EVALUATING VALUE ADDED TAX IN MOROCCO

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Abstract

Following trade liberalisation and the resulting loss in government revenues from trade tariffs, governments need to find other sources of revenue to compensate for this loss. Many developing countries have set their hopes on value added tax (VAT). This was also the case for Morocco when it introduced VAT in 1986. Over the years it has become evident that the Moroccan VAT is not sufficiently simple, neutral and equitable as the number of exemptions and differentiated rates have multiplied and the informal sector is substantial. Therefore a VAT-reform was initiated in 2005 with the aim of progressively implementing a modern VAT, in line with the best international practices, by limiting the number of exemptions and moving towards a two-rate system. The aim of this study is to evaluate the Moroccan VAT-system, especially following the changes that have been implemented so far in the current reform. Issues of particular interest are the effects on government revenue and on equity indicators. The results of this study show that the government revenue from VAT as a proportion to GDP has increased. There has been a slight decrease in trade tariff revenues in absolute terms, which is by far outweighed by the increase in VAT-revenue. As regards equity indicators, there is a probable decrease in vertical equity following the abolition of some exemptions and reduced rates on basic products that generally benefit the poorer groups relatively more, while there are some indications that horizontal equity has been improved.

**Key words:** Morocco, value added tax, VAT, fiscal reform, vertical equity, horizontal equity, informal sector
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Abbreviations and Acronyms

DGI  Moroccan Tax Authority (*Direction Générale des Impôts*)
EU   European Union
GATT General Agreement on Tariffs and Trade
ICPC Central Authority for Corruption Prevention (*Instance Centrale de Prévention de la Corruption*)
IMF  International Monetary Fund
INDH National Initiative for Human Development (*Initiative Nationale de Développement Humain*)
IR   General Income Tax (*Impôt sur le Revenue*)
IS   Business Tax (*Impôt sur les Sociétés*)
ISA  Institut Supérieur de l’Administration
MAD  Moroccan Dirham (currency) 1MAD = 0.09 €
OECD Organisation for Economic Cooperation and Development
Sida Swedish International Development Cooperation Agency
USD  US dollars
VAT  Value Added Tax
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1 Introduction

No fiscal innovation has ever spread so widely, so rapidly or been so successfully adopted in such a wide variety of countries [as value-added tax].

Following the last few decades’ globalisation trend, with trade liberalisation as one of its main components, the reduction of trade obstacles has facilitated the exploitation of comparative advantages. However, another more immediate consequence of trade liberalisation, which is particularly relevant for developing countries, is the loss of trade tariff-revenue. As trade liberalisation proceeds, the lost revenue from import tariffs must be replaced by other sources. To handle this fiscal challenge many developing countries have set their hopes on value-added tax (VAT).

This was also the case for Morocco, when it first introduced VAT in 1986. Morocco has since signed free-trade agreements with the European Union (EU), the United States (US) and Turkey. The EU is Morocco’s most important trading partner and trade is regulated through the Association Agreement that was signed in 1996. In 2005, Morocco initiated a VAT-reform with the aim of compensating for the lost tariff revenue.

The purpose of this study is to evaluate whether the Moroccan VAT can effectively handle the fiscal challenges imposed by trade liberalisation, especially following this reform. To be more specific, the following questions will be addressed:

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1 Bird and Gendron 2007: 20
2 Definition value-added tax (VAT): “a broad-based tax levied at multiple stages of production [and distribution] with – crucially – taxes on inputs credited against taxes on output. That is, while sellers are required to charge the tax on all their sales, they can also claim a credit for taxes that they have been charged on their inputs. The advantage is that revenue is secured by being collected throughout the process of production (unlike a retail sales tax) but without distorting production decisions (as a turn-over tax does).” International Tax Dialogue 2005:8
3 The European Commission – DG External Relations website
4 Brun, Chambas, and Laurent 2007:323
i. What impact has the VAT-reform had on government revenue?

ii. What effects has the VAT-reform had on equity indicators? Who are the winners and who are the losers?

iii. What lessons can be learned from the specific case of Morocco?

The VAT-reform is part of a larger reform of the entire fiscal system, of which the main components are the VAT-reform that started in 2005, the income tax (Impôt sur le Revenue - IR) in 2007 and the business tax (Impôt sur les Sociétés - IS) in 2008.\(^5\) In addition to this, a budget reform has recently been undertaken. However, the principal focus in this paper will be on the revenue side of the fiscal system and not on the expenditure side.

According to Bird and Gendron: “[i]n many developing and transitional countries VAT is the most important single tax.”\(^6\) This study aims to fill a gap of lacking empirical analyses to complement the existing theoretical ones on VAT in developing countries.

