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Has Morocco Benefited from the Free Trade Agreement with the European Union?

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Abstract

Since the free trade agreement (FTA) between Morocco and the European Union (EU) came into force nearly two decades ago, Morocco's export performance on EU markets has been less than stellar and the trade deficit with the EU has surged. This has led many observers to take a negative view of the agreement. Yet, bilateral trade balances are not the best way to assess the effects of a trade agreement, and Morocco has derived major benefits in other ways. As they progress on negotiations towards a more comprehensive and deeper relationship, both Morocco and the EU have much work to do to make the agreement work even better for Moroccans. This Policy Paper presents an assessment of the EU-Morocco FTA and outlines some policy implications, focusing not only on trade flows between the two partners, but also on Foreign Direct Investment, regional integration, and the impact on Moroccan importers and consumers.

Has Morocco Benefited from the Free Trade Agreement with the European Union?

The Free Trade Agreement (FTA) between Morocco and the European Union (EU), which came into force in 2000, remains controversial. It is seen as one-sided, with benefits disproportionately accruing to the EU. Yet, to our knowledge there has not been an in-depth review of the EU-Morocco FTA (EUMFTA), at least not one that is in the public domain. After two decades[1], and with the parties intending to renegotiate the agreement, this is a good time to assess its results.

The EUMFTA brought little in terms of better access for Moroccan companies to EU manufacturing markets, since barriers were already low. The original agreement also entailed gradual and limited liberalization of agriculture by both parties (later modified) and very modest provisions to liberalize services. By contrast, the agreement committed Morocco to reduce its high tariffs on EU manufactures to zero by 2012, a commitment Morocco met on schedule. The twelve-year period of preparation helped Morocco adjust gradually to a much more liberal trade regime. Importantly, the FTA was seen in Morocco as a crucial organizing framework for domestic reforms, an irreversible commitment to make the Moroccan economy more competitive and dynamic.

The EUMFTA remains controversial because it came with high expectations but Morocco's economic performance has been disappointing and the trade deficit with the EU has surged. The agreement is often viewed negatively. In this paper, we argue that, contrary to the view of critics, Morocco has derived considerable benefits from the EUMFTA, despite the agreement's evident limitations and the inadequacy of Morocco's domestic reforms. We also argue that a combination of a deeper agreement with the EU, provided it is adequately structured, and policy reforms in Morocco that address some well-known weaknesses, could contribute significantly to improving Morocco's development prospects.

More specifically, we show that Morocco's exports to the EU have performed better than is generally believed and that this occurred despite strong headwinds. We also show that Morocco's bilateral trade deficit with the EU has increased in large part because of shifts in Morocco's trade in primary commodities, namely exports of phosphates and fertilizers and imports of oil and gas, which have been offset by reduced trade deficits or increased trade surpluses with third parties. We also demonstrate that Morocco has derived benefits from the FTA in the form of lower prices for consumers and for importers of EU parts and components. Moreover, we argue that without the EUMFTA, the sizeable increase in FDI into Morocco – especially originating from Europe – and the associated integration of value chains would likely not have happened.

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1. In the margins of the Association Agreement, other agreements have been concluded between Morocco and the EU. An agricultural agreement covering all agricultural products, which were previously governed by the provisions of the Protocols 1 and 2 of the Association Agreement, was signed in 2010 and entered into force on October 1, 2012. In addition, a Fisheries Partnership Agreement between Morocco and the EU was adopted in 2014 for a period of four years and renewed in January 2019. Also, in June 2013, Morocco and the EU signed the «Joint Declaration establishing a Mobility Partnership between the Kingdom of Morocco and the European Union and its Member States», which sets out policy objectives and a series of initiatives to ensure the most effective possible management of migration.

That said, Morocco's chronic current account deficit, its slowing economic growth, and the extensive underemployment of its young population and its women, leave no room for complacency. These problems cannot be blamed on the EUMFTA. No trade agreement can be a substitute for a purposeful program of domestic reform. Nevertheless, there is much room for improvement in the agreement itself. The EU will have to depart from standard negotiating templates to include agriculture and the movement of people in the agreement. Reforms that facilitate the integration of Morocco into European value chains designed to address European and world markets, including in the provision of services, will also need to be included. As part of the new agreement, Morocco should remove barriers to competition and investment, and accelerate the liberalization of its services sector. We stress here that any new trade agreement with the EU, however favorable to Morocco, will not deal with the fundamental causes of Morocco's large external deficit. Fixing that problem requires better fiscal and exchange rate policies, a tax structure and regulations that are more neutral vis-à-vis the traded and non-traded sectors, reduced reliance on imported fossil fuels, and structural domestic reforms to improve the economy's competitiveness.

In-depth ex-post studies of the effects of the EUMFTA are surprisingly lacking, but ex-ante studies help us frame the analysis

Although the EUMFTA is often the subject of animated conversations and of commentary in the Moroccan press[2], and partial ad-hoc analyses of specific topics relating to the agreement have been done, there has been to our knowledge no systematic ex-post assessment of the agreement.[3],[4]. The parties might have carried out ex-post studies, but if so they have not been made publicly available.

By contrast, there were several ex-ante analyses of the EUMFTA, carried out over a decade ago, which were peer-reviewed. These studies set out the economic logic behind the agreement and attempted to predict outcomes. They are worth revisiting because they provide a valuable frame of reference. The ex-ante studies clearly set out the conditions under which the EUMFTA would lead to growth in Morocco's exports and increased inward FDI, while avoiding trade diversion, reducing prices for Moroccan consumers, and limiting the current account deficit. Most important among these conditions are: most-favored nation (MFN) liberalization by Morocco, which to a great extent has happened; significant real exchange rate devaluation, which has not happened; and domestic reforms, where the record is mixed at best. We examine here three studies that we consider the most complete and/or the most relevant to shed light on the present situation.

2. Negotiations on a deeper Morocco-EU trade relationship have been hampered by disagreement since 2015 over the Sahara. This issue was resolved by the inclusion of the latter in the agreement and negotiations were resumed in 2018. The agricultural agreement has since been renewed and a fisheries agreement adopted. More recently in 2019, the 14th meeting of the Morocco-EU Association Council was held in Brussels. This Association Council was an opportunity to confirm the relaunch of the privileged and multidimensional partnership between Morocco and the EU, and to give it a new impetus in line with the ambitions shared by both sides. This Council also discussed the priorities and themes of the Euro-Moroccan partnership for 2019-2020, and the future of the bilateral relationship in its economic and trade aspects and issues related to mobility and migration (Les Echos, Jeune Afrique, la Tribune, l'Economiste).

3. A recent Bruegel/PCNS paper (Dadush and Myachenkova, 2018) reviewed the Trade Agreements between the European Union and four North-African countries, making a positive assessment, but did not delve into the EU-Morocco Agreement specifically.

4. Studies on the impact of the EU-Morocco FTA on the EU are even scarcer. Berlingieri et al (2018) estimated the consumer welfare impact of the new generation of trade agreements implemented by the EU between 1993 and 2013 through three channels: quality of imported products, their variety and their prices. They found that the four richest EU countries (United Kingdom, the Netherlands, Ireland, Belgium/Luxembourg) saw a much larger increase in the quality of imported goods, about 13%, versus 0.3% for Portugal, Greece and Spain. By contrast, the latter group saw a stronger decline of close to 6% in import prices. They also found that FTAs over the period 1993-2013 led to a cumulative reduction in the consumer price index of 0.24%, resulting in substantial savings for EU consumers of around 24 billion euros per year. However, the authors also concluded that the EU's agreements with low or lower middle-income countries, including Morocco, seem most beneficial to EU consumers in terms of price, quality and variety effects.

The first study, by Rutherford et al (1997), used a 39-sector general equilibrium (CGE) model to examine the welfare benefits to Morocco from the EUMFTA under assumptions of perfect competition. The authors noted that Morocco's liberalization long-preceded the EUMFTA. Morocco liberalized trade already beginning in the early 1980s, greatly reducing licensing and tariffs, which had been over 100%. By 1991, long before the entry into force of the EUMFTA, no licensing and no export boards impeded Moroccan trade. Tariffs had been cut drastically to about 30%, though with many exemptions meaning tariff revenue was still high, at 19% of imports. Still, the authors estimated a large gain for Morocco from the EUMFTA, at 1.5% of GDP every year. The gains would be larger still, 2.5% of GDP every year, on the basis of Morocco liberalizing in relation to the rest of the world. These findings, taken together, implied that trade diversion caused by the EUMFTA, from more competitive suppliers than the EU, would represent a cost for Morocco, but not so large that it would offset the gains from the agreement.

Moreover, the authors concluded that Morocco's liberalization vis-à-vis the rest of the world would entail few additional adjustment costs in terms of displaced capital or displaced labor. In the model simulation, Morocco's loss of tariff revenue was sizable and was assumed to be compensated for by increasing the value added tax and other taxes levied at the border (which in fact occurred). The model assumed a sizable real exchange rate devaluation to keep trade balanced when the tariff cuts were implemented. The real exchange rate devaluation – which did not, in fact, occur – was anticipated as being especially helpful to Morocco's important phosphate exports. Exports of fruit and vegetables were also expected to increase as a result. However, given that the EU would engage in little new liberalization, export gains were expected to add only about a quarter of a percent of GDP to Morocco's welfare. Thus about 80% of the welfare gains from the EUMFTA were expected to arise from lower prices for consumers and importers. Losers in Morocco, Rutherford et al (1997), would include sectors such as cereals, meat, dairy and sugar, which prior to the FTA were the most protected. Manufactures generally were expected to decline, with employment losses, including in textiles and garments (which occurred). Service sectors such as transport, insurance, banking, and "trade" were expected to expand (which also occurred). In computing the welfare gains, no adjustment costs were accounted for. With the benefit of hindsight, we assess that Rutherford et al's prediction that Morocco's exports would grow only modestly was on the mark, and, since Morocco has advanced significantly on both MFN and bilateral liberalization, the prediction that trade diversion would be contained was also on the mark, as we discuss further below.

