The Evolution of the Subsidy System in Morocco

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Abstract: ***The reform of the subsidy policy in Morocco is in a constant evolution due to multiple and crucial governmental decisions taken in the last decade. The system was (and still is) gradually heading towards the liberalization of the prices of highly consumed products such as sugar, liquid petroleum products, butane gas and national soft wheat flour. However, the system is playing a very important role in mitigating the negative impacts of the sudden and brutal changes that occur daily on international markets, on national consumers, especially those belonging to low-income social classes. During the last few years, global crises were constantly emerging and causing a continuously increased inflation for most staple goods, especially liquid petroleum products (Diesel, gasoline, and fuel). This had severe repercussions on public finances, causing for the first time in 2009, a deficit of 6.2 Billion/MAD. A couple of years later in 2012, a year that was a significant stop in the policy changing process, the deficit reached alarming levels and reopened a serious debate about the accuracy of the compensation system. The compensation expenditures were a heavy burden on public finances throughout the years. An issue that the State was dealing with by incessantly trying to find new alternative solutions for the unexpected and immeasurable charges that it inevitably faced everytime a price jump took place on the international markets. The heavier the burden got, the harsher critics spoke of a subsidy system that was initially meant to benefit low-income citizens, by protecting their purchasing power from the instability and price fluctuations of basic products. Thus, the public authorities were forced to adjust and rework the whole approach of how subsidies were distributed, as the targeted social classes barely profited from it, while big companies kept on growing and expanding consumption levels, causing real damage to the efficiency of the compensation fund. Many scenarios were being discussed such as whether the compensation fund should be maintained, reformed or totally removed. This debate kept intensifying until 2013, when revolutionary changes and reforms were adopted for the first time, through the implementation of the partial indexation system. However, before detailing the chronological reforms that marked this rupture in the state's policy, we will first progressively examine the many aspects of the compensation system in Morocco.***

Keywords: Subsidy, reform, purchasing power, compensation fund, public finances

1. Introduction

What is the compensation fund?

In order to achieve a better understanding of the current subsidy policy in Morocco, we must review the historical genesis of this public institution through the important stages that radically changed its course and briefly recall its main missions and goals.

The compensation fund is a public institution with legal personality and financial autonomy. It is placed under the supervision of the Prime Minister (Head of Government), who has delegated this function to the Minister in Charge of General Affairs and Governance. Its main mission is stabilizing the prices of staple goods such as butane gas, national soft wheat flour and sugar.

The compensation fund was founded by the French protectorate in 1941, a very delicate period marked by social tensions and penury, so it was created as a preventive measure to reassure the middle class population in such troubled times. The fund's working mechanism was very simple, it self-financed its own expenditures, with a tax equalization system that was imposing higher taxes on the products that were judged to be non staple goods and not highly consumed by the targeted low income population, therefore, transferring these funds to subsidize the so called staple goods. In 1974 the world witnessed the first oil shock and endured a severe inflationary wave. Prices increased tremendously, it was then that the compensation fund knew its first deficit and the State was forced to take charge of the matter. Ever since, the compensation fund played a very important role in the social governmental strategy, and considerable funds were allocated for this purpose.

The effectiveness of the whole subsidy system was always the subject of numerous debates, as national economists repeatedly highlighted flaws that questioned the real impact of these subsidies which weighed heavily on the public budget to fulfill a mission that was poorly achieved. As there were no restrictions on the subsidized products and full access was granted to all national economic agents combined, the targeted social class was the least benefiting from the system. The wealthy households consumed way more than the poor ones, and if wasn't enough, big companies were (and still are) profiting from the same products at the same costs. A paradox that made everyone contemplate the relevance of the fund as a whole by the simple act of comparing consumption levels between middle class households and huge companies that could easily afford these products for higher prices. It was obviously a system that made the poor poorer and the rich richer.

Although the subsidy policy clearly needed the introduction of serious reforms, at the beginning, the budgets attributed to the different subsidies were more than enough as the fund's balance was consecutively positive, hence the government forecasts were never overrun. This does not mean that the amounts of money were insignificant, but that they were at least measurable. This situation lasted for quite a while. It wasn't until 2009 that all the alarms were rung and demanded an urgent reaction to prevent more damage to public finances, as chaos burst on international market prices, especially petroleum products, to a point where State forecasts were completely overrun and failed to contain and estimate the costs.