1.1 Method, Material and Disposition

In this study the method of benchmarking will be used in the sense that the study will begin by examining the theoretical literature on VAT in developing countries in order to try to establish the characteristics of the “optimal VAT-design” (to be defined in the end of the second chapter). Even though it must be clear that a consensus on an “optimal VAT-design” does not exist, some characteristics are more desirable than others. When the “optimal design” has been identified it will be used as a benchmark against which the Moroccan system will be assessed.

It should be mentioned that the initial idea of this study was to evaluate of the Moroccan VAT-system before and after the 2005 reform. It soon became evident however, that the VAT-reform has not yet been completed and the focus therefore had to be slightly changed. As a consequence of this, the conclusions

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\(^6\) Bird and Gendron 2007: 1
that can be drawn will remain more tentative and less clear-cut than would have been the case had the reform been completed.

The sources used to conduct this study are of primary as well as secondary nature. Apart from the first theoretical part, most of the material used in this study was collected during a field study in Morocco in the autumn of 2010. During the field study interviews were conducted with representatives of Moroccan authorities and NGOs as well as with representatives of international organisations and academics. These persons served as informants. Primary and secondary material was also collected in the form of statistics, government documents, tax legislation, discussion papers and academic reports.

The study is structured as follows; chapter 2 provides a theoretical background of VAT in developing countries; chapter 3 introduces the Moroccan economy and politics in order to put the tax reform into a broader perspective; chapter 4 describes the current fiscal system and the objectives of the reform; chapter 5 evaluates VAT-design and the changes that have been implemented so far using what was presented in the theoretical part as a kind of benchmark; finally, chapter 6 draws the conclusions.
The optimal tax system should raise revenue without discouraging economic activity. In order to achieve this, tax policy design should aim to follow the principles of *neutrality, equity* and *simplicity*; meaning that it should minimise the interference in the allocation process, it should treat people with similar economic abilities in a similar way and distribute income and welfare ‘fairly’ within the society (a more thorough discussion of the concept of equity will follow below) and it should be as simple and transparent as possible in order to be easy to administer and legitimate.\(^7\)

Developing countries face several challenges in tax design. Firstly, the informal sector is generally substantial in these countries, which complicates the taxation of income and consumption. Secondly, many developing countries lack the human resources to create an efficient tax administration and the taxpayers often have limited ability to keep accounts. Thirdly, reliable statistics are often missing which prevents policy-makers from making accurate assessments of potential implications of tax reforms. This tends to lead to marginal reforms or inefficient structures being preserved. Fourthly, there are typically great disparities of income in developing countries and wealthy taxpayers often have the political and economical power to prevent tax reforms that would increase their tax burden.\(^8\)

According to the Diamond-Mirrlees Efficiency Lemma, trade taxes affect the producer’s prices and should therefore be eliminated. Instead, tax on domestic consumption (e.g. VAT) is the optimal instrument for raising revenue for government expenditure and should be used. According to Emran and Stiglitz

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\(^7\) Tanzi; Zee, 2001

\(^8\) Ibid. 2001
(2007), these findings represent the fundamental justification for indirect tax reform in developing countries.\textsuperscript{9}

The Informal Sector

As mentioned above, developing counties generally have large informal sectors. It is not possible to know exactly how large the informal sector is in a given country but some authors estimate it to be around 30\% to 60\% of GDP in most developing and transitional economies.\textsuperscript{10} The existence of such a large informal sector implies potentially severe distortions through misallocation of resources between the formal and the informal sector, a great loss of revenue for the government and is likely to create inequalities and enhance governance problems.\textsuperscript{11} Some studies suggest that the informal sector have increased and that individuals and enterprises at all income levels are engaged in the informal sector to a varying extent. A key measure to reduce the size of the informal sector is to limit the red tape and the compliance costs of the tax system.\textsuperscript{12}

An argument that is sometimes put forward against VAT is that it is primarily a tax on the formal sector and hence inappropriate for circumstances where the informal sector is significant.\textsuperscript{13} This argument could be used against other types of taxes as well and it is not necessarily true for VAT as it can in fact be an instrument to push more economic activities into the formal sector.