The second study (Elbehri and Hertel, 2006) used a less-detailed CGE model, but incorporated increasing economies of scale that gave rise to imperfect competition. In contrast to the Rutherford et al (1997) findings, Elbehri and Hertel (2006) concluded that the EUMFTA would likely reduce Moroccan welfare significantly and that Morocco would be much better off in a scenario of multilateral trade liberalization, as then anticipated under the Doha negotiations. The difference in conclusions arises from the assumption of Elbehri and Hertel that firms in the manufacturing sector – where the EU has clear comparative advantage – are subject to economies of scale and the biggest firms have a degree of monopoly power. European manufacturing firms are, of course, far bigger than Moroccan firms at the outset and were expected to gain large shares in Morocco with liberalization. European firms were expected to exercise their monopoly power and keep prices high, thus appropriating a large share of the gains from tariff reduction. It was assumed Morocco would not make offsetting gains in agriculture or services, where economies of scale are less prevalent anyway. Additional negative effects on Morocco's welfare were expected to arise from trade diversion. If, as assumed, Moroccan labor markets are rigid (as they may well be in the formal sector), Morocco would suffer from increased unemployment and adjustment costs. The Elbehri and Hertel model underscored the critical importance of multilateral trade liberalization, which leads to reciprocal tariff reductions with the rest of the world, allowing Morocco to derive greater gains from export markets. Multilateral liberalization also makes Moroccan markets more competitive, reducing the monopoly power of EU firms[5], which the FTA enhances. With the benefit of hindsight, we can conclude (see below) that the monopoly power of European firms was sufficiently contained. Clearly, Morocco's MFN status and bilateral liberalization helped in this regard, though by the same token, Morocco's manufacturing sector suffered from even greater international competition than caused by the EUMFTA.

The third study was conducted by International Monetary Fund researchers (Alonso-Gamo et al, 1997) and took an eclectic and heuristic approach, not relying on a single model. The study concluded that the potential gains from the FTA were large, and larger than could be assessed by focusing on tariffs alone. The IMF study viewed the EUMFTA as an important first step towards Morocco's deeper integration with the European Union, involving liberalization of services, easing of regulations, harmonization of standards, transfers of technology, and improvement in logistics and the trade infrastructure that cuts trade costs. The gains would also include a boost to domestic and foreign investment since the EUMFTA would also help lock-in reforms, anchor expectations and enhance credibility. The IMF analysis emphasized the importance of two types of companion reforms that are necessary for the EUMFTA to succeed: reforms that improve the competitiveness of Moroccan firms and strengthen the investment climate in Morocco, and MFN liberalization. In hindsight, there clearly has been MFN liberalization and a broad process of closer integration with the European Union, including through FDI and Morocco's integration into value chains. However, as we show below, domestic reforms in Morocco have not been sufficient to boost international competitiveness and accelerate growth to the extent hoped.

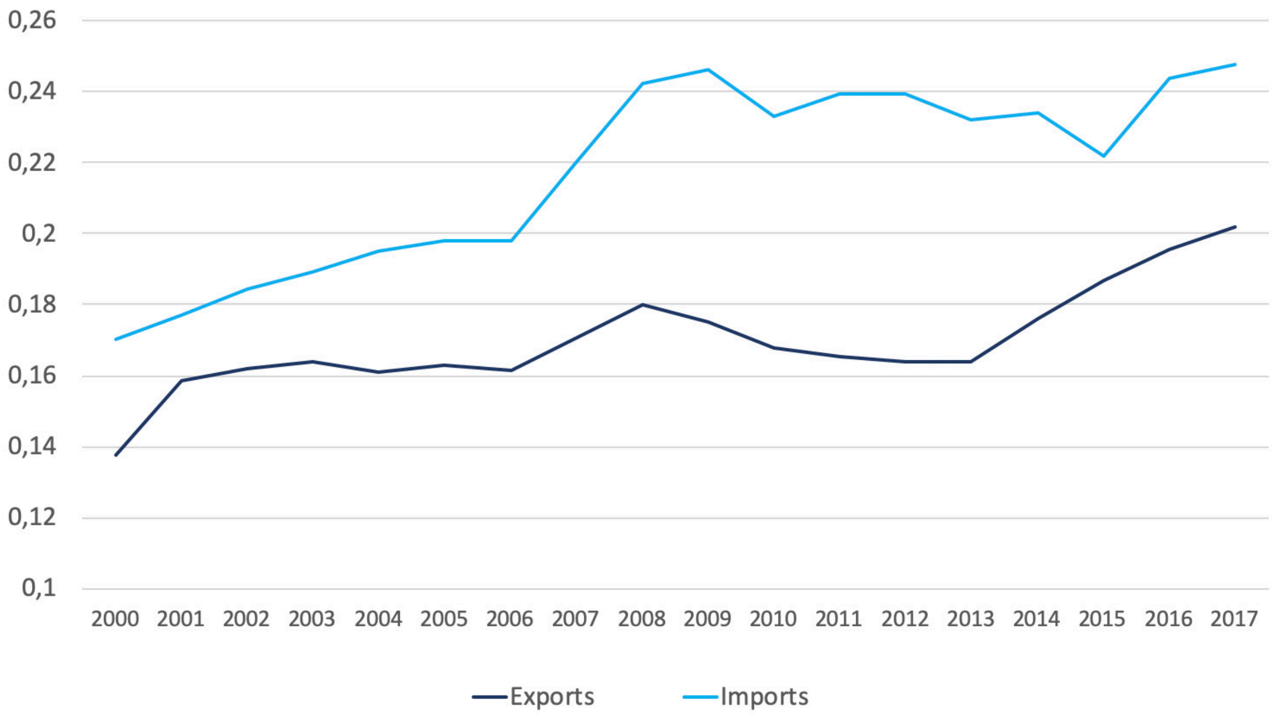
Guided partly by these ex-ante studies, in the rest of this note we review Morocco's trade performance since the EUMFTA came into force and draw out some policy conclusions.

Morocco has seen respectable growth in exports to EU markets

When the FTA came into force in 2000, Morocco's share of European markets for merchandise was 0.6%. In 2017, it was 0.8%. That performance certainly represents a respectable outcome, but is less than many observers had hoped. From 2000 to 2017, Morocco's exports to the EU grew less rapidly than Morocco's exports to the rest of the world (6.7% vs. 9.6% on average annually). Figure 1 shows that Morocco's share of world exports of merchandise increased handsomely up to 2017 compared to 2000, from 0.14% to 0.2%, while its share of world imports increased even more from 0.17% to 0.25%.

5. Bouzahzah et al (2007) reached similar conclusions.

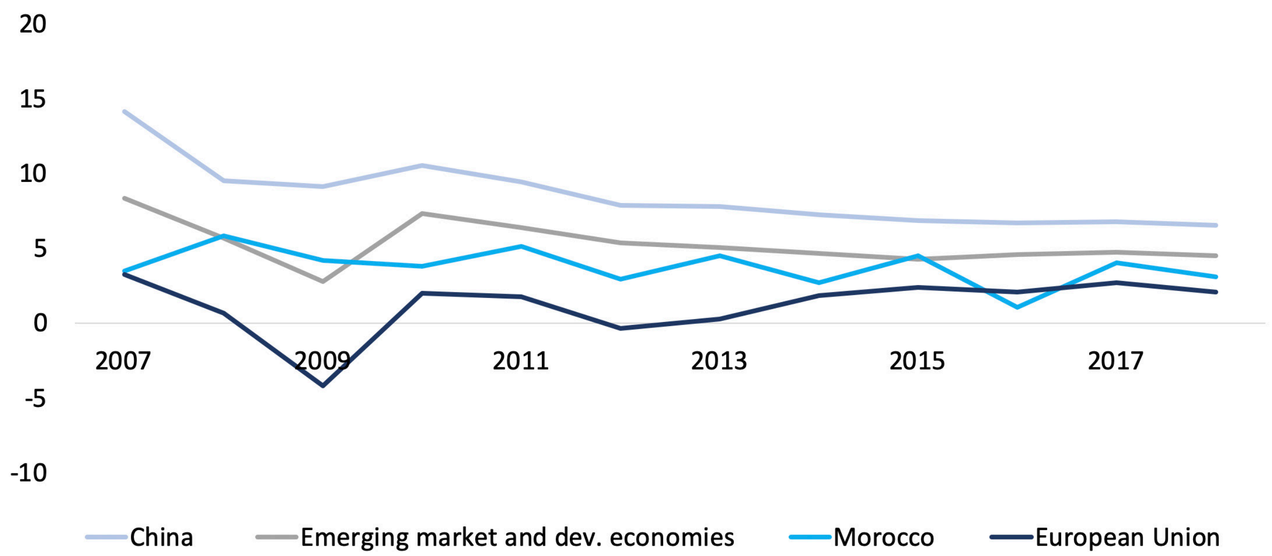
Figure 1: Morocco's share of world trade (%)



Source: Cepii.

Why didn't Morocco's exports to the EU grow faster? Why did Morocco's exports to the EU grow more slowly than Morocco's exports to the rest of the world? Several headwinds contributed, mainly unrelated to the FTA. Perhaps most important, Europe is the world's slowest growing region. Starting in 2008, Europe suffered massively from the global financial crisis and the euro crisis. The crisis had a particularly pronounced effect on southern Europe, notably Italy and Spain, which are, with France, the main trading partners for Morocco.

Figure 2: GDP growth of selected economies, 2007-2017



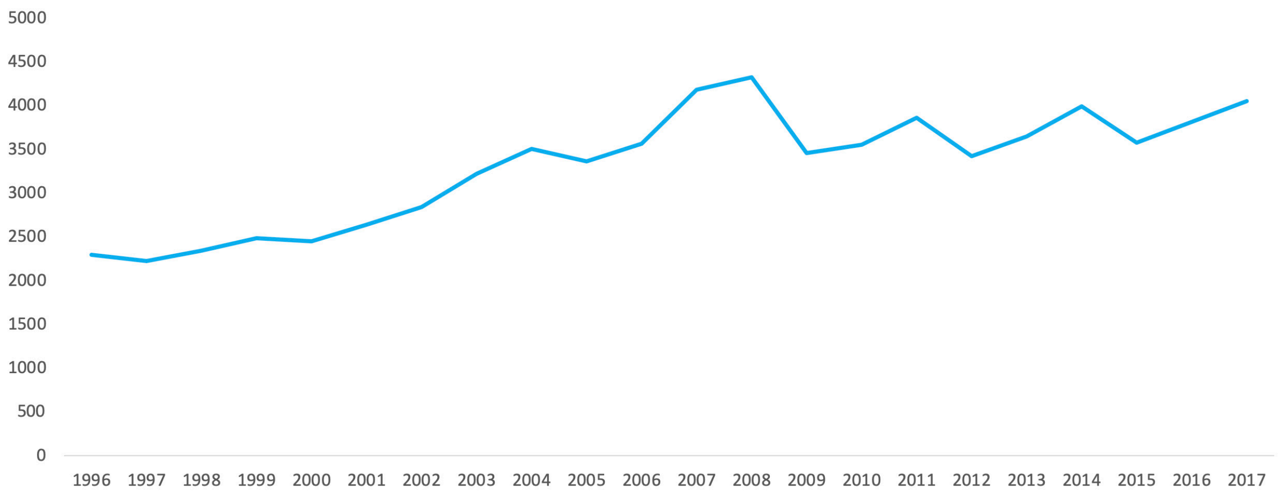
Sources: IMF.

