POLITIQUE BUDGÉTAIRE ET ACTIVITÉ ÉCONOMIQUE AU MAROC : une analyse quantitative

Édité par :
EL MOKRI Karim - RAGBI Aziz- TOUNSI Said
INTRODUCTORY NOTE

FISCAL POLICY IN MOROCCO: ASSESSMENT AND CHALLENGES

By

Said Tounsi and Karim El Mokri
INTRODUCTORY NOTE
FISCAL POLICY IN MOROCCO: ASSESSMENT AND CHALLENGES

By

Said Tounsi, Teaching / research professor in economics, University Mohammed V Rabat Agdal, Morocco
and

Karim El Mokri, Senior Economist, OCP Policy Center, Morocco

The issue of a powerful fiscal policy comeback is not only being debated in Europe. It is also interesting for Morocco, in many respects. If in Europe there is controversy between the proponents of the structural budgetary balance rule and critics of restrictive policies in the context of major financial and recessive shocks, in the South of the Mediterranean fiscal policy is caught between the multiple social and economic requirements and the constraint of sustainability.

1.1. Fragility of budgetary performance

On the eve of the structural adjustment policy, the budget deficit stood at 14% of GDP leading to a heavy reliance on external debt, which ultimately resulted in a default situation. The recovery of public finances from 1983 to 1992 resulted in a decline in the deficit from 9.2% to 2.2% of GDP. In the process, even if the Treasury deficit financing structure has changed significantly in favor of internal funding sources, the weight of foreign debt remained dominant at 67% within the total Treasury debt.

Between 1993 and 2008, public finances have structurally generated budget deficits that are either mitigated or exacerbated by the succession of cyclical factors (drought, privatization revenues, the voluntary departure program, and commodity price fluctuations). Starting in 2009, it is clear that budget deficits increased until 2012 under the impact of the international economic situation.

Meanwhile, fiscal imbalances in Morocco contributed to a widening of the current account deficit, thus creating a “twin deficits” situation. Between 1980 and 2014, the correlation coefficient amounted to 0.65 between these two aggregates evaluated in billions of dirhams and 0.49 as a percentage of GDP.1

Indeed, in 2000, the growth-oriented momentum of domestic demand, driven by a consumption-oriented fiscal policy (higher wages, weight of the solidarity fund expenses, etc.), has resulted in widening the budget gap, and contributing to a deteriorating current account balance.

The use of the Granger causality test has clarified the existence of a unidirectional causality between the Treasury financing requirements and the current account balance. Despite efforts over four decades in controlling deficits, exceptional funding sources mainly continue to pace the evolution of budget balances in Morocco.

From 1983-1999, the budgetary authorities have resorted to the constitution of arrears, rescheduling of external debt, privatization, and tax amnesties while enjoying grants, and during certain periods, the differential oil prices. Budget management arrangements currently assume new forms, which include cuts in capital investment, management of carryovers of appropriations and handling of special Treasury accounts.

1.2. The fragility of the fiscal performance is supported by a retrospective analysis of fiscal sustainability.

Approaches based on stationarity tests of the budget deficit and Treasury debt recognized weak sustainability of fiscal policy between 1980 and 2013. The various cointegration tests proposed in the literature (Trehan and Walsh, Bohn, Quintos, Ahmed and Rogers) indicated low fiscal sustainability between 1980 and 2013 for the case of Morocco. In other words, fiscal policy in Morocco was qualified as having weak sustainability with a ratio of non-stationary debt that imposes an inflection in the level of expenditure and / or an increase in the tax burden in the medium term.

1.3. Fiscal policy in terms of a reaction to the economic cycle

The assessment of fiscal policy can be approached in terms of a reaction to the economic cycle. In developing countries, fiscal policy has often been described as suboptimal, a characteristic attributed to the fact that, for years, most of these economies have adopted pro-cyclical fiscal policies. Public spending had in fact tended to increase in periods of expansion and to contract during a recession. Several authors have addressed this feature in empirical literature (Gavin and Perotti (1997), Tornell and Lane (1999),

3. The partial capital budget freeze, equal to 15 billion dirhams in 2013 per decree No. 2-13-285 by the head of government concerning the cut of part of investment credits.
4. Expressed as a value and as a percentage of GDP.
This behavior is the opposite of what is usually observed in developed countries that pursue a rather countercyclical policy. The advantage of a countercyclical approach lies in its ability to stabilize or smooth the economic activity profile, unlike the procyclical policies in developing and emerging countries, which on the contrary, contribute to amplifying the boom and bust phases.

