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The Macroeconomic Impacts of Reforming Subsidy Policy in Morocco

Moustapha Hamzaoui[1], Safaa El Yahyaoui[2]

[1]Professor, Head of Economy, Finance and Development Laboratory Team, Abdelmalek Essaadi University, Faculty of Economics, Tangier, Morocco

[2]PhD student, Economy, Finance and Development Laboratory, Abdelmalek Essaadi University, Faculty of Economics, Tangier, Morocco

Abstract: ***The subsidy system in morocco has been subject to several structural reforms the last couple of years, aiming to stop the huge budgetary overruns that started accumulating since 2009, reaching their highest level in 2012. The budgets allocated to the compensation fund exceeded the budgets allocated to public investments of the same year, an abnormal structural flaw that was weighing heavily on public finances. This was obviously due to the structural dysfunctions of the subsidy policy in the country, as the subsidized staple products were not exclusively available to the deprived social classes but in the reach of all social classes combined, in addition to industrial companies that use these products as an input in their goods or services. The efficacy of such a system was not optimal as the targeted groups of the population were not the ones benefiting the most from the subsidized products, as their consumption levels are much lower compared to high income social classes and large industrial firms. This paradox triggered a number of consecutive interventions to redress the subsidy policy. These crucial changes started in September 16th 2013, as the partial indexation system was implemented, an action that was the first step towards the complete liberalization of petroleum products' prices such as fuel and gasoline in February 2014, then diesel in January 1st 2015. The impact of these reforms was remarkable on a budgetary level for the State, as all overruns stopped and arrears were cleared by 2015. Compensation expenditures reached 56.6 Billion/MAD in 2012 and moved down to 13.8 Billion/MAD in 2015. The government successfully removed these subsidies with perfect timing and conjuncture, because of the historical price drops witnessed, as the average annual crude oil prices went from 111.63 USD/Barrel in 2012 to 43.55 USD/Barrel in 2016. This allowed the State to unburden the public budget and avoid all social tensions caused by the negative impacts the subsidy removal would have, if it had happened in a different scenario. The downward tendency of the international market prices remains unchanged and therefore, all financial indicators are positive and the budgetary savings are still improving. On a social level, we can only cautiously observe the changes on international markets and hope for a durable stability in terms of price fluctuations, as no accompanying measures to support the disadvantaged social classes were implemented. A study was carried out by the HCP to estimate the impacts of a probable future price increase of liquid petroleum products, which results we'll showcase shortly afterwards.***

Keywords: socio-economic impact, subsidy removal, budgetary balance

1. Introduction

The short term impact of the removal of LPP's subsidy, on a financial level at least, is quite clear by now, as the reforms implemented avoided overruns for the 2013, 2014 and 2015 financial acts. On the other hand, the accumulated arrears that reached over 22 Billion/MAD in 2012 have been completely settled due to the excess amounts of the financial acts of 2013, 2014 and 2015, providing respectively 10 Billion/MAD, 6.65 Billion/MAD and 7.5 Billion/MAD to clear the said arrears. Furthermore, as we mentioned above, compensation's expenditures dropped sharply, allowing the creation of new opportunities for the government to expand public investment budgets and work on other social projects in other sectors like health, education and other vital priorities. Nevertheless, we must not disregard any possibility of a sudden price jump that would completely change "the successful" qualification attributed to the whole price liberalization process, as purchasing power would actually deteriorate alongside many other economic and social indicators.

2. Results and Discussion

The socio-economic impact of LPP price increase

The annual average crude oil prices downward tendency played a very important role in the reforms of the subsidy system in Morocco. The sharp drop in prices mitigated the brutal impact that a sudden subsidy removal would have on domestic price levels. Nevertheless, the fluctuations on international markets cannot be predicted as any event, political tension/war or any kind of speculation wave can instantly turn the prices upside down.

For this purpose, a study carried out by "the High Commissioner for Planning" to assess a probable LPP price increase in the not so distant future, the following table showcases the results of the said study:

Table1: the impact of a probable price increase of LPP's in (%) for 2017.

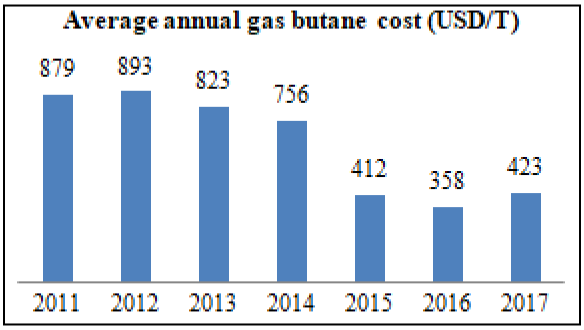
Consumption	**-0.97**	**Gross domestic product**	**-0.69**	**Prices**	**+0.97**	**Exportations**	**-0.19**	**Budgetary balance**	**+0.75**
Investment	**-2.45**	**Employment (number of job losses)**	**-11340**	**Real household income**	**-1.11**	**Importations**	**-1.26**	**Trade balance**	**+0.59**