Compounding these problems, the rise of China and the end of the multi-fiber agreement (MFA) meant far greater competition on European markets, especially in the textile sector, which represented over 40% Morocco's goods exports in 2000 (Table 1) China's textile exports to the EU surged, accounting for 34% of the EU's textile imports in 2017 versus 11% in 1996[6]. Imports from other Asian countries, namely Cambodia, Vietnam, Pakistan and Bangladesh, whose labor costs were lower than Morocco's, also rose significantly as the MFA was phased out. In 2017, these four countries accounted for 26% of the EU's textile imports versus 6% in 1996. Morocco barely held its own, maintaining a 3.5% market share of the EU's textile imports over this same period.

Table 1: Share of EU's textile imports from the world (excl. EU)

	1996	2000	2010	2017
China	11%	17%	43%	34%
Bangladesh	3%	4%	8%	14%
Turkey	10%	12%	13%	12%
India	6%	7%	8%	7%
Pakistan	3%	3%	3%	5%
Cambodia	0%	0%	1%	4%
Vietnam	1%	1%	2%	3%
Morocco	4%	4%	3%	3%
Tunisia	4%	4%	3%	2%
Indonesia	3%	4%	2%	2%
Rest of the world excl. EU28	55%	42%	16%	15%

Figure 3: EU clothing and textile imports from Morocco, 1996-2017 (million USD)



Sources: WITS.

6. Earliest year available in the World Integrated Trade Solution database.

Furthermore, the accession of 13 mainly central and east European nations to the EU since 2004, which are classified as middle-income economies and whose comparative advantage was not dissimilar to Morocco's, added to the competitive pressures. The new accession countries received various forms of aid from incumbent EU members, amounting to multiples of the assistance provided to Morocco and to other Southern Mediterranean partners. Many European companies naturally favored the new EU members in their foreign investment decisions – outsourcing that might instead have favored Morocco. Finally, the political turmoil in Morocco's neighbors over the years, culminating in the Arab Spring, clearly did not help Morocco's competitiveness and attractiveness as an investment destination, even though Morocco has been relatively stable.

Since these adverse shocks are, hopefully, one-time events, it is possible that Morocco's trade performance on European markets will improve in the coming years – provided European growth is sustained. According to the October 2019 IMF projections, the European economy will expand at only a modest pace of 1.6% over the next five years. This performance, if realized, would represent an improvement on the post-2008 period, but European growth would remain very low by world standards. Thus, even in a good scenario, the need for Morocco to become better established in large and faster growing markets in Asia and North America is clear (Dadush and Saoudi, 2019). Sub-Saharan Africa, though a small market, also presents clear growth opportunities in some sectors for Morocco.

One reason for optimism is that the composition of Morocco's exports to the EU has changed significantly, increasing in diversity and sophistication, a process that has been clearly helped by the FTA and by the increased foreign direct investment (FDI) associated with it (Table 2). In 2000, apparel and clothing accessories accounted for almost half of Morocco's exports (41%) to the EU, followed by electrical equipment (13%). Other exports were principally low value-added manufactures or agricultural products. By 2017, electrical equipment had become the most exported products with a share of 21%, while the export share of apparel and clothing accessories had dropped to 18%. In addition, road vehicles made their entry into the top three types of product exported. They accounted for 17% of Morocco's export to the EU in 2017 versus virtually none in 2000. Another interesting point is the increased share of fruit and vegetable exports, which went from 7% in 2000 to 12% in 2017.

Table 2: Morocco's top 10 exports to the EU in 2000 and 2017 (in percentage share)

2000		2017	
Apparel/clothing/accessories	41%	Electrical equipment	21%
Electrical equipment	13%	Apparel/clothing/accessories	18%
Fish/shellfish/etc.	11%	Road vehicles	17%
Vegetables and fruit	7%	Vegetables and fruit	12%
Petroleum and products	3%	Fish/shellfish/etc.	8%
Crude fertilizer/mineral	3%	Railway/tramway Equipment	3%
Inorganic chemicals	3%	Manufactured fertilizers	3%
Manufactured fertilizers	3%	Textile yarn/fabric/art.	2%
Footwear	2%	Inorganic chemicals	2%
Metal ores/metal scrap	2%	Footwear	2%

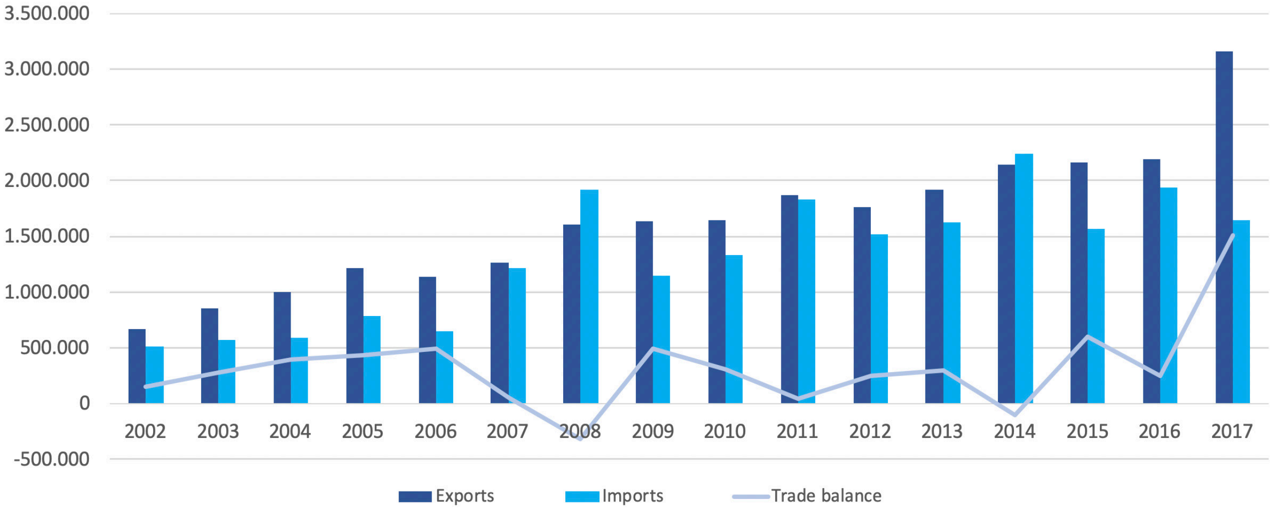
Source: WITS, SITC Rev 3 classification.

Agriculture exports to the EU have increased rapidly despite remaining barriers

The EU remains by far the largest market for Moroccan agricultural products, accounting for 66% of Morocco's agricultural exports in 2017, worth $3.1 billion, compared to 62% in 2002. Exports to the EU are way ahead of the next largest markets: the United States, Turkey and Russia. Exports of agricultural products, especially fruit and vegetables, have been long perceived as a comparative advantage of Morocco. The EUMFTA included provisions to regulate agricultural trade and contributed to modest liberalization in that sector. Starting in 2006, these articles were renegotiated, resulting in a new agreement signed in December 2010, which entered into force on October 1, 2012. While the new agreement liberalized a large portion of agricultural trade between the two parties, several products important for Morocco are deemed sensitive by the EU and continue to be governed by seasonal tariff rate quotas.

The new agreement, now in its seventh year of application, has been reflected in sustained growth of Moroccan agricultural exports to the EU, which increased by 11% on average annually[7] between 2002[8] and 2017, helped by relatively favorable weather conditions in Morocco. Edible vegetables and certain roots, edible fruit and nuts, and preparations of meat, fish or crustaceans were the three main categories of agricultural products exported by Morocco to the EU over 2013-2018, with shares of 36%, 23% and 20% respectively. In particular, Morocco's exports of vegetables to the EU increased by 12% on average each year between 2002 and 2017, reflecting in part an increase in the Moroccan vegetable supply and better valuation of the products sold, thanks to efforts to improve quality (Harbouze, 2019). Morocco's agricultural imports from the EU consist mainly of cereals, with a share of 38% on average during the past five years, followed by animal and vegetable fats and oils (15%) and dairy products (9%). Morocco's agricultural imports from the EU have been growing but at a slower rate than exports to the EU: 8% on average annually. Morocco's agricultural trade balance with the EU is in significant surplus[9].

Figure 4: Morocco's exports, imports and trade balance with the EU for agricultural products

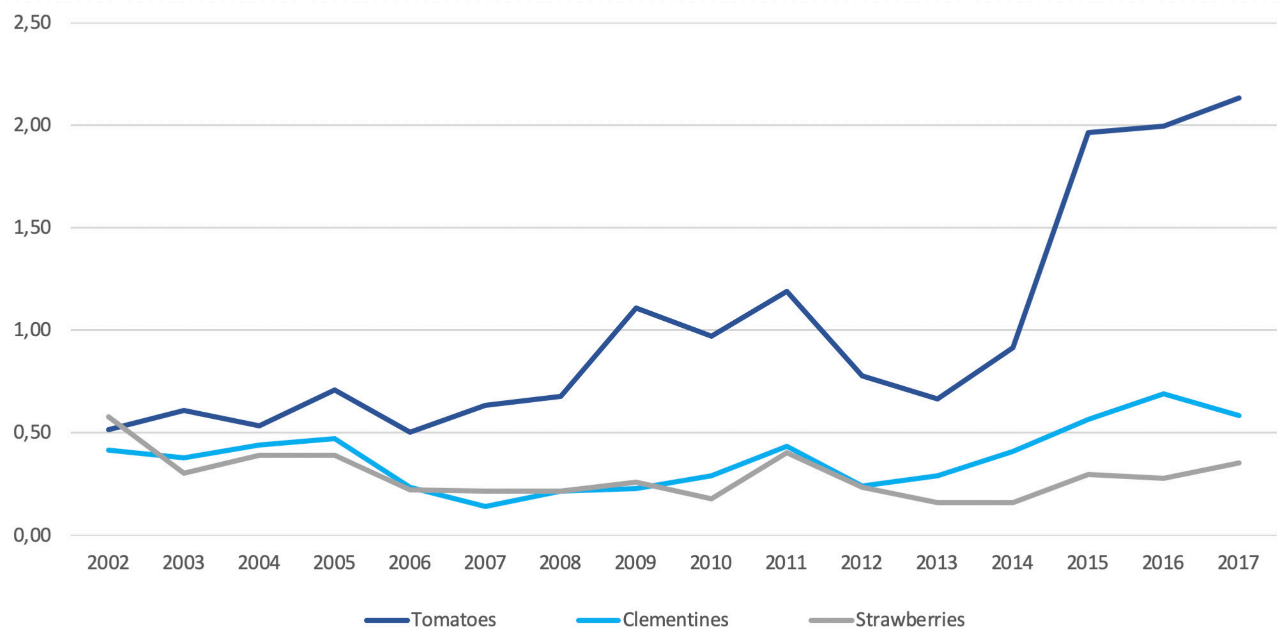


Source: WITS.

