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Road map for enhancing Morocco – Brazil economic relations[1]

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Summary

There is much room for deepening Brazil and Morocco's bilateral economic relationship, in the fields of trade and investment flows. This is the main conclusion of the assessment of both countries external economic relations and of their bilateral trade and investment flows. This policy brief aims at presenting a roadmap for fostering bilateral economic relations, focusing on the avenues for a bilateral free trade agreement and for bilateral treaties on investment promotion. This approach is based on the findings that the trade and industrial policies adopted by both countries create important obstacles to bilateral trade.

1. Introduction

The assessment of Brazil and Morocco's economic structures, their external economic relations, and their bilateral trade and investment flows, indicates that there is much room for deepening the bilateral economic relationship, in the field of trade as well as in investments[2]. Although a roadmap for fostering bilateral economic integration should comprehend a varied set of initiatives, combining trade and investment promotion activities with negotiations of bilateral agreements on trade liberalization and investment facilitation, this brief will focus on this latest subset of initiatives (the negotiating agenda). This decision is based on the finding that the trade and industrial policies adopted by both countries create important obstacles to bilateral trade.

Section 2 addresses the main features and trends of Morocco and Brazil trade and industrial policies, while Section 3 proposes a road map for bilateral trade negotiations objectives, scope and primary thematic agenda. Section 4 presents policy recommendations designed to enhance bilateral economic relations.

2. Trade and industrial policies in Morocco and Brazil: characteristics and trends

Brazil and Morocco share a common aspiration: the development of diversified and sophisticated industrial sectors. To this end, both countries have been implementing a wide set of industrial and trade policies that have relevant impacts on market access conditions for bilateral trade. Furthermore, Morocco has been intensifying its agricultural policy with the aim at making the country's "agriculture a driver of economic and social development" (WTO, 2015). Although in the FDI arena both countries adopt quite liberal approaches, the frequent regulatory reforms and changes in industrial policies also calls for bilateral instruments that mitigate uncertainties and facilitate investments.

1. Paper produced in the framework of the CINDES - OCP Policy Center analytical partnership

2. Rios, S.P., Motta Veiga, P. and Guimarães, E - Morocco – Brazil economic relations: current situation and strategies for a deeper relationship, CINDES, 2016.

2.1 Morocco

Moroccan industrial and trade policies oscillate between providing sectorial-targeted incentives and horizontal instruments to stimulate industrialization and exports.[3] As in Brazil, the Moroccan government opened its economy in the 1990s, reducing import tariffs, licensing requirements and reduced credit incentives to exports. By the end of that decade, the government had introduced several selective investment promotion schemes, aimed at promoting structural transformation, mainly through investment subsidies for the textile and automotive sectors.

During the last ten years, Morocco launched three industrial development plans. The Emergence Plan, presented in 2005, was followed by the National Pact for Industrial Emergence (PNEI) announced in 2009, which targeted the development and modernization of six key industrial sectors: aeronautics, automotive, agro-industry, off shoring, textiles, and pharmaceutics. Seeking to accelerate industrialization in some sectors, the Moroccan government launched a new industrial policy in 2014: the Industrial Acceleration Plan (PAI), for the period 2014-2020. The new plan aims to continue supporting the development of sectors like the automotive and aeronautics, while pursuing the growth of more traditional sectors, such as textiles and pharmaceutics.

From 2009 to 2012, the Moroccan government progressively introduced tariff reforms allowing for the gradual elimination of the applied tariffs for all industrial products. Although there has been a considerable decline in these tariffs' level, they still remain relatively high.[4] However, Morocco has negotiated Free Trade Agreements (FTAs) with most of its largest trade partners, having liberalized the majority of its industrial goods imports in these preferential pacts.

In the agricultural sector, Morocco has launched the Green Morocco Plan 2008-2020 (PMV), which, as mentioned above, aims to enhance agricultural productivity, boost employment and rural incomes, increase international competitiveness, and improve sustainability and environmental protection. To implement this program, the share of the Moroccan Government's investment budget allocated to agriculture rose from 4% in 2008 to 13% in 2014 and 2015.[5]

Following tariff liberalization for industrial products, the Moroccan government implemented a tariff reform for agricultural products, reducing average tariffs by one third, from 44.5% in 2009 to 27.4% in 2015. In contrast with the industrial sector's preferential trade negotiations, the liberalization of agricultural products' imports in Morocco's negotiated FTAs was limited. Moreover, the commitments stated in the country's FTA with the US – to extend grant to the partner any better preferential conditions (i.e.: preferential tariffs) accorded in trade negotiations with other partners – limits Morocco's ability to negotiate better terms of market access to agricultural product imports.