Activities taking place in the informal sector tend to escape direct taxes but it is harder to flee indirect taxes. The reason for this is that the actors operating in the informal sector may avoid paying VAT on their sales but cannot reclaim the VAT paid on their input from actors operating in the formal sector nor on their imports.\textsuperscript{14} The missed opportunity to reclaim VAT on input is an incentive to register at the tax authorities. Hence, VAT taxes the informal sector on all the inputs that it purchases from the actors in the formal sector as well as on its

\textsuperscript{9} Emran and Stiglitz, 2007:4f
\textsuperscript{10} Bird and Gendron 2007:74; Schnider 2002, Emran and Stiglitz 2007:4
\textsuperscript{11} Keen, 2007:374
\textsuperscript{12} Bird and Gendron, 2007:78ff
\textsuperscript{13} Keen 2007:374
\textsuperscript{14} Bird and Gendron 2007:75
imports. In fact, the VAT on imports functions like a tariff and is administered and collected in a similar way. According to Keen (2007), many developing countries raise more than half of their gross VAT collections from imports. As such, VAT serves in practice partly as a surrogate tariff on the purchases of the informal sector.15

In effect, in most cases both theory and empirical results show that VAT is more likely to decrease tax evasion than tax on sales or income. In some studies there is evidence that VAT-systems have discouraged ‘formalisation’ of the economy but in those cases the fault normally lies in the specific design and implementation of the tax and not in the VAT itself.16

The Administration

In most developing countries […] tax administration is tax policy. The real tax system is that which is administered, not that which appears in the formal law. It is thus critical that the VAT design take into account real administrative limitations.17

No tax system is costless to administer, the key is to strike the right balance between administrative costs, excess burden and equity.18 The conditions that need to be fulfilled in order to create a good VAT administration include: “simple, clear, stable tax laws; adequate service and support to tax payers in complying with tax obligations; simple procedures of registration, filing, payment, and refund; effective collection enforcement; reasonable audit coverage, strict application of penalties; and provisions for independent review”.19

Every individual who is engaging in activities that are taxable under VAT should register at the tax authorities. The tax authorities need to make sure that their services function in a simple and adequate manner in order to encourage people and corporations to register. There must be a system to verify new registrants in order to avoid fraud. A good VAT-system creates incentives to

15 Keen 2007:375ff
16 Bird and Gendron 2007:80
17 Ibid. 2007:8
18 Rosen 2002: 325
19 Bird and Gendron 2007:162
register by making sure that the mechanism of tax-free purchase of inputs is sufficiently large.

It is a common requirement that registrants file returns on a monthly basis or for smaller taxpayers, bimonthly, quarterly or even annually. When returns fail to be paid on time a notification should be issued automatically followed by a suitable penalty. Well functioning and modern auditing procedures are fundamental for a good VAT-system. Auditing is essential for any tax system but particularly with regard to self-assessed taxes such as VAT. A crosscheck of purchases of one registrant with the recorded sales of others is an efficient way to discover fraud. However, tax-officials need to have the relevant training and investigating skills in order to be able to carry out such auditing. Penalties should be enforced rigorously and instantly. The penalties that exist should be enforced without exception in order not to undermine the credibility of the system.²⁰

In most countries there is a certain threshold, defined in terms of annual turnover that should be reached before an enterprise must register as a VAT-taxpayer. The reason for this is that it would overload the tax administration if it had to process numerous low-return taxpayers instead of concentrating their efforts on the medium and large taxpayers. This is especially true for developing countries with more limited administrative capacities. It is somewhat puzzling then that many developing countries apply relatively low threshold levels for VAT-registration. Instead of including all registrants in the VAT-system some countries provide some form of simplified accounting that is often called VAT but that in reality is a form of flat-rate turnover tax. This solution generally adds more complexities to the tax-system however.²¹

### 2.1 Efficiency and Equity issues

In practice, the balance between equity and administration in any particular country at any specific time, like that between efficiency and political reality, is almost always more stuck by luck than by science. For a country

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²⁰ Bird and Gendron 2007:167ff
²¹ Ibid. 2007:115ff
to be able to introduce VAT, it may be politically necessary to introduce some degree of explicit progressivity within the VAT itself.\textsuperscript{22}

Tax Base and Excess Burden

The efficiency costs incurred by taxes can be divided into three categories: 1) costs of the tax collecting authority for tax administration 2) the resource costs of the tax-payers when they fulfil their tax obligations while aiming to minimise their tax payments or evade paying tax 3) distortion costs when tax payers change their behaviour to avoid taxes.\textsuperscript{23}

At the moment, we will focus on the third of these costs. A tax that changes relative prices generates excess burden (also called deadweight loss or distortionary cost), which is inefficient since it impacts individual utility negatively more than needed to raise a given amount of revenue.\textsuperscript{24} The excess burden is made up of the reduction in consumer and producer surpluses (the area B and F in the figure below), which is a result of unrealised market exchanges. When economic actors let factors other than the pure market forces impact their behaviour the outcome will not be Pareto optimal. The size of the excess burden is determined by the rate of the tax and elasticities of the supply and demand. An efficient tax should raise revenue while minimising behavioural responses and hence the excess burden.\textsuperscript{25} To achieve this, taxes should be levied on low elasticity goods, such as basic products. According to the Ramsey rule, tax rates should be set so that the tax-induced percentage reduction in the quantity demanded of each product is the same, in order to minimise the total excess burden.\textsuperscript{26}