7. Based on current $ value of exports.
8. Earliest year available under HS 200.
9. Except for the years 2008 and 2014.

Morocco is the leading supplier of tomatoes to the EU after Spain, selling the equivalent of 32% of its total production of tomatoes (416 000 tons) to the EU in 2017. It also exported 12% and 11% of its production of strawberries and clementines to the EU during the same year. Morocco's share of the tomatoes imported[10] by the EU increased sharply, from 0.5% in 2002 to 2.1% in 2017. The market shares of Morocco's clementines, on the other hand, increased modestly during this same period, from 0.4% in 2002 to 0.6% in 2017, while that of strawberries decreased from 0.6% to 0.3%.

Figure 5: Morocco's market shares of tomatoes, clementines and strawberries (% of EU imports)



Source: WITS.

In addition to subsidies, which in 2017, amounted to some 37% of farmers' incomes in the EU, and which are considered out of bounds in all the EU's bilateral trade negotiations (Baltensperger and Dadush, 2019), barriers to Morocco's agricultural exports to the EU remain high. This is especially the case for fresh or chilled tomatoes (Morocco's largest agricultural export by far), garlic, cucumbers, courgettes, clementines and strawberries. These products benefit from tariff reductions compared to MFN applied rates but are subjected to tariff rate quotas (TRQ) which change with the season. These TRQs are put in place in order to protect from foreign competition the EU's domestic production, particularly of tomatoes and clementines, especially when they are in season. Some of these products also remain subject to a minimal entry price[11].

In some cases, for products including garlic, courgettes and cucumbers, Morocco's exports don't even fill the quotas and enter duty free. But in other cases, the quantities exported to the EU exceed the quotas. This is the situation for tomatoes and strawberries[12]. In those cases, the reductions in MFN

10. Calculated by dividing Morocco's exports to the EU by the EU's imports from the world, excluding intra-EU imports.
11. It is the case for tomatoes, cucumbers, courgettes and clementines. In addition, some liberalized products also remain subject to the conventional entry price according to specific timetables. These are artichokes, oranges, table grapes, apricots and peaches/nectarines.
12. According to WITS data on export quantities and the text of the Agriculture Agreement. For instance, in 2017, Morocco exported 3788 metric ton of cucumber to the EU whereas the quota is 15000 tons between the period from 1 November to 31 May.

customs duties are 60% for tomatoes and 80% for strawberries, so Morocco faces high applied tariffs of 15% and 12% respectively[13].

It is evident that, despite the remaining TRQs on some of Morocco's top agricultural exports to the EU, Morocco has reaped major benefits from its renegotiated agricultural agreement with the EU. Further expansion of Morocco's agricultural exports to the EU market will depend on the EU removing the residual barriers and on, perhaps most importantly, Morocco's ability to increase its agricultural productivity and to deal with the sector's water and financial constraints.

Foreign direct investment in Morocco has increased, and Morocco-based producers have become more integrated with European firms

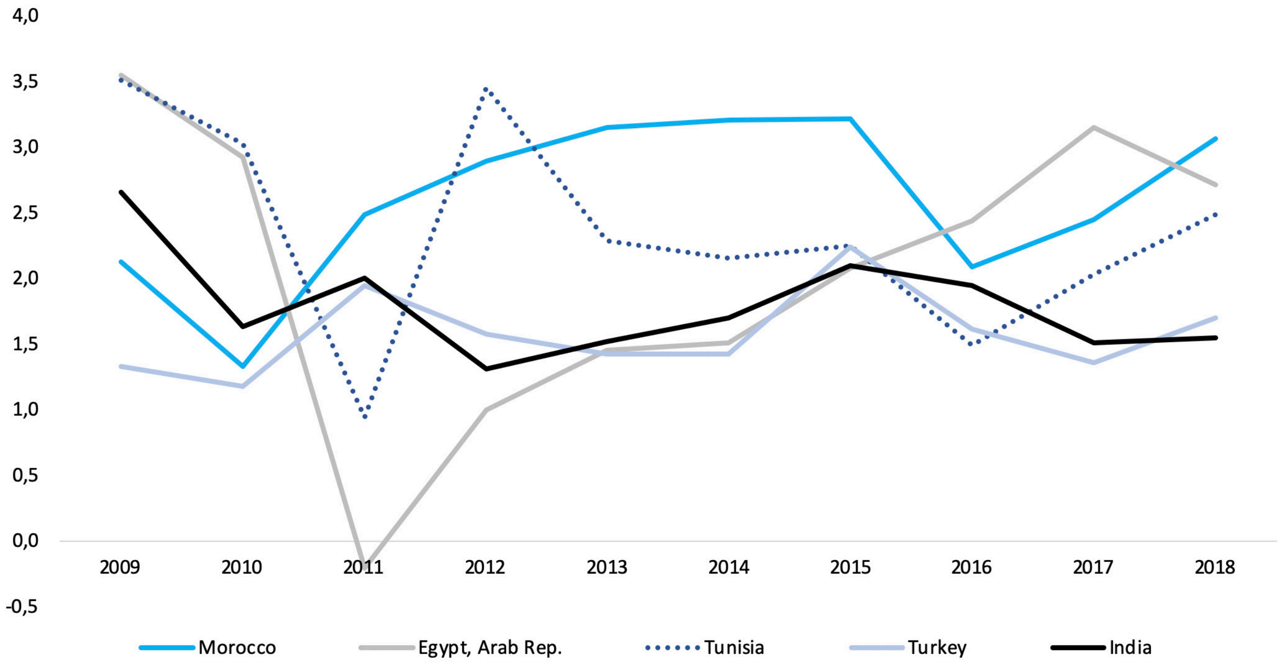
It is difficult to imagine that European auto manufacturers would have set up in Morocco if it did not allow tariff-free import of parts and did not have unimpeded access to European markets.

As anticipated, FDI picked up in Morocco following the EUMFTA. FDI has remained at a respectable level of 2.5-3% of GDP since. Although some of the inward investment is motivated by the opportunity to access European markets, some initiatives aim to profit from Morocco's domestic opportunities, including in real estate and various types of services. As anticipated, the FTA appears to have increased investor confidence in the Moroccan economy by "locking in" liberalization and establishing greater policy discipline in realms ranging from macroeconomic stability to labor markets and product regulations.

Since 2015, FDI into Morocco came primarily from France (24%), the United Arab Emirates (15%), Saudi Arabia (9%) and the United States (9%). Much of it took the form of investment in real estate and services, but about 25% was directed at industry. In 2017, sustained foreign investment into Morocco from multiple sources contrasted with declines in FDI into the rest of North Africa (except Egypt). During that year, FDI in Morocco increased by 23% to $ 2.7 billion. By the end of 2017, the Government had reported 26 auto industry investments worth $1.45 billion, including a deal with Renault (France) to increase local sourcing of components to 55%. FDI into the country's financial sector also expanded, as banking relations with China deepened.

13. According to AHS tariffs from WITS. Latest year available (2015).

Figure 6: Foreign direct investment, net inflows as a share of GDP



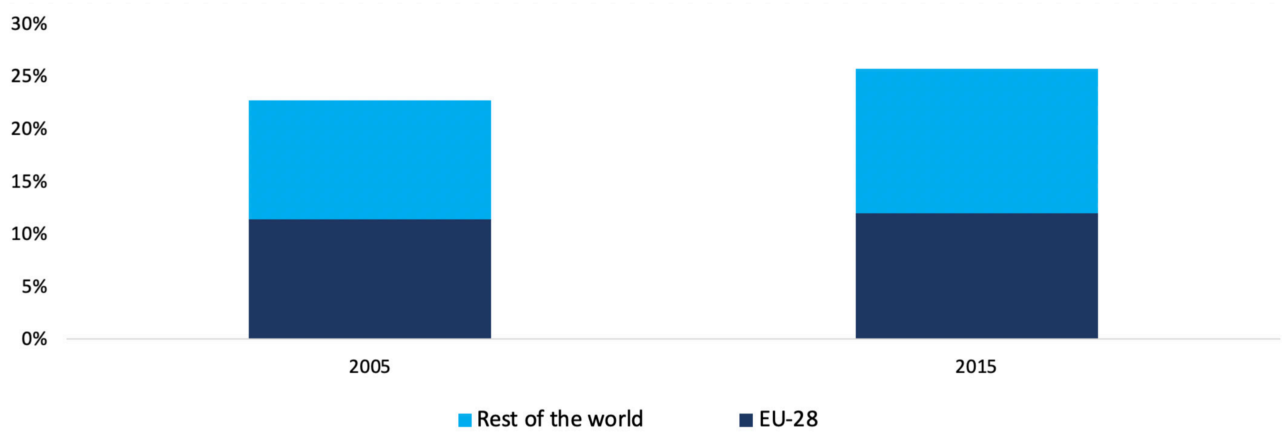
Source: WDI.

Morocco's FDI outflows grew steadily after 2014 to reach a high of 960 million dollars in 2017. Over this period, 21% of Morocco's FDIs went to Egypt, 18% to France, 15% to Côte d'Ivoire and 7% to the United Arab Emirates. Morocco's outward FDI has mainly targeted sectors characterized by high added value per worker, such as the banking (56%), industrial (15%) and telecommunications (14%) sectors.

Increased FDI provides only one indication of Morocco's increased integration into global value chains. A more direct measure is provided by the OECD database of trade measured in value added (TiVA)[14], which now includes Morocco. The share of foreign added value in Morocco's exports increased from 23% in 2005, the year for which the data starts, to almost 26% in 2015. A 2018 PCNS study found that this share was 19% in 1995, confirming the trend (Abdelaaziz and Msadfa, 2018). The share of value added by the EU in Morocco's exports has also increased, reaching 12% in 2015.