2. Results and Discussion

Flaws of the subsidy policy in Morocco:

It is no secret that the compensation fund in morocco was failing terribly to achieve its purpose, carrying too many defects that cost considerable resources to the State, this dysfunction was caused by many factors that can be summed up in two categories: anomalies related to subsidized products and anomalies related to the subsidy system as a whole.

2.1 Anomalies by Product

a) National soft wheat flour

This sector is regulated by a multitude of texts and stakeholders that form a complex legal framework, making the apprehension of the system difficult even for stakeholders in the industry. The existence of a multitude of organizations in charge, sometimes pursuing different objectives may limit the effectiveness of the compensation system set in place, particularly in terms of implementing arrangements to make the system more efficient.

b) Sugar

The industrial segment of the sugar sector, which has two refineries and four sugar factories, has been owned by the COSUMAR group since the privatization of the state-owned companies operating in the sector in 2005. This monopoly does not imply the prohibition of creating new companies but gives the group significant market power and excludes all competition in this market.

It should also be noted that the sector suffers from a lack of visibility, and thus of credibility, as this monopolistic situation enables no clear image of the real industrial costs and margins of both extraction and refining, aggravating the inefficiency of subsides allocated to this product. A critical situation that needs further examination of the fundamentals of these assessments from the government, in order to provide proper amounts by refining the subsidy calculation.

c) Butane gas

The multiplicity of stakeholders in the gas sector generates a significant increase of unnecessary charges, in addition to the exaggeration of certain fees charged by gas importers, (in particular storage costs), reaching very high percentages of the amount of the subsidy.

2.2 Anomalies related to the subsidy policy in general

The lack of political will and commitment to set the subsidy system on the right path

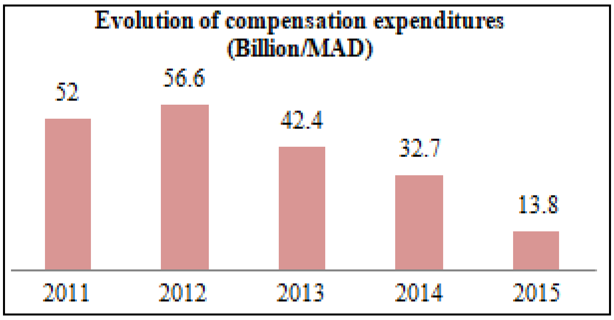
The political elite leading the country have aggravated the financial situation of the compensation fund, as successive governments continued to subsidize basic necessities in order to stabilize the economic and social order despite the inefficiency of these subsidies. Additionally, close relations were forged with lobbies profiting from this situation (producers, distributors, and company owners…etc), considering that these decision makers are amongst those who benefit from the system as company owners and distributors, it was (and still is) most likely impossible to introduce some serious reforms that would put the deprived social classes as a priority. The reforms that took place in the past few years regarding liquid petroleum products might be a good remedy to put an end to the system’s inefficiency, as these industrial companies would endure the increased prices now that all subsidies allocated to the said products are removed, Although, the real negative impact is going to affect consumers, especially low-income consumers, which makes us wonder if removing these subsidies was the right decision to make, and if it wasn’t better for the State to keep subsidies but target them instead?

The non-targeted distribution of subsidies

The generalization of subsidies for all social classes and economic agents has emptied the compensation system from its legitimacy and its socio-economic efficiency, due to the simple fact that the most favored social classes benefit more from the subsidy than the poor because of their higher purchasing power, in addition to the industrialists who integrate it as an input in products that cannot be considered as basic consumer products.

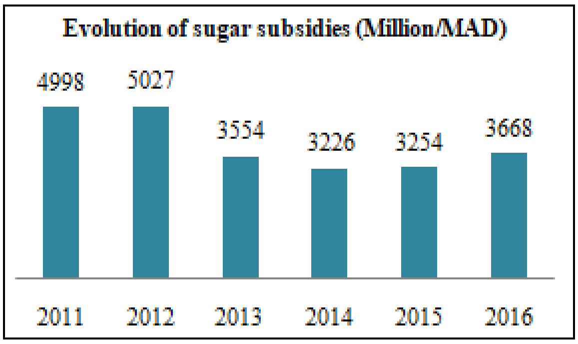
The chronologic evolution of the compensation fund expenditures