Several research studies have provided a number of explanations for the pro-cyclicality of fiscal policy, which prove more complementary than competitive. One of them relates to the borrowing capacity of governments that tends to increase in boom periods and reduce in periods of recession and crisis due to the rising cost of borrowing. This constraint limits the flexibility of countries suffering from an unfavorable economic climate to initiate a countercyclical fiscal policy, leading them ultimately to reduce public spending. In addition to this economic argument, there are also more institutional and political explanations; the problem of myopic governments is politically justifying procyclical fiscal policy in the sense that government, attaching great importance to the probability of being re-elected, tend to reduce taxes or increase spending and, to some extent, neglect the negative effects on macroeconomic stability in the medium and long term (Rogoff and Siebert, 1988; Rogoff, 1990). The “common pool” problem is another possible explanation for procyclical public expenditures, to the extent that each interest group or entity that spends would like to maximize its own utility without considering the general budgetary restrictions or the multiplicity of spending requests from other competing entities (Drazen, 2004, and Debrun and Kumar, 2007). In addition, during expansion periods of the economic cycle, the common pool problem arises more acutely since the competition for the common budgetary resources intensifies, thus generating a significant increase in spending and in the deficit. This is the “fiscal voracity effect” suggested by Tornell and Lane (1999).

All of these political explanations reflect the existence of a close relationship between the quality of institutions and the cyclicity of fiscal policy. This empirical hypothesis

---

7. Luis A. Catão and Bennett W. Sutton, Sovereign Defaults: The Role of Volatility, IMF Working Papers 02/149 (International Monetary Fund, 2002.)
(Frankel et al, 2011) emerges via a negative correlation between the quality of institutions and the procyclicality of fiscal policy. The Chilean experience is an illustration of this relationship given that since the early 1980s, this country has experienced a significant improvement of its institutions, in parallel with a transition process from a procyclical fiscal policy to a countercyclical one (Frankel, 2011).

The relationship between fiscal policy and the business cycle over the last 15 years has undergone a significant change. Indeed recent studies (Frankel et al, 2011) showed that in a sample of 94 developed and developing countries, less than 10% of developing countries included in the study had a countercyclical fiscal policy between 1960-1999. This percentage increased to almost 35% during the period 2000-2009, reflecting a continued transformation of fiscal policy in emerging and developing countries towards a countercyclical approach.

The recent international crisis was rich in lessons about identifying certain factors determining the efficiency of the fiscal policy response during severe recessions. OECD analyses have shown that the countries that suffered at the outbreak of the crisis of high budget deficits were forced to follow a restrictive procyclical policy. In contrast, countries that initially were in a comfortable fiscal situation could initiate countercyclical fiscal stimulus measures during the crisis. Similarly, empirical studies show that in countries with high budget deficits, fiscal policies are less reactive during recessions than they are in countries with a small deficit or surplus (Egert, 2010). Similarly, it has been shown that fiscal policy becomes more effective when the debt to GDP ratio is low (Rohn, 2010). It thus seems that these empirical results lead ultimately to a common conclusion, namely that any country that wishes to increase the effectiveness of fiscal policy during severe recessions must build reserves or safety cushions during booms of economic activity and ensure debt sustainability in the medium and long term.

The effectiveness of fiscal policy in the countries opting for explicit fiscal rules rather than a discretionary approach depends largely on the choice of the type of rules to adopt. These rules may cover flows (rules on expenditures, revenues, or a balanced budget) or rather rules in terms of stocks (public debt ratio). The trend observed over the years is that an increasing number of countries are moving towards a combination of these two types of rules (Agénor, 2015). In addition, to guarantee a certain effectiveness of fiscal policy in developing countries where the budget depends heavily on natural resource revenues, it is recommended to combine fiscal rules and stabilization funds (Agénor, 2015). Revenues from commodities exports can fund these funds during the phases of

exceptional increases in their prices.