14. "The 2018 edition of the TiVA database provides indicators for 64 economies including all OECD, EU28 and G20 countries, most East and South-east Asian economies and a selection of South American countries. This edition covers the period 2005 to 2015, with preliminary projections to 2016 for some indicators" (OECD).

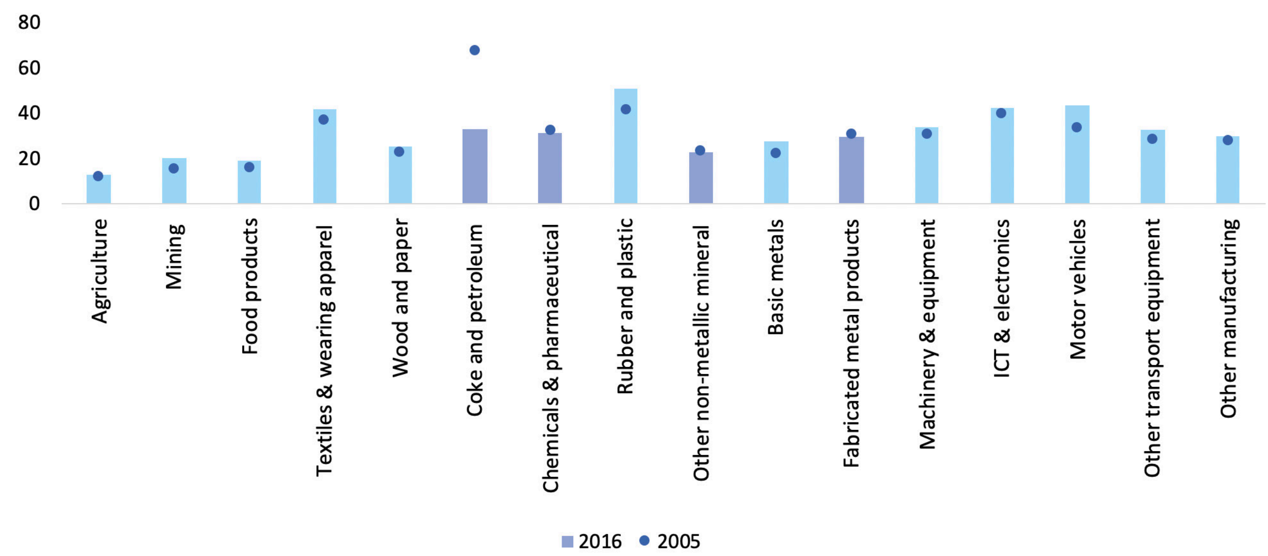
Figure 7: Origin of the value added contained in gross exports of goods and services



Source: OECD.

Regarding trade in goods specifically, the distribution of value added in Morocco's exports by sector gives a more detailed picture. Manufactured exports, which are more dependent on intermediate products, are distinguished by their high share of foreign value added. The rubber and plastic sector is the most dependent on foreign inputs with a share of about 50%. It is followed by the automotive industry, where foreign value added reached 43% in 2016 compared to 33% in 2005, reflecting developments in relation to Renault car plants, which started production in Morocco in 2013 (Abdelaaziz and Msadfa, 2018).

Figure 8: Foreign value-added share in Morocco's gross exports of goods (red denotes an increase since 2005)



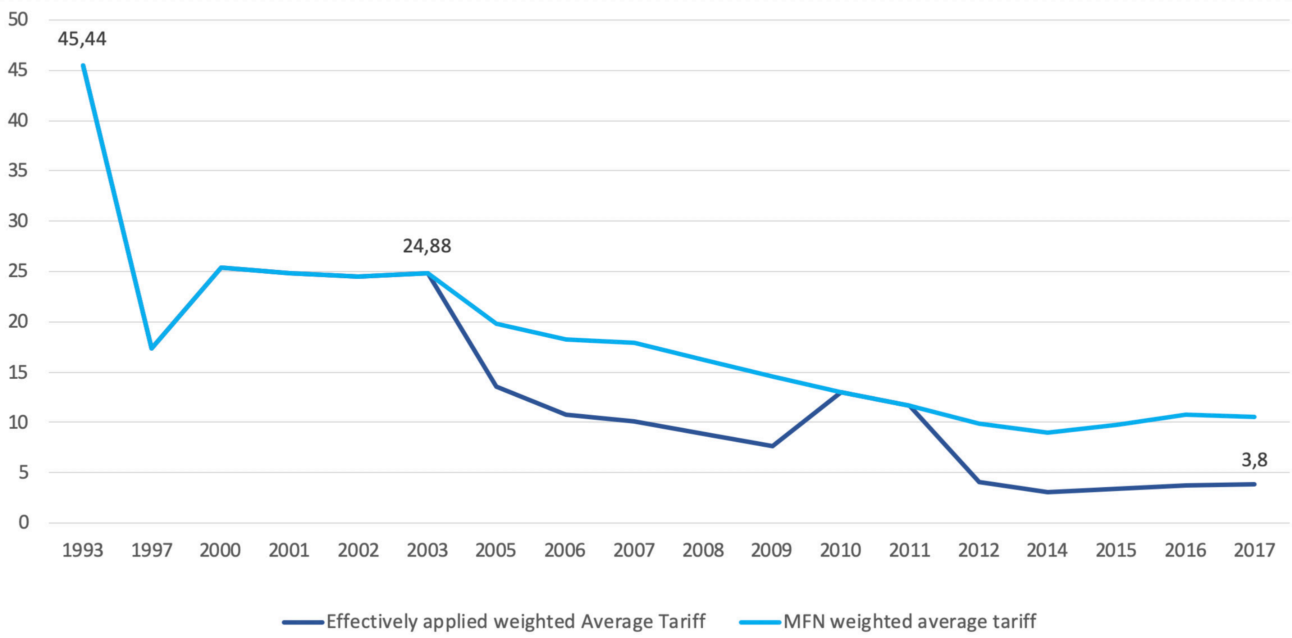
Source: OECD.

Moroccan importers and consumers saw lower price inflation

We have so far analyzed the evolution and structure of Morocco's exports to the EU, as well as its record on inward FDI. But in evaluating the EUMFTA, an exclusive focus on these sources of foreign currency earnings can be misleading. Trade agreements tend to bestow welfare gains by lowering the prices of imports for consumers and for firms that import parts and raw materials. Models typically estimate these gains to be far larger than the gains that accrue from increased exports[15]. As Rutherford et al found in their 1997 paper, the EU-Morocco FTA would likely conform to this pattern, with 80% of the gains accruing to consumers. The mirror image, although only partial, of the gains accruing to consumers is the reduction in the government's tariff revenues. In fact, tariff revenues declined from 3.1% of Morocco's GDP in 2000 to 0.8% of GDP in 2017 and had to be offset by other taxes, such as value added tax and excise taxes.

There is a strong theoretical presumption that trade liberalization will lead to lower prices of importable products, since – unless competition is very imperfect – the price of imports should decline as a direct result of the tariff reduction, domestic producers will be compelled to become more efficient, and the costs of their imported inputs should also decline (P. Goldberg and N. Pavcnik, 2016). But did Moroccan importers and consumers really gain? Unfortunately, it is not easy to isolate the effect of the FTA on Moroccan consumers. One example, however, is highly suggestive. While Morocco's trade liberalization relative to the EU and the rest of the world has progressed (Figure 7), the average price of automobiles in Morocco has not changed since 2006[16], and has even declined slightly since 2015, despite a rise of 18% in Morocco's consumer price index over the same period.

Figure 9: The evolution of trade tariffs applied by Morocco vis à vis the world



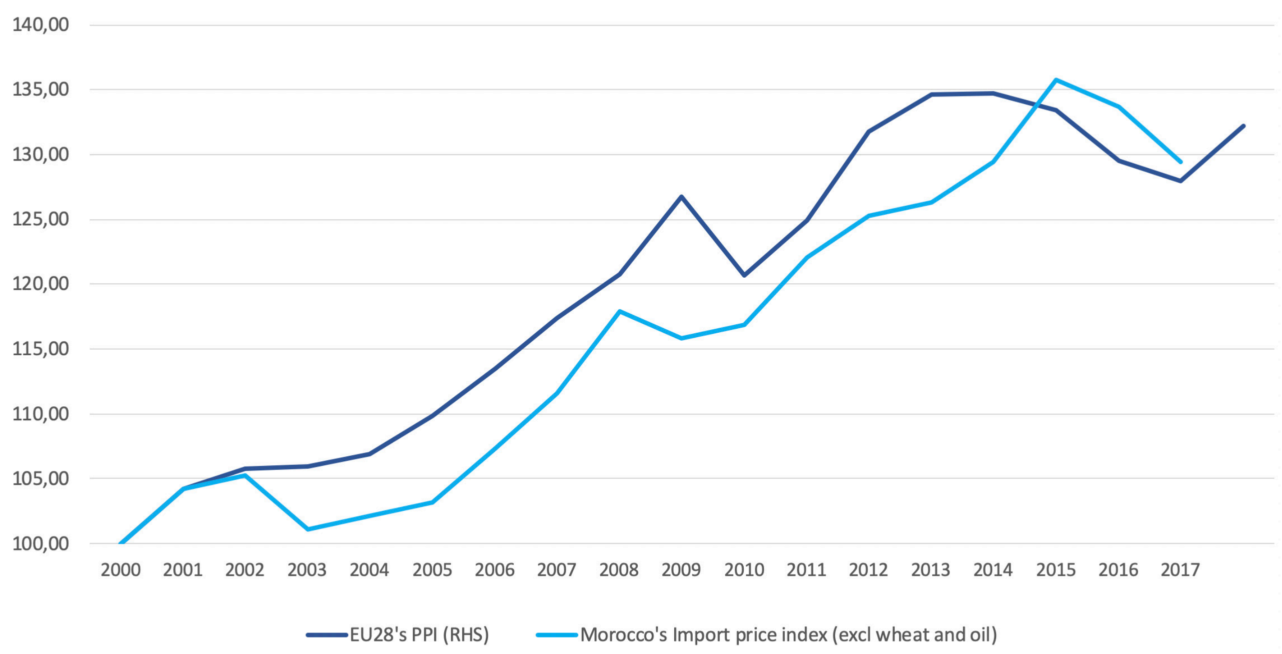
Source: WTO.