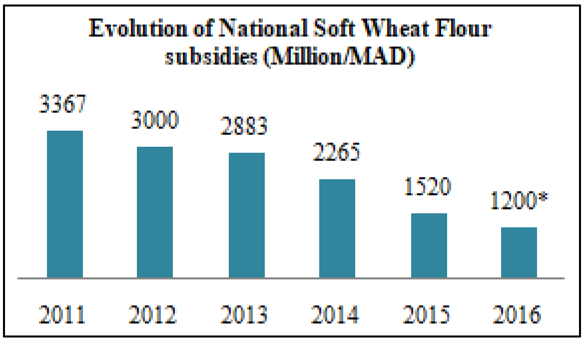
The charges of the compensation system reached their highest level in 2012, causing serious budgetary overruns. This triggered a chain of reforms that have taken place, leading to nearly 70% reduction of compensation expenditures between 2012 and 2015, as it is detailed in the graphs below:



Source: Ministry of Economy and Finance

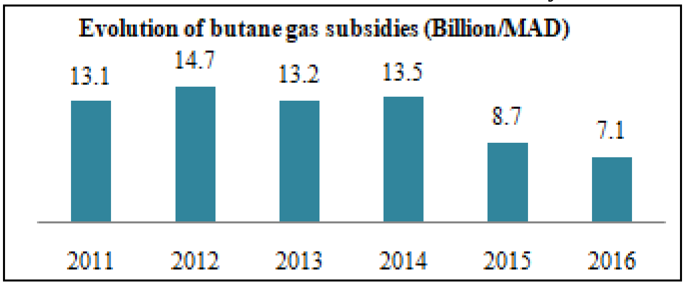
Sugar, butane gas and national soft wheat flour: Are the only remaining subsidized products for now after removing all other subsidies.





*Estimated

Source: Ministry of Economy and Finance



Source: Ministry of Economy and Finance

The chronologic evolution of the reforms carried out by the government:

The numerous dysfunctions mentioned above led the government to apply successive reforms to the subsidy policy. In the past five years we witnessed some radical changes in the subsidy system, as the government applied new reforms once the budget overruns started to reach critical levels and threatened the stability of public finances, as reported by the Ministry of Economy and Finance. The implementation of the partial indexation system in 2013 was a huge step for the State as it helped significantly reduce the arrears accumulated throughout the years, especially 2012, in which arrears reached an amount of 22 Billion/MAD. The implementation of the said reform not only relieved the government by reducing the resources allocated to the compensation fund, but it also allowed it to clear all the accumulated arrears thanks to the positive balances registered in 2013, 2014 and 2015.

The partial indexation system 2013: The partial indexation system was implemented in September 16th 2013, introducing mainly the partial liberalization of liquid petroleum products (diesel, gasoline and fuel N2). It consisted of fixing ceiling levels for the subsidies allocated to these products as established in the finance bill, and passing on the resulting variations from different fluctuations on international markets to selling prices, both upwards and downwards.

The indexation system 2014: After the successful experience of 2013, the indexation system was expanded to include further liquid petroleum products. Gasoline and fuel N2 (intended for industrial use) were both completely indexed and thus excluded from all subsidies since January 1st 2014.

As for diesel, the subsidies were maintained longer and progressively reduced. In January 2014 the subsidies were fixed at a level of 2.15 MAD/L, they moved down to 1.70 MAD/L in April, then 1.25 MAD/L in July, and finally settled at 0.80 MAD/L in October of the same year. In general, the selling prices were reviewed and adjusted every 16th of every month, but for this specific product (diesel) the selling prices were only reviewed in cases in which the fluctuation had an impact exceeding +/- 2.5%.

Regarding Fuel ONEE (National Office for Electricity and Drinking Water Supply), which is a fuel intended for the production of electricity, it was also included amongst the products that were completely unsubsidized in January 1st 2014, instead, the amount of subsidies previously allocated to it, was transferred to the institution as a direct financial aid.

The complete liberalization of diesel prices in 2015: Diesel was the last of liquid petroleum products (LPP) to be unsubsidized in January 1st 2015, thus all these products' prices were reviewed and adjusted on the 1st and 16th of every month in accordance with the prices quotation on international markets.