As far as FDI regimes are concerned, encouraging FDI inflows has been a priority for the Moroccan government since the 1990s. The 1995 Investment Charter, established by the Framework Law nº 18-95, is still the main investment legislation. This provides a convertibility regime for foreign investors in Morocco and allows for certain income tax or corporate tax exemptions. In addition, the Charter also establishes conditions for state contributions to some investment expenditure, such as land purchases, vocational training, or external infrastructure.

Morocco's investment regime has been going through modernization and changes. A draft investment law, consolidating all relevant texts is under preparation. In 2009, Morocco adhered to the OECD Declaration on International Investment and Multinational Enterprises. Upon doing this, Morocco undertook to grant national treatment to foreign investors, with the exception of a negative list, which includes a cap on foreign ownership of capital in air transport companies, maritime transport companies, and marine fishing companies, limitations on the ownership of agricultural land and majority stakes in the capital of large national banks. On the institutional level, the Moroccan Investment Development Agency was created, also in 2009, and is responsible for promoting FDI in Morocco.

Morocco has signed around 60 Bilateral Investment Treaties (BITs), of which 48 have entered into force. Furthermore, Morocco's free trade agreement with the United Sates incorporates a chapter on investment, aimed at protecting investors and investments from regulatory risks and policy instability. These agreements include ISDS provisions. Morocco has also negotiated and implemented 50 international agreements for the avoidance of double taxation.

3. See: http://www.worldbank.org/content/dam/Worldbank/document/MNA/mena_jobs_or_privileges_chap3.pdf

4. See WTO (2015).

5. Idem.

2.2. Brazil

Until the beginning of the trade liberalization process in 1988, the tariff structure in place in Brazil was roughly the same as the one implemented 30 years earlier in 1957, when the import substitution strategy was at its initial phase. At the end of the 1980s, liberalization began cautiously by eliminating tariff redundancy, suppressing certain surcharges applicable to imports and partially eliminating special tax regimes applied to imports. These measures decreased the average nominal tariff rate from 57.5% in 1987 to 32.1% in 1989.

Unilateral trade liberalization was deepened in 1990 and concluded at the end of 1993, eliminating the extensive range of non-tariff border barriers and reducing the average tariff to around 13%.

Implemented during a period of deep macro-economic crisis, with domestic demand down and the real exchange rate quite high, trade liberalization had little impact on the import flows and practically did not affect domestic demand until 1994. It was only with the implementation of the 'Real Plan' in July 1994 – to fight hyperinflation - and the subsequent appreciation of the national currency and the expansion of domestic demand, that the effects of trade liberalization were widely felt in the domestic market. From then onwards, the opening of trade began to work as an inter and intrasector selectivity factor, discriminating between companies and sectors based on their capacity to adapt to a competitive environment.

Currently the simple average nominal tariff rate is 13.7%, with the maximum rate of 35% applied to automobiles, textiles, toys, furniture and shoes. There are also rates around 18% for electronic goods, 14% for capital goods and from 4% to 12% for inputs and raw-materials.

Despite some occasional tariffs increases applied by Brazil, there has been no relevant inflection in trade policy since the trade reform of the 1990s until recently. The shift towards a more protectionist stance in the trade policy began to appear at the beginning of 2010, following a sharp increase in Brazilian imports. Since then the Brazilian Government became more sensitive to private sector pressures, introducing some protectionist measures, although in a selective and occasional manner. Included in this new policy trend, we notice the expansion of public credit through the Brazilian Development Bank (BNDES) with subsidized interest rates – and even negative in real terms –; dissemination of domestic content requirements for access to official credit and tax incentives or to participate in public bidding in areas such as oil and gas; broad preferences for local companies in government procurement and, the use of domestic taxes to discriminate against imports, etc.

In the area of trade negotiations, the reflection of these new protectionist winds has been the lack of interest in moving forward with 'in progress' initiatives such as the EU-MERCOSUR free trade negotiations.