15. Most CGE models do not adequately examine the gains from FDI.
16. Earliest data available.

Automobiles are a good example of how the FTA and trade liberalization generally might have benefited Moroccan consumers, though the implications of one example should not be overstated. Cars are goods that only a part of the Moroccan population can afford (Arbouch and Dadush, 2019), and they might not be representative of other consumer products imported from Europe. In practice, as argued by Elbehri and Hertel (2006), the extent to which the EUMFTA led to lower prices (and the distribution of the gains from Morocco's tariff reductions) depends on the market power of European exporters in specific sectors. Where these exporters face competition and/or a high price elasticity of demand, the gains from tariff reductions are likely to accrue to Moroccan importers and consumers, but that might not always be the case.

To address this issue, we adapted a method first proposed by Feenstra (1989) and compared the evolution of the price of Morocco's imports since 2000 – eliminating volatile items – with the producer prices of Morocco's main suppliers. Insofar as Moroccans are the main beneficiaries of tariff reductions, Morocco's import prices at the border should rise about as fast as the prices of its main suppliers and not much faster, allowing prices at the retail level to decline. Figure 10, which shows that the evolution of Morocco's core import price index (excluding oil and wheat and bulky one-time items such as aircraft) and expressed in dirham was very close to that of the EU's producer price index for manufactures. Since the dirham depreciated by about 10% against the euro over this period, Figure 10 can be taken as a strong indication that Morocco kept its import prices well in check.

Figure 10: Morocco's core import prices and EU producer price indices (2000=100)



Source: Ministry of Finance of Morocco and OECD.

Table 3 shows that the producer prices of France, Spain, China and the United States, expressed in dirham, increased by 34% to 54%, much faster than Morocco's core import prices (not shown) which increased by about 29%.

Thus, the profit margins of Morocco's main suppliers may have declined a bit – they have certainly not increased – as Morocco liberalized. Assuming – as we must – that we can trust the data, one factor that could account for this is progress on multilateral liberalization, and the fact that Morocco has also concluded trade agreements with the United States, Turkey and Arab countries. As Figure 9 shows, Morocco's MFN tariffs declined from around 25% in 2000, to 11% in 2017, and the effectively applied tariff, which accounts for bilateral trade agreements, was cut to 4%, low by the standards of developing countries. This likely made many Moroccan domestic sectors more competitive and may have helped the Moroccan consumer appropriate a larger share of the gains from the FTA with the EU. China joined the WTO in 2001 and saw its share of Moroccan markets surge as Morocco's multilateral trade liberalization progressed, contributing to the competitive pressure on Morocco's domestic markets.

Table 3: Producer price index of manufacturing industries (% change between 2000 and 2017)

	Share of Moroccan imports (%)		PPI	Exchange rate EUR/MAD	PPI in MAD
	2000	2017			
France	24,0	11,88	17,8	11,6	29,4
Spain	9,9	16,88	37,3	11,6	48,9
United States	5,6	6,86	41,0	-8,8	32,2
China	2,3	9,05	24,3	11,7	36,0

Source: OECD and Federal Reserve of St. Louis.

Table 4 shows a comparison of export and import unit values, which are less reliable measures of price changes, and which cover all products including Morocco's imports of oil, food, and exports of phosphates. The unit value of Morocco's imports has increased far less than the unit value of the exports of Morocco's main suppliers, and less than the unit value of Morocco's exports, indicating a significant improvement in Morocco's terms of trade.

Table 4: Export and import unit values and terms of trade (% change between 2000-2017

Export Unit Value	2000-2017 (% change)
France	65,11
Spain	66,09
United States	22,80
China	22,91
Morocco - Import Unit Value	28,26
Morocco - Export Unit Value	69,75
Morocco - Terms of Trade	32,35

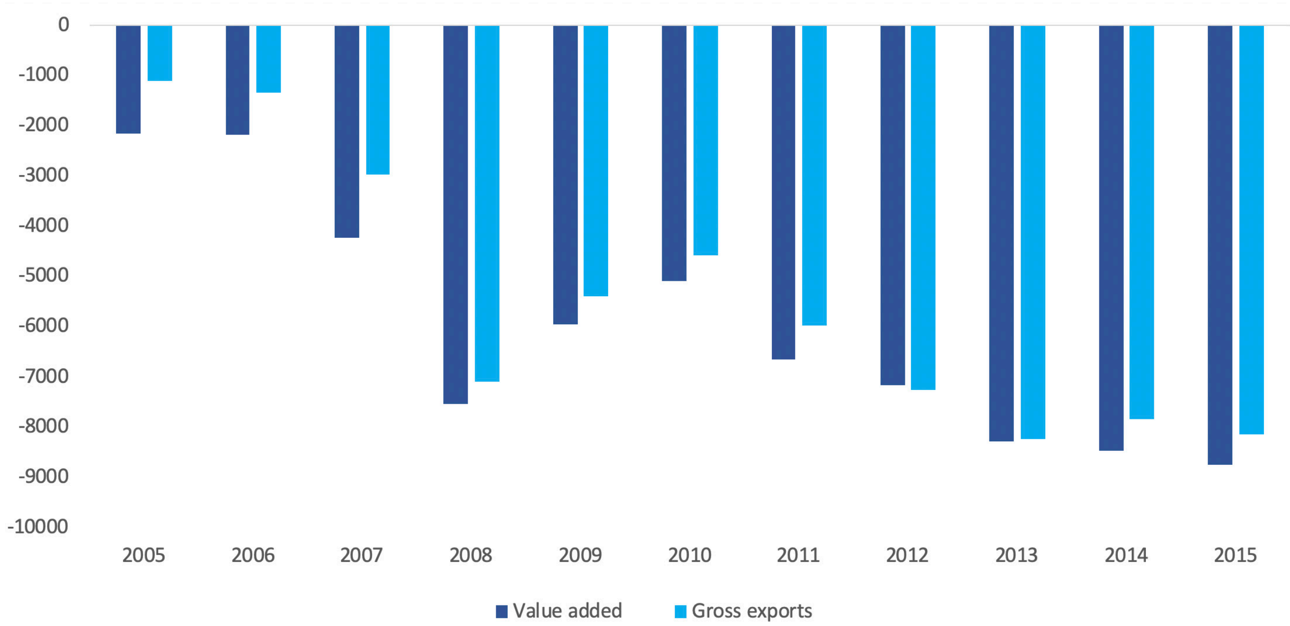
Source: UNCTAD.

These price comparisons provide more evidence in support of the thesis that Morocco's consumers and importing firms have drawn significant benefits from Morocco's integration into global markets.

Morocco's bilateral trade deficit with the EU is a misleading indicator of the gains from the EUMFTA

Morocco's trade deficit with the EU, expressed as a share of GDP, has more than doubled. From 2000, when the FTA came into force, until 2007, when the global financial crisis hit, it remained near -3% of Morocco's GDP. Since then, it has deteriorated greatly, reaching -7.8% of GDP in 2017.

Figure 10: Moroccan bilateral trade deficit with the EU, in millions of dollars (goods and services)



Although a cause of great concern among observers in Morocco, the increased bilateral merchandise trade deficit with the EU presents only a very partial picture of the effects of the EUMFTA and is, in fact, misleading.

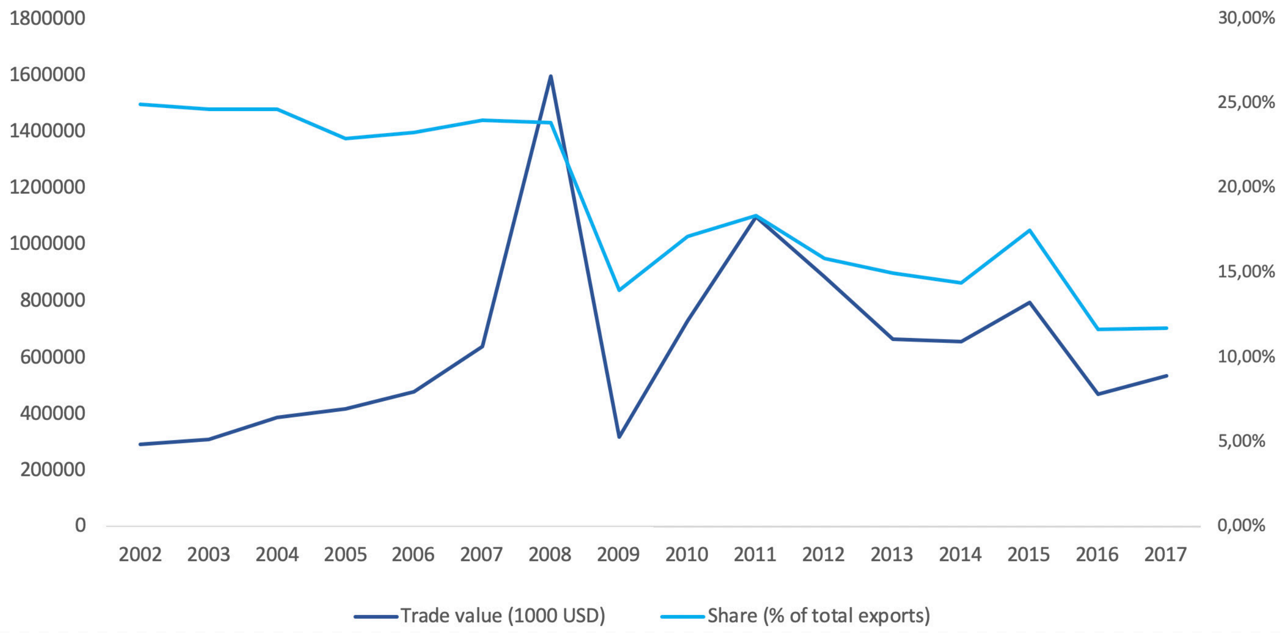
The merchandise trade balance fails to reflect Morocco's positive services trade balance with the EU (mainly tourism). Nor does the bilateral trade balance provide an adequate measure of the benefits derived from a trade agreement. After all, a trade agreement is intended to benefit both parties and the bilateral trade balance cannot improve for both. A more appropriate indicator is the volume of total trade between Morocco and the EU, which increased from 32% of Morocco's GDP in 2000 to 39% in 2017. The increase in the volume of bilateral trade, defined as the sum of exports and imports, is a better measure of the extent to which Moroccan exporters, and also Moroccan consumers, and firms that import parts and components from Europe, benefit from the trade agreement[17].

17. Viewed from the EU's perspective, two-way trade with Morocco grew faster than that with major partners such as the United States, Brazil and Russia, but not as rapidly as trade with Turkey, which forms a customs union with the EU, nor with the rapidly advancing China.