Morocco as a developing country is no exception to the rule on the fiscal policy - economic cycle relationship. In other words, fiscal policy in Morocco is on average procyclical, according to the empirical results of a study by Baddi (2015) covering the period 1970-2012. In the absence of studies on the explanatory factors of the procyclicality of Morocco's fiscal policy, the stylized facts about the national economy already enable speculation on the subject; indeed, the absence of countercyclical behavior by Morocco’s fiscal policy may be the combined result of several factors discussed above. First, after the intensification of the debt situation in the late 1970s, Morocco was forced to adopt the structural adjustment policy in the 1980s in order to reduce demand and restore macroeconomic balances, which led to a restrictive fiscal policy and less flexibility to initiate countercyclical actions. The quest for balanced budgets was also an obstacle to a countercyclical fiscal policy in Morocco in recent years, especially from 2009, with the deterioration of the country’s budget balance. Indeed, the macroeconomic discipline required by the IMF via the TPA and the concern for maintaining sustainable budget deficits and debt levels in order to secure funding at a lower cost are all elements that prevent countercyclical public spending during the recent period. In addition, one of the questions that should be asked is how the theory of myopic governments applies to Morocco’s case? In other words, would the procyclicality of fiscal policy in Morocco be due in part to the fact that governments care more about their likelihood of re-election? Such a hypothesis requires empirical arguments to verify the case of Morocco. Finally, the fiscal policy - monetary policy relationship in Morocco could have raised an additional constraint that could have reduced the government’s ability to initiate a countercyclical policy. Indeed, results of the study by Lahlou (2015) show that the functioning of the fiscal / monetary policy mix follows a strategic balance behavior. In other words, the two policies act with some coordination while trying to simultaneously achieve decreased growth volatility, maintained price stability, and anchored inflation expectations by agents. This coordination can thus constitute, in certain cases, an additional constraint to adopting a countercyclical fiscal policy in Morocco.

In terms of lessons, the quest for optimality towards a countercyclical fiscal policy in Morocco should push policymakers to consider the advisability of adopting fiscal rules combining targets in terms of flows and debt stock in order to reconcile the balances in the short and long terms. In parallel, Morocco could gain in terms of fiscal policy effectiveness if it opted for establishing a stabilization fund that would be financed in particular by revenue windfalls from phosphate exports (Agénor, 2015).

1.4. Fiscal policy guidance indicators

The review of budgetary developments in the past two decades using the fiscal stance indicators brings out a clearly identified time breakdown of the fiscal policy evolution. These indicators can help provide additional information to the simple observation of the total deficit. The result can refine the assessment of the state of public finances and in particular to determine whether the ex post deficit reduction observed is rather due to structural measures or simply due to favorable market conditions.

Work by Akboul and Ragbi\(^{20}\) states that in the case of Morocco, the structural component largely explains the evolution of the budget balance. Fiscal consolidation is due in large part to the structural component of the budget balance, which rose from -11.9% to +0.9% of potential GDP between 1981 and 1999.

Excluding exceptional items, the breakdown of the budget balance indicates a deterioration of the structural balance over the period 2000-2004 and an improvement between 2005 and 2008, given the exclusion of elements that characterized both periods (35.5 billion dirhams in privatization revenue and 21.4 billion dirhams under the aforementioned exceptional expenses). The consideration of the cyclical response by various tax revenues to the output gap and the lag effect between the tax base and the actual tax revenues only slightly affect the assessment of the structural balance.

Douira (2014)\(^{21}\) identified two cycles: from 1995 to 2002 and from 2003 to 2011. The first cycle was characterized by adverse economic conditions, with a negative output gap. A cyclical component comprised two-thirds of the budget deficit and a structural component comprised one-third. The second cycle was accompanied by favorable economic conditions with a positive output gap and a budget deficit mainly consisting of the structural component. It seems clear that during these years, the Treasury was able to reduce some budget vulnerabilities while recording a higher structural deficit. This situation reveals a worsening of the underlying fiscal position.

---

1.5. Fiscal policy is caught between the multiple social and economic demands and the constraint of sustainability.

1.5.1. The economic and social constraint

The choices made by the government since 2012 in terms of fiscal policy, in particular the cuts to capital expenditure, management of carryovers of appropriations, handling of arrears and special Treasury accounts are designed to develop a number of effects favorable to controlling the fiscal deficit. However it is equally important to consider the impact of this choice, not only in terms of allocation but also especially in terms of the redistribution of income inequality and well-being of the population. Indeed, the country must satisfy the economic and social requirements which implies achieving a faster pace, basic infrastructure, the establishment of industrial zones, strengthening vocational training, the implementation of financial instruments to facilitate access of businesses to adequate funding, and urgency in the implementation of some social expenditure to overcome weaknesses in the areas of education, youth unemployment, social protection, geographic inequalities, and the promotion of good governance of public policy on social and solidarity efforts.

On the revenue side, the budget’s redistributive component can be analyzed in terms of the tax contribution to reducing income inequality and poverty. The Moroccan tax system is characterized by (i) a stable tax burden with a 24% threshold that can enable sustained economic growth, but remains focused on a very limited “triangle of taxpayers” (consumers, employees and a small number of businesses); (ii) a structure still characterized by the primacy of indirect taxes on consumption; (iii) deteriorating public expenditure coverage mainly because of the importance of incompressible state expenses especially the wage bill; (iv) low elasticity with respect to GDP and on a downward trend and (v) “inefficient and inequitable” tax expenditures that hinder their performance; (vi) a very small contribution to reducing regional inequalities.