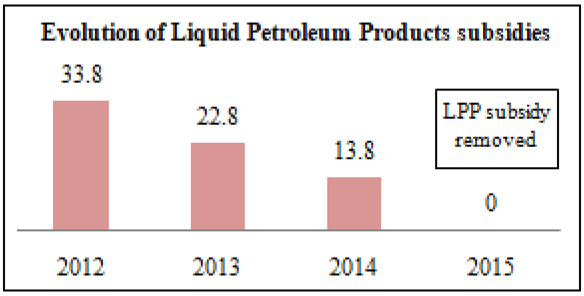
An agreement was signed in December 26th 2014 between the government, the country's only oil refinery SAMIR and oil companies' association (GPM) for the period between January 1st and November 30th of 2015. The parties involved, seeking mutual interests, have agreed on the followings clauses:

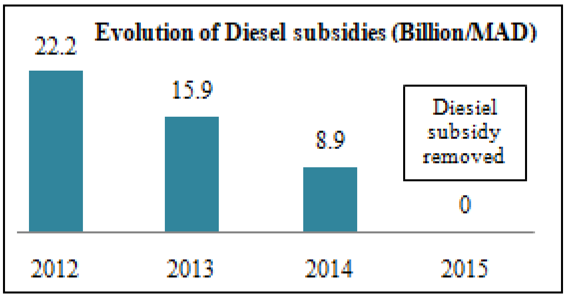
- Assisting professionals of the petroleum sector in matters of LPP pricing, within the fixed ceilings by the government every 15 days, for a transitional period.
- Create a healthy competitive framework that puts the consumers' satisfaction first for all companies operating in the sector.
- Ensure the country's supplying security in the best possible conditions.
- Ensure regulations are met in terms of quality and storage.

To conclude, the compensation fund since 2015 only subsidized three main products: sugar, butane gas and national soft wheat flour.

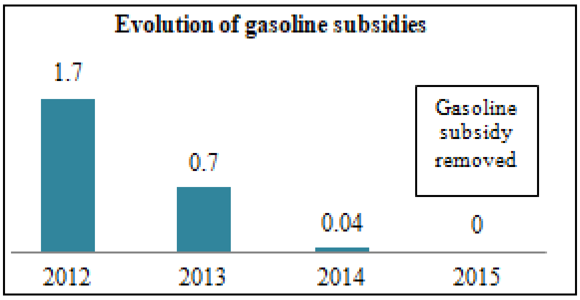
The impact of the carried reforms:

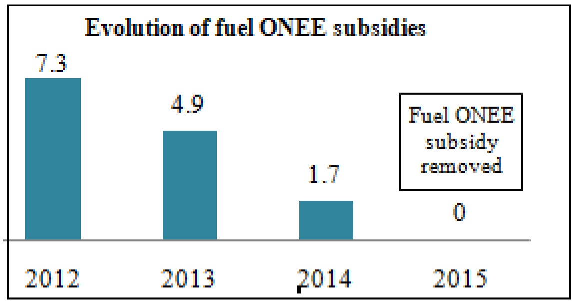
The budgets allocated to compensation between the periods of 2010-2014 reached 214 Billion/MAD, a budget that would create a great deal of opportunities if it was allocated to public investment instead or distributed in a targeted way. As the reforms were gradually taking place, compensation expenditures went from 56.6 Billion/MAD in 2012 to 13.8 Billion/MAD in 2015. The state successfully avoided overruns ever since, and arrears were progressively cleared. The graphs below showcase the evolution of subsidies allocated to LPP in the period covering from 2012 to 2015:





Source: Ministry of Economy and Finance





Source: Ministry of Economy and Finance

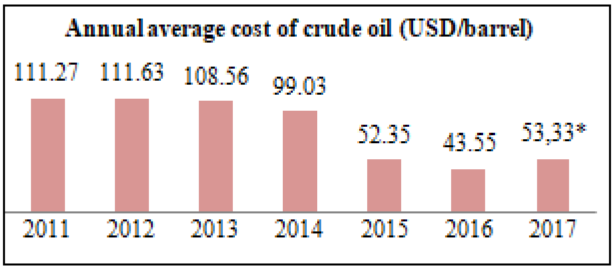
Long term impact of the new compensation policy in Morocco

The financial impact on the public budget is crystal clear, all key financial indicators are positive and all statistics approve the success of this new price liberalization approach. However, the real relevant questions are: what's the impact on national consumers and their purchasing power? Were there any noticeable changes after the implementation of these reforms in terms of support for disadvantaged social classes?