Moreover, the increase in Morocco's bilateral trade deficit with the EU since 2007 reflects to a significant degree the deterioration in the bilateral balance on primary commodities – phosphates and petroleum – partly offset by Morocco's improved bilateral balance with third parties. These offsets might account for about half of the deterioration in Morocco's bilateral balance.

The value of Moroccan exports of phosphates and fertilizers (P&F) destined for the European Union has been highly volatile, reflecting world prices, which peaked in 2008. Between 2007 and 2017, P&F exports to the European Union fell by about 50%, from around $1.2 billion in 2007 to about $600 million. However, over this period, Morocco's market share of Europe's imports of phosphates and fertilizers declined only marginally. The sharp fall in Europe's total imports might have been due to changes in product standards, which favored domestic European producers of fertilizers using recycled materials. Over the same period, Morocco's total exports of phosphates and fertilizers increased by about $2 billion, a near doubling (reflecting increased volumes, not prices) as new sources of demand were exploited in third markets, most importantly Brazil and the United States[18]. It is also worth noting that since 2011, the composition of Morocco's exports of these products to the EU has shifted in favor of higher value-added manufactured fertilizers instead of phosphate rock.

Figure 11: Morocco's exports of phosphate and fertilizers to the EU

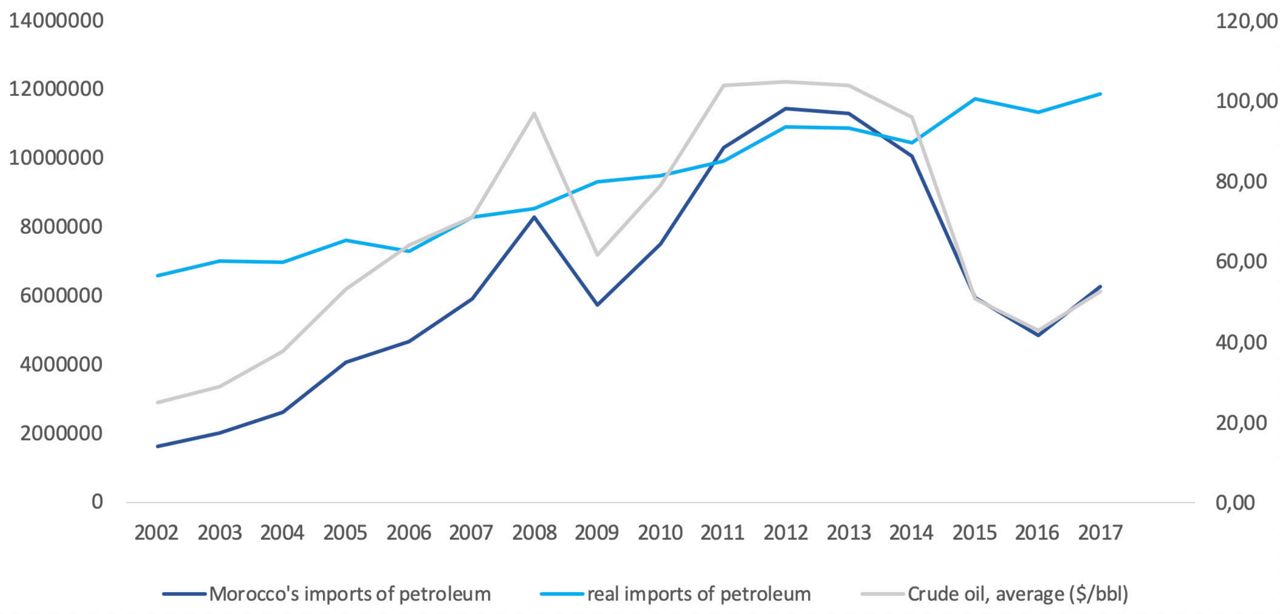


Source: WITS.

The other important factor affecting Morocco's bilateral trade balance with the EU is the shifting composition of Morocco's imports of petroleum and petroleum products. The volume of Moroccan imports of petroleum and petroleum products rose rapidly from 2002 to 2017, with values highly volatile, reflecting world crude oil prices.

18. However, in OCP's Etats financiers consolités 2018, we observe that Morocco's exports of P&F have drastically increased by 37%. This record was due to rising exports of fertilizers which largely compensated for the decrease in crude phosphate.

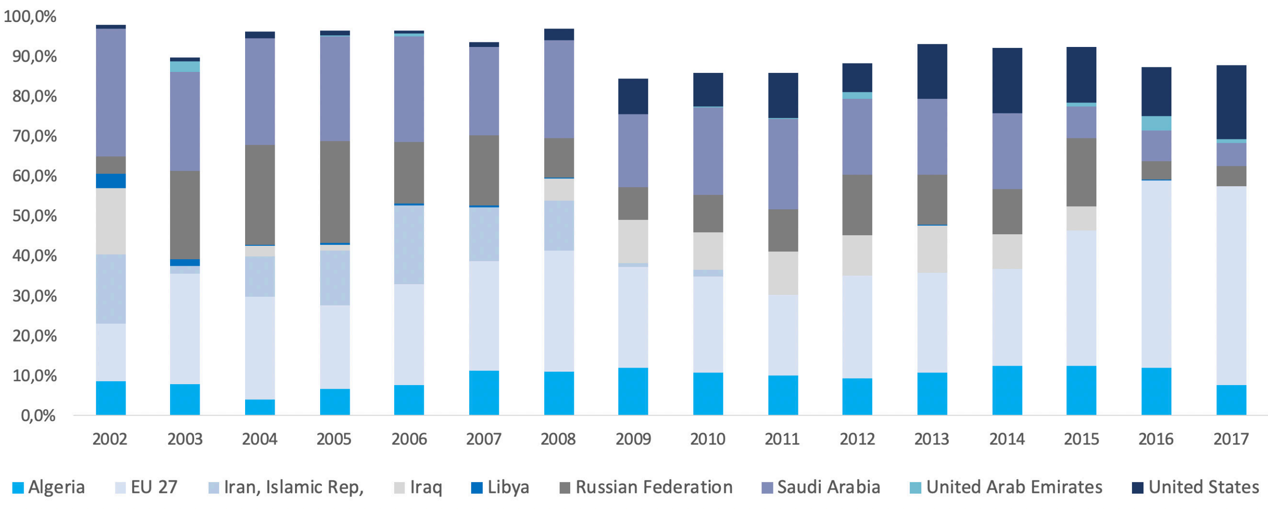
Figure 12: Total Morocco's imports of petroleum (nominal and real in 1000 USD) and crude oil prices ($/bbl)



Source: WITS.

The EU's share of Moroccan imports of petroleum surged from 14.5% in 2002, to 49.7% in 2017, while traditional suppliers, namely Russia and Saudi Arabia, saw their shares reduced correspondingly. This reorientation reflects the collapse following large losses and allegations of mismanagement of Morocco's refiner SAMIR, which used to supply around 50% of the local market. This led Morocco to import more refined petroleum products from its nearby EU producers and to stop importing crude oil (Figure 12)[19].

Figure 13: Shares of the main exporters of petroleum to Morocco (% of total Morocco's imports of petroleum)



Source: WITS.

19. Local distributors anticipated SAMIR's eventual bankruptcy and began importing oil products even before Samir's collapse.

It is fair to conclude that the reorientation of Morocco's exports of phosphates and of imports of petroleum in favor of the European Union, which amounted to about $2.5 billion to $3 billion per year during the last several years, had little to do with the FTA, and would almost certainly have occurred anyway. These shifts account for the lion's share of the deterioration in Morocco's bilateral trade balance with the European Union. More importantly, these shifts had little effect on Morocco's overall current account position, to which we now turn.

Morocco's global current account deficit is worrisome but is not due primarily to the EUMFTA

Morocco's global current account deficit remained small in the first half of the 2000s, the years immediately following the entry into force of the EUMFTA. Morocco's current account balance reflects a negative balance in merchandise trade, largely offset by a positive balance in services, mainly tourism, and a large inflow of migrant remittances. The deterioration in Morocco's current account deficit started in 2007 with the outbreak of the global financial crisis. Despite the worsening external environment, in the years that followed the outbreak of the global crisis, over 2008-2011, Morocco's economy grew quite rapidly, at an average rate in excess of 4%, which meant that, as domestic absorption and imports increased, export growth was muted. Since the crisis, Morocco's current account deficit has averaged nearly 6% of GDP, a high and worrisome level in the light of Morocco's high external debt, at 42% of gross national income in 2018, according to the World Bank (WDI).

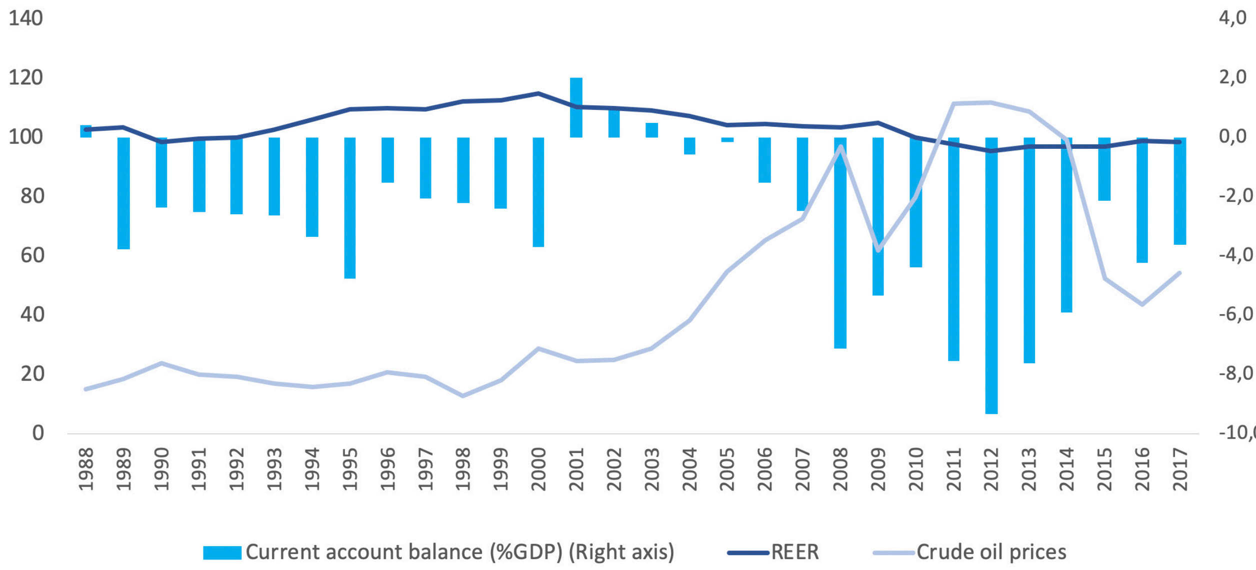
Trade liberalization with the European Union and more broadly with the rest of the world – especially China (Ait Ali and Dadush, 2019) – may have contributed to Morocco's increasing trade and current account deficits, but was not the main factor. Three other factors appear to have played a major role in the deterioration of Morocco's external balance in recent years: a decline in domestic savings, mainly due to a widening fiscal deficit; high and volatile oil prices not compensated for or offset by exchange rate movements[20] or changes in macroeconomic policy; and insufficient progress on improving the economy's competitiveness and outward orientation.