This strategy, however, seems to have reached its limit. On one side, many of these policies are being challenged by the European Union and Japan under the WTO Dispute Settlement Mechanism. On the other side, the fiscal space to support industrial policies involving the significant use of subsidies is much narrower nowadays.

In such a scenario, the new government is pointing to a shift in the strategy of the trade and industrial policies from the management of short-term problems and sectorial difficulties – whose instruments remain in place – to issues that are predominantly 'horizontal' affecting all industrial sectors. This revival of what is known as the 'Custo Brasil' agenda, focusing on the systemic and regulatory costs that negatively impact on the cost of production and investment in Brazil, should materialize through a new round of concessions and privatizations in the infrastructure hardware (especially in the transportation sectors), measures to reduce the cost of energy in Brazil, etc.

Regarding the trade policy agenda, the new winds in Brazil point to a more assertive stance towards trade negotiations. The negotiations of preferential trade agreements with relevant partners (European Union and Mexico) are at the top of the priority list of Brazilian trade policy agenda.

In contrast with the protectionist tradition that characterizes Brazil's trade policy, Brazil has had a relatively liberal and notably stable FDI regime since for more than fifty years[6]. Nevertheless, this regulatory contrast was highly functional from the point of view of the model of development: the large, dynamic domestic market protected by all sorts of trade barriers was the main factor that attracted the flows of FDI to Brazil. Since the very beginning, foreign investments in the country

6. FDI regime is regulated by constitutional rules and by a Basic Law (Law no. 4131) from the early 1960s. The stability of the liberal nature of the legislation was preserved despite the significant political changes that characterized Brazil between the 1960s and the 1980s.

were oriented by a market-seeking logic, the profitability of investments being guaranteed by a protectionist trade policy.

The Brazilian policy tradition during the industrialization period thereby combined trade protectionism based on high tariffs and non-tariffs barriers with a liberal and stable regulatory framework for foreign direct investment. The liberalizing reforms that were the feature of the 1990s also impacted the investment regime. In 1991, restrictions on the entry and operation of foreign companies in the information-technology sector were lifted, some mechanisms restricting the outflow of capital were removed, financial flows were partially liberalized, and a series of amendments to the Constitution (mostly adopted between 1995 and 1996) removed the state monopoly in telecommunications and in oil and gas, as well as with the constitutional distinction between national and foreign companies operating in Brazil. Those elements enabled foreign companies to participate in the privatization processes, bidding for public-services concessions.

During Lula's administration, outward FDI flows grew and were promoted by the government under a "national champions" strategy in sectors seen as strategic where Brazil had strong comparative advantages. While Brazil has not implemented any BITs[7], Brazilian companies investing abroad, especially those operating in highly regulated sectors and in countries subject to political and economic instability, began to argue for the convenience of negotiating bilateral investment agreements that could provide some degree of protection against regulatory and political risks in the host countries.

In 2012, the Brazilian government began to discuss internally alternative formats for the regulation of investments at the international level. This initiative gave rise to a Brazilian framework for the Agreement on Cooperation and Facilitation of Investments (ACFI).[8]

This framework seeks to combine investment promotion tools with risk mitigation provisions, without incurring commitments that are not compatible with Brazilian constitutional limitations or political sensitivities. The most relevant provision that is usually stated in a typical BIT and is lacking in the ACFI framework is the investor protection through the Investor-State dispute settlement (ISDS) mechanism.

Mozambique, Angola, and Malawi in Africa, and Mexico, Chile, Colombia, and Peru in Latin America are the seven countries with which Brazil has signed ACFIs. Currently, Brazil is negotiating ACFIs with several developing countries, including Morocco.

Brazil has also negotiated and implemented 33 bilateral agreements for the avoidance of double taxation (ADTs). However, there are some peculiarities in the Brazilian tax legislation that impair the achievement of full benefits from these agreements. Most of the problems faced by foreign investors with the use of the ADTs benefits in Brazil are related to the interpretation of important provisions of these agreements. Brazil and Morocco are currently negotiating an ADT.

3. A roadmap for an economic partnership between Brazil and Morocco

As seen in the previous section, Brazil and Morocco adopt trade and industrial policies that are geared towards the development of local productive chains. These policies translate into tariff and non-tariff barriers to imports, which affect the opportunities to increase bilateral trade. Moreover, the barriers can represent relevant obstacles to the seizing of the opportunities to increase and expand bilateral trade.