With regard to spending and their socio-economic impacts, the historical evolution of fiscal policy in Morocco shows that after independence and until 1977, the country needed to restructure its economy to meet growth requirements, while public investment expenditures experienced a significant increase as a result of ephemeral higher phosphate prices. The oil shock, depressive effects of drought and the reversal of the international financial situation precipitated the country into a serious debt crisis causing the intervention of the international financial institutions and the adoption of a structural adjustment policy. The implementation of the recovery program and consolidation of government spending has resulted in the contraction of public spending especially investment spending and recovery of macroeconomic balances. Finally, the post-rescheduling stage focused on preserving the gains from fiscal consolidation and thus the consolidation of fundamentals. Reducing the budget deficit limited the rapid

rise of public debt and expenses related to its repayment and remuneration. In the same sense, the massive use of domestic debt to cover the needs arising from financing the budget deficit, as well as funding the negative net flows of external debt, resulted in a significant increase in domestic debt with largely modernized management modes. Similarly, during this period, in order to stabilize the payroll as a percentage of GDP, in 2005 the budget authorities launched the voluntary departure program for civil servants and implemented a new policy of streamlining human resources management to increase public sector efficiency.

In recent years, it is clear that despite some strengthening of the weight of capital expenditure within total public expenditures, it remains dominated by operating expenses including payroll and Compensation Fund expenses. The compensation system in Morocco has failed to achieve its objectives since it could not target the most disadvantaged among its primary beneficiaries or reduce the burden of poverty. Given the urgency of reforming the compensation fund system, the 2012 Finance Law created the Social Cohesion Fund in order to strengthen the social cohesion mechanisms for the vulnerable and poor population, in particular by financing expenditures related to RAMED, support for schooling (Tayssir), and assistance to people with special needs. However, the operationalization of this social cohesion mechanism is hindered by uncertainty about the sustainability of the fund’s resources and the difficulty of contributions by local authorities and public institutions. In general, the assessment of Morocco’s fiscal policy impact on poverty and inequality with a dynamic computable general equilibrium (CGE) model supports the idea of the need to rehabilitate the budget redistribution function, which according Khellaf (2015) can also serve also the human development goals by contributing to the well-being of households and by reducing poverty and inequality, which are obstacles to a sustainable development process.

These weaknesses show that the country still cannot contain the various social deficits, although it has many social action and solidarity programs. They reveal that the state still fails to raise the level of effectiveness of these programs, to which it nevertheless devotes over 50% of its general budget. This shows how the budgetary costs of these actions are today very real, and in confronting such strong and burdensome budgetary and financial constraints they practically determine the achievement of the sustainability objective.

1.5.2. The potential sustainability constraint

Prospective analysis of debt sustainability in Morocco as advocated by various IMF reports, in particular those established during consultations under Article IV, shows that Morocco’s public debt is overall sustainable. Since 2004, the debt sustainability analysis revealed that the risk to its sustainability was low to moderate. The reference

scenarios, often based on optimistic projections, showed that the debt level was overall sustainable and robust in confronting different likely macroeconomic shocks.

However, by adopting the same methodology but with more conservative working hypotheses including an unfavorable international economic environment, the alternative scenario indicates that Morocco’s debt burden would not be sustainable medium-term and would exceed the benchmark of 70% set for the debt burden of emerging economies, even before submitting it to various stress tests. Similarly, the debt level significantly increases after applying the various shocks to exceed the bar of 77% of GDP, which is considered by the IMF as the maximum sustainable level. In sum, under the assumption of a more cautious alternative scenario, the debt burden would be unsustainable in the medium term and very vulnerable to various macroeconomic shocks.

The issue of sustainability can be assessed in the medium-term by reviewing the budget balances in particular by assessing the sustainability of the primary balance until 2019 and by building on two reaction functions. The first assumes that the decision-maker reacts to economic conditions, past debt, and a set of control variables. The second assumes that the ratio of the primary balance responds to two objectives: a target in terms of a 60% debt ratio as a percentage of GDP, and a target in terms of a public deficit ratio of 3% percent of GDP. For the first fiscal reaction function, the primary balance is very persistent and responds positively to the increase of public debt and in a counter-cyclical manner to fluctuations in the economic cycle. For the second reaction function, it appears that the primary balance reacts in a more significant manner to the debt target than the budget deficit target. Ultimately, fan chart analysis suggests that the primary balance target would not be achieved during the forecast period if fiscal authorities aimed only at improving the economic environment to generate higher tax revenues. However, the likelihood of the sustainability of fiscal policy increases if fiscal authorities simultaneously set budget deficit and debt targets as a priority. In this case, the budgetary leeway necessary to achieve these two objectives must be more oriented towards public spending.