The current account deficit is equal to the excess of domestic absorption over national income, or, otherwise stated, the excess of domestic investment over domestic savings In 2007, Morocco's current account deficit was -2.5% of GDP. In 2018, it was -5.5% of GDP, a 3% of GDP deterioration[21]. During this period, domestic investment, in which public investment plays a big role, remained steady and high at about 33.5% of GDP[22]. Meanwhile, national savings declined from about 31% of GDP to 28% of GDP[23]. The decline in domestic savings is more than accounted for by the increase in the general government's net borrowing, from about 0.5% of GDP in 2007 to nearly 4% of GDP in 2018. Meanwhile, the savings rate of the Moroccan private sector (households and firms) rose slightly over the period from a high level compared to many other countries. Several studies have pointed to the low productivity of Morocco's capital stock and the low effectiveness of its high rates of public investment (Agenor and El Aynaoui, 2015; Abbad, 2017).

20. The policy of subsidizing oil products during a certain period may have prevented demand from adjusting to international price and kept it inelastic (AAA comment).
21. It is worth mentioning that we are now in an adjusting period. The current account deficit went from around 10% in 2012 to 5.5% of GDP (AAA comment).
22. It should be noted that Morocco is dependent on imports of capital goods, so a current account deficit should not always be interpreted negatively, because it is a sign that the economy is investing.
23. Source of the numbers in this paragraph is the IMF's WEO database.

To a degree, Morocco's current account deficit also reflects high dependence on imported energy, a dependence that is generally not compensated for by flexibility in the exchange rate and/or fiscal adjustment during periods of high oil prices. Morocco's current account balance is very sensitive to fluctuations in oil prices (Figure 14). Morocco's real exchange rate tends to be stable despite large fluctuations in the oil price, reflecting Morocco's pegged exchange rate and the country's success in maintaining a relatively low and stable rate of inflation. Oil prices have abated since 2014, but they remain higher than in the 1990s, and their spike between 2004 and 2014 helps account for Morocco's large current account deficits during most of the post-crisis period, which have added to Morocco's external debt[24], [25].

Figure 14: Morocco's current account balance as a share of GDP, Morocco's real effective exchange rate index, 2010=100 (REER) and oil prices



Source: IMF, St Louis Fed.

Throughout the 1990s, observers pointed to the importance of domestic policy reforms in Morocco for the FTA to succeed[26]. In part to encourage these reforms, the EU established technical assistance facilities – admittedly modest in size – to support of Morocco's "mise a niveau" program.

Structural weaknesses contribute to Morocco's external deficits. In the World Economic Forum (WEF) Competitiveness index, published annually, Morocco ranked 71 out of 137 countries in 2017, which is a slightly better ranking than in 2014 (77) and is above Morocco's ranking in per-capita income.

24. According to the 2019 IMF's article IV on Morocco, the current account deficit widened in 2018, despite strong exports by the automotive and phosphate sectors, to 5.4% of GDP in 2018, from 3.4% in 2017. This is explained, mainly, by the increase in energy imports. The slow GDP growth rate in 2018, 3%, is accounted for by the weather-induced shortfall in agriculture. Also, Morocco "lags behind in the quality of education, labour market efficiency (particularly in terms of job creation for young people) and gender equality, with a low and declining rate of female participation in the labour force".

25. FDI has also funded a part of the deficit given that it represents around 3% of GDP. In addition, in come case, reserves were diminishing. They represented around 10 months of imports in mid-2000 and now 5 months, which means that beside debt and FDI, Morocco also draws on its stock of reserves (AAA comment).

26. See Alonso-Gamo et al (1997), pages 44 and 45, for a good overview of the complementary reforms needed for the EU-MENA agreements to succeed. These included policies that foster multilateral trade liberalization, macroeconomic balance, eliminations of regulations and restrictions in key sectors and numerous 'behind-the-border reforms', stable security situation, and regional liberalization.

However, Morocco's ranking has worsened since 2007, the earliest available date, when it was 64[27]. Morocco's strengths, according to the 2019 WEF report, include inflation control, institutional stability, infrastructure quality and market potential[28]. Weaknesses include illiteracy, the inefficiency of higher education and vocational training and the mismatch between skills and market needs – a cause of the high rate of youth unemployment. According to the WEF, Morocco also has weak innovation and technological capacity. The WEF report also mentions factors that undermine the business climate including corruption, lack of access to finance and taxation. The World Bank's Doing Business report ranks Morocco slightly higher than the WEF at 69 out of 190 countries, with good results and recent improvements in registering property, trading across borders and resolving insolvency, but with low scores in obtaining credit, protecting minority investors and enforcing contracts.

There is also a strong presumption that Morocco's regulations – including its restrictions on capital outflows – and tax structure tend to favor investment in the non-traded sector, notably construction, at the expense of exports and import-competing sectors.

Policy implications

Our assessment suggests that the EUMFTA, accompanied by multilateral trade liberalization, has brought significant benefits to Morocco – increased exports, increased FDI, lower prices and policy discipline – but these benefits did not so far translate into the sustained growth acceleration that many expected. Morocco's macroeconomic vulnerabilities persist, and observers are right to worry about the sustainability of Morocco's global current account deficit. They are also rightly concerned about Morocco's high unemployment and underemployment, which affects especially the young, and which is not helped by the trade deficit. Current IMF projections suggest GDP will grow at a modest pace of 3% or less in 2019, on account mainly of a fall in agricultural production, much of which is rain-fed and subject to weather variation (IMF, 2019, article IV). The current account is expected to only gradually improve over the medium term, declining to 4% of GDP as exports rise, boosted by increased demand from the euro area and the expansion of higher value-added export sectors such as aeronautics and automobiles. Morocco's public debt is high at nearly 65% of GDP, but is judged to be quite resilient to shocks (IMF, 2019, article IV). However, risks related to the possibility of deterioration in the international financing and trading environment leave no room for complacency.

A better trade agreement with the EU would not be a panacea that would resolve Morocco's macroeconomic vulnerabilities. Nor can a new deep and comprehensive free trade agreement with the EU automatically improve the country's shortcomings in international competitiveness. But if the new agreement is well-conceived and is accompanied by accelerated reforms within Morocco – reforms that the agreement can help structure and organize – it can certainly help.

It is true that sectors including automotive and aeronautics have grown in the wake of the EUMFTA and have created tens of thousands of jobs, albeit helped by generous government support (free zones, industrial parks, tax holidays, etc.). However, the value-added contribution and spillover effects of these sectors remains an open question, while other important sectors, such as textiles and steel, have lost ground. The next version of the EUMFTA should include measures that facilitate the integration of EU and Moroccan value chains and their extension towards third parties, most notably in

27. https://tcdata360.worldbank.org/indicators/gci?country=BRA&indicator=632&viz=line_chart&years=2007,2017.
28. In the World Economic Forum rankings, market potential is an indicator of market size. It refers to the size of domestic and foreign markets measured as an expenditure-weighted average of market access including own domestic demand.

Africa. This will require paying special attention to rules on investment, taxation, transport, customs, standards, and rules of origin, and will have to include measures that make Morocco's service sector more efficient.

Moreover, Morocco has substantial offensive interests[29] in agriculture, and agriculture must form part of a new trade agreement with the EU. Fruit and vegetables are among the first category of interests, as Morocco has strong export capacity in this sector, reinforced by many investments. But 45% of Moroccan agricultural exports are deemed sensitive products by the EU. Therefore, Moroccan agriculture – a sector that employs over 35% of the labor force – should be less constrained by high tariffs in key sectors such as tomatoes when exports to the EU exceed certain quotas (tariff-rate quotas). The EU needs to examine the remaining tariff and non-tariff barriers that stand in the way of Morocco's agricultural and processed foods exports, such as overly restrictive standards and rules-of-origin. In addition, given Morocco's improved capacity in service sectors including IT, consultancy, finance, transport and construction, the EU should allow for their provision across all modes, including increased mobility of Moroccan professionals and workers. This means facilitating their temporary residence in Europe for work reasons. The EU cannot insist on liberalization of services in Morocco and at the same time exclude movement of people – an important mode of services trade – from the negotiation.

Still, to derive more benefits from the existing EUMFTA and even greater benefits from a future agreement, much of what needs to be done is within the purview of Morocco's policymakers. To help improve the current account balance and reassure investors about the economy's sustainability, key steps should include a reestablishment of fiscal balance, more parsimonious use of imported energy (renewables, conservation, etc.), and greater exchange-rate flexibility. Other important steps should include measures to improve the efficiency of public investment and to reduce reliance on it, while boosting private investment. Enabling private investment requires reforms to facilitate doing business in Morocco. Private and public investment should both be reoriented towards the tradeable sector, requiring changes in the tax structure and regulations, including a gradual relaxation of capital outflow restrictions.

Facilitating foreign investment further is also essential. This requires, among other measures, the carefully sequenced liberalization of Morocco's service sector. Despite overall progress on MFN liberalization, the tariff on finished goods imports (approximately one quarter of total imports) has recently been raised to 30%, which is too high and provides the EU and other preferred exporters with a significant scope to raise prices. Dealing with the country's shortage of qualified workers – requiring improvement in the education sector and increased participation of Morocco's increasingly educated women – are crucial reforms that should stimulate private investment in the medium to long term.

Insofar as a deep and comprehensive new trade agreement with the European Union would help provide a framework to organize and encourage these reforms, it should be welcomed. But the agreement needs to be balanced and structured in a way that maximizes benefits for Moroccans and does not only reflect an abstract template conceived in Brussels.

29. Overall, in the context of FTA negotiations, countries have offensive interests, such as improving their access to the markets of their trading partners, and defensive interests, such as maintaining barriers to ensure the protection of their own markets for certain sectors. The defensive interests of developing countries have received less attention, even though they are arguably as important, not only to their own citizens' welfare but also to the stability of the global economy (Polaski, 2005).

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