The compensation fund was supposed to be an instrument amongst many others to forge a solid social strategy that would facilitate a fair and equitable wealth distribution, the purpose was to support the poor and strengthen their purchasing power. Nevertheless, for the last couple of years the government was more focused on short term results, as all governmental reports point to the successful experience of removing subsidies and its positive impact, although it is not accurate to actually judge the success of this experience based on short term results/indicators.

To be able to form an impartial judgment on the matter, we absolutely must review the whole process and the conjunctural background events that manifested during the period of these reforms. To do so, we must not forget the background of how and when these reforms took place. The precise timing of these reforms is far from being a coincidence.

The first and most important detail that bursts into mind when analyzing the changes witnessed regarding the compensation fund in our country, is the average supply cost of these unsubsidized products. Logically, if these widely consumed products were no longer benefiting from compensation subsidies, the prices must have gone up and the population's purchasing power naturally has gotten lower. How can weakening the poor's purchasing power be a success for the government? Except this was never the case, which brings us to point out the historical and sharp price drops of all liquid petroleum products on international markets, as the following graph shows:



***Estimated Source:** https://www.statista.com/statistics

The average annual crude oil prices went from **108.56** USD/barrel in 2013 to **43.55** USD/barrel in 2016, a total of **60%** decrease. This huge drop was perfectly synchronized with the said reforms that were consecutively taking place since September 2013. This automatically leads us to another question: Were these reforms a result of a convenient conjuncture to get rid of a heavy burden, or an urgent remedy to stop a financial structural flaw that was requiring immediate intervention?

Either way, we can only be concerned about the repercussions of probable price jumps, and question the accuracy of the whole reform process. There is no doubt that it was time for a change, we might even say that it was imposing itself, but was it really the right way to do it?

The radical changes that we witnessed in the past few years could severely affect the economy and cause real damage to the poor. If the prices climb back up once again, the production costs (means of transport, industrial products and all others merchandises or services directly or indirectly related to using of these LPP) would constantly fluctuate and proportionally go upwards, which will rebound on the whole economy, and people's purchasing power.

On 2016's "Summary of the report on compensation accompanying the Finance Bill" released by the Ministry of Economy and Finance, they state and I quote: "The indexation system allowed consumers to benefit from oil price downturns on international markets, which resulted in a significant drop in fuel prices at fuel stations, below even the prices recorded before the indexation for certain products". We can barely sense this "significant drop in prices" as the prices remained unchanged the last couple of years despite the sharp drop in LPP prices, showcasing a poor price control from the government and random price levels displayed by distributors. There was and still are no correlated tendencies for prices, especially downward tendencies.

HCP simulation: in June 2012, a study carried out by the HCP (the High Commissioner for Planning) assessing the effects of a probable increase in prices of diesel, gasoline and industrial fuel, excluding any possible accompanying measures, on the main macroeconomic indicators and national accounts during the period covering 2012-2017, clearly underlines the repercussions of an imminent petroleum price increase. Except for these two indicators, a positive trade and budgetary balance of about 0.59% and 0.75% respectively, all other social and economic indicators have a negative tendency for 2017:
Consumer prices would rise of about 0.97%, purchasing power would be lowered proportionally, and thus, their consumption levels would degrade of about 0.97%.

As for investment, a decrease of 2.45% is expected, causing a number of job losses reaching 11340 jobs. Also, the gross domestic product (GDP) would be reduced of about 0.69%.

Luckily in 2017, the prices followed the stable low prices tendency that started since 2014, but it's a perfect simulation for how national accounts would develop in a scenario in which prices would increase and no measures are taken by the State to support the underprivileged social classes.

3. Conclusion

The subsidy system in Morocco plays an important role in maintaining the poor's purchasing power despite all inefficiencies, removing the said system would require serious mitigating measures to put into place in order to keep social balance. The government should allocate considerable budgets to create social welfare programs in terms of healthcare, education and other sectors that have direct impacts on the lives of these deprived social classes, as was the case in other countries that went through similar experiences.

In addition, the government must implement a serious price control system, as most importers, distributers and the rest of stakeholders involved do not respect the price ceiling and tend to exaggerate costs that rebound negatively on domestic price levels.

The short term results of these reforms are beyond satisfying, although we must wait for further developments in the matter to form a whole picture and make the right judgment.

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