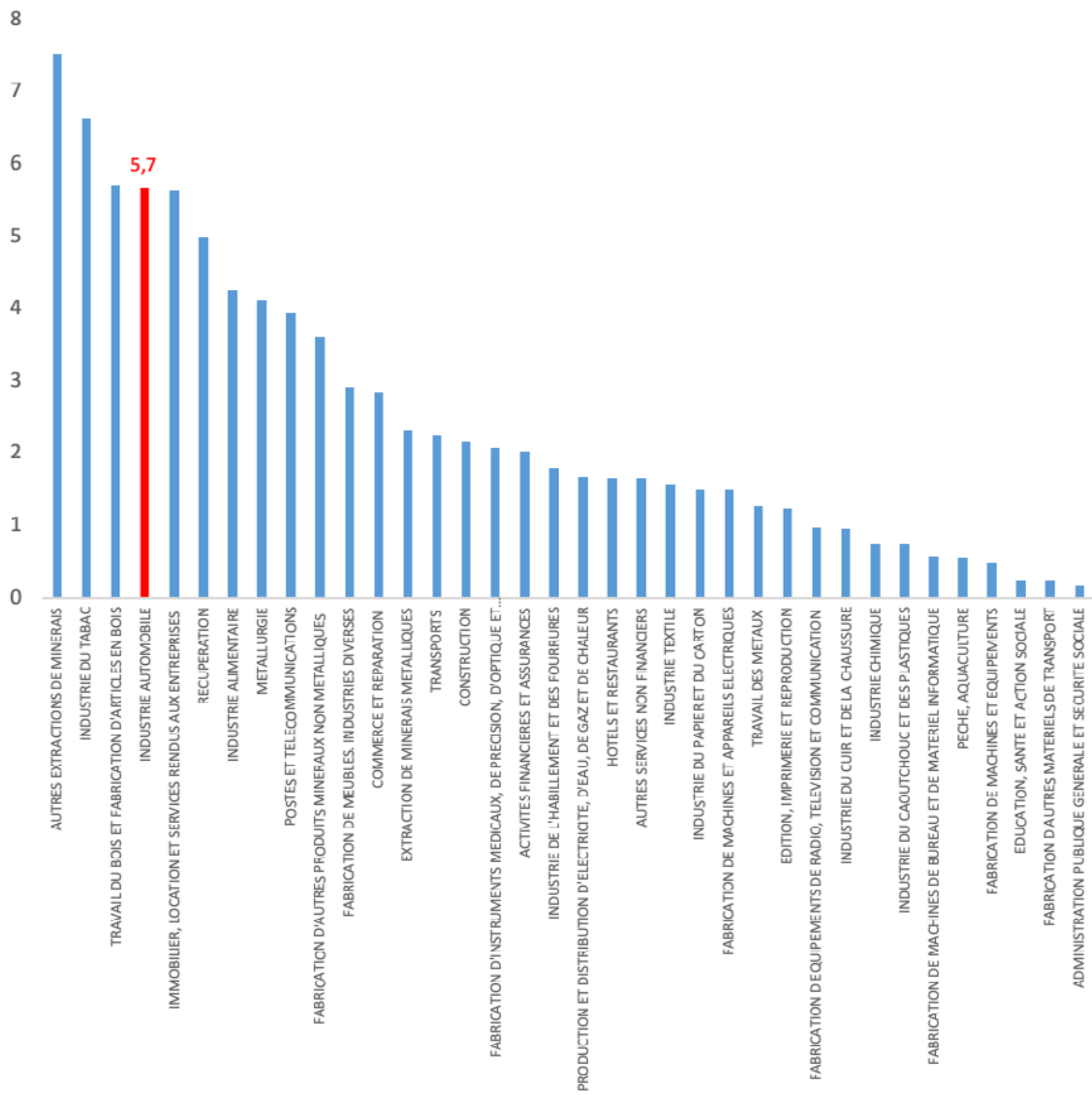
To take the example of the decline in the sector's export earnings, estimated at 13.9 billion dirhams, and by deducting imported inputs and the return on investment, the effective loss of earnings would be limited to around 40% of the initial amount. Beyond the exact quantification of the profitability of foreign investment and profit repatriation, this didactic exercise aims to shed light on a new facet of the automobile sector's contribution to the generation of foreign exchange on the current account, and also to draw more attention to the need to integrate the dimension of the shareholders' nationality in the automobile sector for a better assessment of the effective spillover effects of the sector on external balances and economic activity in general.