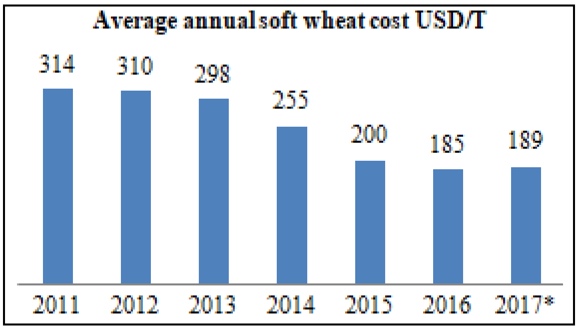
Source: High Commissioner for Planning (HCP) **"**Simulation of the impact of the increase in prices of petroleum products on the main national economy aggregates"-2012

The table above displayed an assessment of the negative impact of a probable LPP's price increase for 2017. As we all know, the average annual crude oil prices in 2017 were swirling around 53.33 USD/Barrel (estimated), the prices were stable and low compared to the high price levels in the years previous to 2014 (above a 100 USD/Barrel), although, these numbers invite us to carefully prepare for a similar scenario in the years to come.

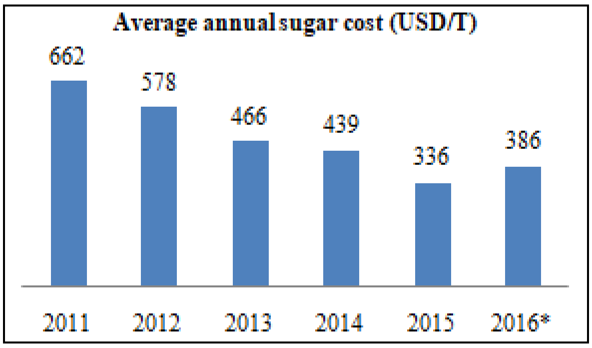
The impact of a probable subsidy removal for sugar, national soft wheat flour and butane gas:

Currently, only three products are still being subsidized by the compensation fund: sugar, national soft wheat flour and butane gas. Despite the price "stability" of these staple products (compared to the usual brutal price changes of liquid petroleum products on international markets), the subsidies allocated to them play a very important role in strengthening people's purchasing power, thus alleviating the deprived social classes' expenses. The following graphs showcase the evolution of these products' prices in the past few years:





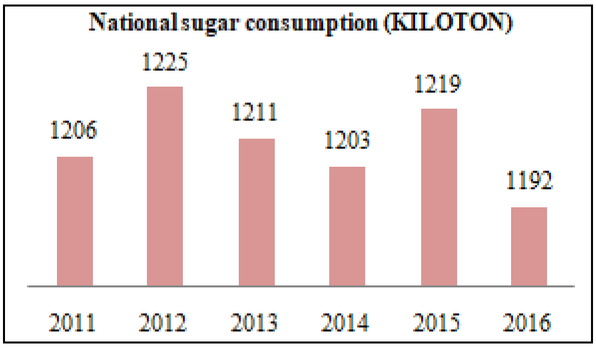
Source: Ministry of Economy and Finance * **From January to September 2017**

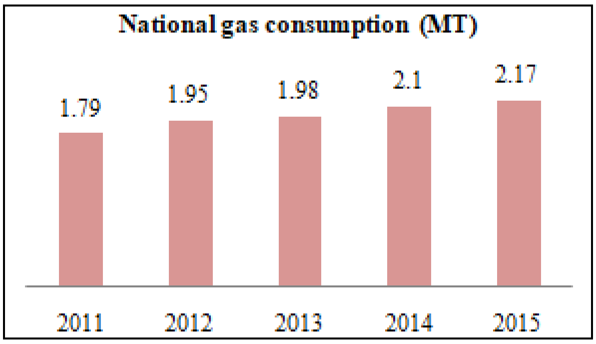


***from January to July 2016 Source:** Ministry of Economy and Finance

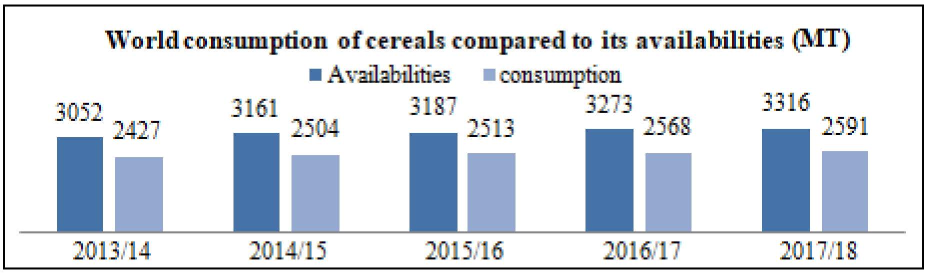
Consumption levels of the subsidized products:

As these staple products keep receiving governmental subsidies, consumption levels are becoming very high, the low prices trigger higher amounts of consumed subsidized products. One unit of butane gas without the subsidy would cost 140 MAD, while when subsidies are allocated, the unit price of gas butane costs around 40 MAD. There is no doubt that high priced products' consumption is more rational and more balanced. However, it should also be noted that the targeted social classes' income does not allow high consumption levels anyway, which begs us again to question the effectiveness of the current subsidy system, as the disadvantaged social classes are clearly not the main recipients of these subsidies. The graphs below display the evolution of the national consumption levels of the said products:





Source: Ministry of Economy and Finance



Source: Ministry of Economy and Finance

In June 2012, the Moroccan Competitiveness Council released a report on a study carried out to estimate the economic and social impacts of the removal of sugar, butane gas and national soft wheat flour subsidies on prices, public budget and low income social classes. The study was based on 2011 average price levels. The study's results were the following:

National soft wheat flour:

a) The budgetary impacts of subsidy removal: The State could save, through the scenario of National soft wheat flour complete price liberalization, an amounted sum of 14,2 Billion/MAD for the period covering 2011 to 2016.
b) *The impact on competitiveness:* Price liberalization would involve the elimination of import duties and thus encourage traders to import and abandon domestic production in case world prices are lower than domestic prices, as well as if the quality of imported wheat is higher than the quality of local wheat.
c) It is generally asserted that the domestic wheat production chain cannot compete with imported soft wheat (due to the many structural dysfunctions and high dependency on rainfall patterns), which might lead, in the medium term, to the disappearance of national soft wheat production, generating serious socio-economic consequences such as: total dependence on foreign supply (aggravating the trade balance), face price volatility on international markets, job losses, and a probable large-scale rural exodus.
d) *The socio-economic impacts:* The rise in consumer prices that would result from soft wheat price liberalization would have direct impacts on consumers, as their expenses would proportionally increase, and indirect impacts on industries using flour as units' average production cost would rise.

Sugar:

a) *The budgetary impacts of subsidy removal:* The State could save, with the scenario of sugar complete price liberalization, an amounted sum of 23,8 Billion/MAD for the period covering 2011 to 2016.
b) The impact on competitiveness: The rise in prices caused by the liberalization scenario could put locally produced sugar in a fierce competition with imported sugar if world prices decrease. Especially considering the fact that domestic produced sugar's cost prices are higher than the imported one, even after imposing import duties.
c) *The socio-economic impacts:* If we consider the average consumption of sugar on a national level, which is about 36.4kg per person yearly, liberalization would lead to an increase in expenditure of approximately 150 MAD per person annually (based on 2011 prices).

As for companies, if we take into account the industries consuming around 300,000 tons of granulated sugar per year, the additional annual cost that they would generate in this scenario would be 1.2 Billion/MAD according to 2011 prices.

Butane gas:

a) *The budgetary impacts of subsidy removal:* The State could save, through the scenario of butane gas complete price liberalization, an amounted sum of 70,3 Billion/MAD for the period covering 2011 to 2016.
b) *The impact on competitiveness:* the significant rise in consumer prices (from 40 to 140 MAD) would dissuade some economic operators from using this energy source, which until now is very accessible, and encourage them to look for more efficient sources. In addition, consumption levels would become significantly balanced and optimal.
c) *The socio-economic impacts:* as for the disadvantaged social groups, an average amount of 229 MAD per person is expected to be added to their yearly expenses, and 408 MAD per person yearly for wealthier social classes.

The amounts of subsidies allocated to all three products combined, for the period covering 2011 to 2016, have reached 108.3 Billion/MAD. A significant amount that, in case of subsidy removal, would make a huge difference for public finances, therefore, for public investments as well.

All budgetary advantages aside, removing these staple products subsidies would have a devastating impact on the deprived social classes in terms of purchasing power, and could potentially aggravate poverty rates in the country. Thus, the government should absolutely anticipate the repercussions of such a reform and provide accompanying measures to support the poor.

3. Conclusion

The government is called upon to intervene through the compensation fund to establish equity and fair wealth distribution by supporting the poor's purchasing power. The inefficient subsidy system led to huge budgetary overruns, as compensation expenditures soared in the previous years to the reforms taking place. These structural reforms began in September 2013 and finally put an end to the massive amount of arrears accumulated. The removal of subsidies was gradual as liquid petroleum products were the first to undergo price liberalization in 2014, then gasoline followed in 2015. A chain of reforms that makes everyone speculate about an imminent subsidy removal for the remaining products that are still being compensated today. The numerous studies that were carried out by different institutions highlighted the negative impact that such a decision would make the disadvantaged people endure.

The government ought to find serious alternatives to a similar scenario, by putting in place new financial measures to support low income social classes. These accompanying measures can take many forms and shapes, the most plausible amongst them would be the allocation of a direct aid to these social groups, despite the challenges that the state faces when it come to finding a proper way to identify the most deserving people for these financial allocations and the right selecting criteria to choose. Some insist on implementing serious fiscal framework reforms, while others see that finding alternative ways to increase government revenues should be explored, such as formalizing the informal sector which could resolve many problems in terms of budgetary receipts for the state.

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