The negotiation of a bilateral free trade agreement that removes most of trade barriers, eliminating tariffs and setting the convergence or the equivalence of regulatory issues, and which creates an institutional framework to offer predictability of regulations and settlement of disputes would contribute to foster bilateral economic relations. Furthermore, this roadmap should include an agreement that promotes and protects investment and a treaty to eliminate double taxation in investment operations. It is important to take into account that Brazil is a member of MERCOSUR, and as such, has the commitment to negotiate preferential trade agreements together with its partners, as a bloc. Currently, this should not represent a relevant obstacle, since MERCOSUR members are entering into a period of convergence in relation to approaches to political and economic policy and the bloc has already negotiated a Framework Agreement on Trade with Morocco.

7. During the Cardoso Administration (1995–2002), Brazilian authorities negotiated 16 Bilateral Investment Treaties (BIT), in line with the strategies followed by most developing countries. However, none of these treaties were approved by the Brazilian Parliament. As a result, Brazil is the only emerging economy that has no such agreements in place aimed at protecting foreign investors' rights.

8. See Morosini and Badin (2015) for an accurate description of this instrument.

The scope and degree of ambition of a bilateral FTA should take into consideration the priorities and sensitivity of Morocco's and the MERCOSUR member states' trade and industrial policies. An initial approach to a FTA should incorporate the elimination of barriers to the bulk trade in goods and services. Subsequent negotiating rounds could incorporate other thematic areas, if considered convenient by both parties.

3.1 Elements for an FTA between Brazil and Morocco

- **Tariffs**

In order to achieve an ambitious and comprehensive FTA, tariffs should be eliminated for substantially all trade (more than 90% of trade volume/value in 10 years after the agreement comes into force). There should be no a priori exclusion of products from the liberalization schedule. In the course of negotiations, both sides should consider options for dealing with the most sensitive products. These products could be contemplated with longer phase-out periods for tariff elimination, but should not be completely excluded from liberalization commitments. Nor should the list of sensitive products be concentrated in a single sector, in order to avoid the exclusion of an entire sector from the liberalization process.

- **Trade facilitation and customs procedures**

In order to facilitate bilateral trade and to allow companies to reap the full benefits of the trade preferences negotiated under the FTA, Brazil and Morocco should join efforts to cooperate in the implementation of the Trade Facilitation Agreement (TFA), reached in the Bali WTO Ministerial Conference.

Brazil and Morocco should implement a mutual recognition agreement for each country's Authorized Economic Operator Program, in order to speed up customs procedures for trade in goods.

- **Rules of origin**

The definition of rules of origin is a very relevant step for the effectiveness of preferential trade agreements. Special attention should be given to the design of the rules, which should be simple, flexible and transparent and should not hamper the ability of companies to benefit from the trade preferences negotiated in the agreement.

- **Regulatory issues: Sanitary and Phytosanitary (SPS) and Technical Barriers to Trade (TBT)**

Technical regulations and private standards are proliferating and creating new barriers to trade, particularly when they are established individually by countries outside of the umbrella of international fora.

MERCOSUR and Morocco should explore ways to address behind-the-border obstacles to trade, with an emphasis on standards and regulations applied to imports of manufactured and agricultural products. It is important to find ways, for example, to protect human health or safety, animal or plant life or health, the environment, to prevent deceptive practices, and to guarantee national security, without creating unnecessary barriers to trade.

A bilateral FTA should incorporate an ambitious SPS (Sanitary and Phytosanitary) chapter that goes beyond the WTO SPS Agreement, addressing the requirements that SPS measures be based on science and on international standards. This chapter should refer to: (i) the promotion of a more prevention – based mechanism; and (ii) the expansion in breadth and depth of information-sharing.

Both Parties should develop deep cooperation in exchanging views and information at a bilateral level and in relevant international bodies engaged in food safety and human, animal or plant life or health issues; and facilitating the timely exchange of information about their respective SPS measures. To this end, the FTA should incorporate a Sub-Committee on SPS Cooperation, to be integrated by experts from both sides with the purpose of undertaking consultations, including science-based consultations, to identify and address specific issues that may arise from the application of SPS measures with the objective of achieving mutually acceptable solutions.