III. Policy Recommendations

It is interesting to consider the foreign ownership dimension in analyzing the net performance of export sectors: The growing abundance of data on value-added trade provides a more refined understanding of the integration of economies in value chains. For the national case, this new statistical system has made it possible to provide an initial response to the contribution of Morocco's new world business activities to trade and the intensity of upstream and downstream relations that these sectors maintain with the rest of the economy. The strong presence of foreign capital in the automotive industry, for example, also raises the question of the need to take this dimension into account when assessing, among other things, the net contribution of these sectors to foreign exchange inflows, given the growing weight of the investment income component. In 2019, it accounted for more than 1.6% of GDP. Thus, the net effect of the decline in the sector's exports on the current account is weaker, due to the significant import content of the sector's exports and the return on investment repatriated in part or in full.

It is not enough to identify the share of domestic value added contained in our exports, but it would be relevant in addition to have an idea of the distribution of this value added between the factors of production and to deduct from it the share associated with capital which will eventually be repatriated. This exercise is all the more relevant for the automotive sector in view of the relatively high compensation paid to capital compared to labor. The statistics provided by the latest version of the 2015 Social Accounting Matrix show that the share of value added associated with the capital factor is 5 times higher than that of labor and is thus among the highest in the Moroccan economy.

Graph (6): Capital return / labor compensation ratio



Source: HCP and calculations by the author

In order to do so, it is essential to consider the establishment of a more comprehensive statistical system for this purpose. The 6th edition of the Balance of Payments is poorer than the previous one. The 5th edition provided at least a sectoral classification of primary investment income "Administration, Banks and other sectors of activity", whereas the new edition is limited to a classification by purpose with a distinction between FDIs, portfolio investments and other categories of investments. To complement economic analyses, it would be advisable to draw a map of foreign presence in the national economic fabric and to list primary investment earnings by sector or branch of activity at the most precise level possible, while respecting the principles of confidentiality.

Having said this, the statistical system is not an end in itself, but a means of informing decision-makers in the implementation of better-informed industrial policies that would put national capital or local entrepreneurs at the center of any policy to promote the sector. FDIs will always remain the main vehicle for technology sharing and transfer and the best approach to penetrating global value chains. Once the cruising speed of the sector has been reached, national entrepreneurs will have to take over and position themselves at the heart of the automotive industry, consolidate their presence in first and second tier subcontracting activities and thus constitute a milestone of sustainable growth for the Moroccan economy. To this end, policymakers should consider designing industrial policies that are more focused on national capital, which would at the same time accompany the commendable efforts made by the Moroccan authorities to promote the country's attractiveness to foreign investors.

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Abdelaziz Ait Ali is a resident senior economist who joined the Policy Center for the New South after five years of experience at the Central Bank of Morocco. He has served as an economist in the Department of Studies and International Relations. He was in charge of monitoring and analyzing the Real Estate Asset Price Index as well as other asset prices, including equity markets, for the purpose of designing monetary policies, but also for financial stability objectives. Thus, macroeconomic issues continue to be an area of interest for him. In addition, Abdelaaziz addressed long-term issues and in particular, the issue of structural transformation and the role of the manufacturing sector in development in Morocco, but also in the African continent. Abdelaziz holds a master's degree in econometrics from the Hassan II University in Casablanca.

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The Policy Center for the New South (PCNS) is a Moroccan think tank tasked with the mission of contributing to the improvement of international, economic and social public policies that challenge Morocco and Africa as integral parts of the Global South.

The PCNS advocates the concept of an open, responsible and proactive « new South »; a South that defines its own narratives, as well as the mental maps around the Mediterranean and South Atlantic basins, within the framework of an open relationship with the rest of the world. Through its work, the think tank aims to support the development of public policies in Africa and to give experts from the South a voice in the geopolitical developments that concern them. This positioning, based on dialogue and partnerships, consists in cultivating African expertise and excellence, capable of contributing to the diagnosis and solutions to African challenges.

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