A TBT (Technical Barriers to Trade) chapter should also be incorporated in the FTA. The objective of this chapter should be to promote transparency and dialogue in the regulations and standards setting process.

The agreement should allow for reducing redundant and burdensome testing and certification requirements, by promoting confidence among certification bodies of both countries. Agreements on mutual recognition of tests and certifications should be adopted in order to reduce costs and delays in bilateral trade. In this context preference should be given to international standards.

- **Services**

Services are increasingly an undissociated component of trade in goods. In order to foster bilateral economic relations, trade in services should be encouraged. Moreover, to reach a substantial liberalization in trade in services, efforts should be undertaken to achieve substantial sectorial coverage, going well beyond the General Agreement on Trade in Services (GATS) commitments of the countries involved (GATS Article 5).

- **Dispute Settlement Mechanism**

A robust mechanism for dispute settlement involving all the themes included in the FTA should be incorporated in the Agreement.

3.2. Agreement on the Facilitation of Movement of Natural Persons

Movement of natural persons is essential in enhancing business relations. Free movement of intra-corporate transferees, including prompt issuance of working permits and visas, movement of specialists, students etc. should be addressed.

3.3. Negotiation of an Agreement on Cooperation and Facilitation of Investments

The Brazilian government proposed to Morocco the negotiation of an Agreement on Cooperation and Facilitation of Investments (ACFI), according to a framework that seeks to combine the promotion of investments with the mitigation of risks. Developing and signing on such an instrument could contribute to the exchange of information and lead to the creation of a more predictable umbrella in order to stimulate bilateral investment operations. It could also be an intermediate step in the direction of the incorporation of an Investments chapter in the future MERCOSUR-Morocco FTA.

3.4. Negotiation of a Double Taxations Avoidance Agreement

Brazil and Morocco have launched negotiations for the signing of a Double Taxation Avoidance Agreement (DTAA). This is a complex negotiation since the two countries have different approaches towards the models of DTAAs they negotiate – Brazil following the model of NATO and Morocco the one of the OECD.

Brazil has a complex and burdensome tax regime, which results in high tax burden and compliance costs. In order to foster bilateral investments, it is important to reduce the tax burden on capital allocations. The avoidance of double taxation should be part of a broad bilateral initiative.

FTA and other bilateral initiatives, such as those destined to facilitate the movement of natural persons and to reduce the tax burden over investment operations could be considered the starting point for more profound bilateral economic integration. There are several other aspects that could be included in a bilateral agenda. However, Brazilian and Moroccan economic relations are still very shallow and the setting of a very ambitious agenda could have a paralyzing effect.

4. Conclusion

Although there are, between Morocco and Brazil, trade and investment opportunities aiming at deepening their bilateral economic relationship[9], some aspects of the national trade and industrial policies of each country hinders the achievement of such opportunities for growing bilateral economic flows.

On the one hand, the high level of tariff protection applied to many of the products selected. On the other hand, the existence of trade agreements which confer competitive advantages, mainly in the case of Morocco, to other suppliers that compete with Brazil in the Moroccan market.

In this context, the negotiation of an FTA that removes the high tariff protection in both countries and that assures exporters market access conditions similar to the ones granted to other suppliers by preferential trade agreements in force is crucial to allow the seizing of the opportunities to expand bilateral trade between Brazil and Morocco. Some proposals for the construction of a roadmap of bilateral negotiations that could contribute to the fostering of trade and investment flows were presented in the previous section. In addition to the conclusion of a FTA which covers the liberalization of goods and services, the roadmap includes recommendations for the negotiation of investments and taxation agreements, which could facilitate and protect investments and reduce their costs. Bilateral FDI is still insignificant, but the increase and diversification of investment initiatives could support the

9. Guimarães, E.A.; Rios, S.P.; Motta Veiga, P. (2016) - Mapping the opportunities for deepening Morocco-Brazil bilateral trade, Policy Brief, October.

increase of trade and the development and cooperation in some industrial sectors that are gaining relevance in both economies. As both countries have quite liberal FDI regimes, bilateral investment agreements, as proposed here, should contribute to create a regulatory framework favoring the growth of investment flows between Brazil and Morocco.

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