\textsuperscript{22} Bird and Gendron 2007:24f
\textsuperscript{23} Balassa, 1989:5
\textsuperscript{24} Rosen, 2002:286
\textsuperscript{25} Mankew, 1998:165
\textsuperscript{26} Rosen 2002: 536
However, a society may be willing to accept a higher excess burden in order to achieve a more equal distribution of income.\(^{27}\) In that case, distortions can be limited by using a VAT-system with a broad tax base and a simple design. In general, there are two positive implications of a broad tax base: firstly, the tax-rate required in order to raise certain revenue is lower, secondly the administration of the tax system is simpler since there are fewer possibilities to escape tax and most activities are caught in the tax net.\(^{28}\) Unless the system to monitor transactions and ensure tax compliance is well developed, which is normally not the case in developing countries, a simplified tax system is to be recommended.\(^{29}\)

**Tax Incidence**

When evaluating the effects of a certain change in tax policy one must go beyond who is legally responsible for paying the tax in order to understand who is actually carrying the burden. The tax burden may be shifted to other individuals...

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27 Rosen 2002:318  
28 Bird and Gendron 2007:123  
29 World Bank Publications 1991:41ff
than the formally responsible one due to changes in behaviour. The incidence of the tax reveals the ultimate distribution of its burden. When VAT is introduced on a certain commodity, there are two effects that work in opposite directions; the income and the substitution effects. Which of the effects will dominate depends on the elasticity of the demand and supply, i.e. how easy it is for the producer or the consumer to change behaviour following the introduction of VAT.\textsuperscript{30} If the demand is elastic, most of the burden will be born by the producer. On the other hand, if the demand is inelastic most of the burden will be carried by the consumer. Generally speaking, basic commodities have low demand elasticity and hence when a tax is levied, the consumer will carry most of its burden.

Equity

Equity is, just like efficiency, a central issue for taxation. Yet, there is no consensus on its definition. There are two general conceptions of equity; horizontal equity and vertical equity. Horizontal equity implies that individuals with equal economic capacities should pay the same amount of taxes, while vertical equity concerns the overall implications of the fiscal system for the income and welfare distribution in the society.\textsuperscript{31} A society with a large informal sector is horizontally inequitable since it excludes many taxpayers from the system.

In the choice between taxing income and taxing consumption the latter is usually assumed to be inherently more regressive than the former.\textsuperscript{32} However, this is not necessarily the case; a VAT may be more progressive than a personal income tax, given that it is well designed, if the taxation of income in practise is limited to affecting a partial group of wage earners due to a large informal sector. In that case, an increased role of indirect taxes may make the system more horizontally equitable.\textsuperscript{33}

\textsuperscript{30} Case 1986:105ff
\textsuperscript{31} Bird and Genrond 2007:70ff
\textsuperscript{32} Tanzi and Zee 2001:3, Tait 1988: 218
\textsuperscript{33} Bird and Gendron 2007:75
2.2 VAT-design

As mentioned above, there is no consensus on what constitutes an optimal VAT-design. Instead, the optimal design varies depending on the prevailing circumstances in every country.

Rates

For many years the common advice was not to impose a VAT of less than 10 % since this would simply not be likely to cover the costs of administering the system. There are nonetheless several examples of countries with standard rates below 10 %. Many developing countries need to impose higher VAT-rates in order to compensate for difficulties in exploring other taxes. The ‘revenue maximising tax rate’ (RMTR) designates, as indicated by its name, the optimal rate for raising the most revenue. When the VAT-rate is lower than the RMTR the revenue can be augmented by increasing the VAT-rate. Conversely, with a VAT higher than the RMTR, the revenue would increase if the VAT-rate was lowered, due to increased incentives for (potential) tax-payers to skip evading tax. According to Bird and Gendron, no developing country is likely to have passed the RMTR yet and hence revenue is likely to increase with a rise of the VAT-rate while cutting rates will have the opposite effect.

Differentiated Rates

There are efficiency and equity arguments that can be put forward in favour of multiple VAT-rates, but the trouble is that they tend to be contradictory since

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34 E.g Japan, Taiwan, Canada, Nigeria and Panama (Bird and Gendron 2007:113).
35 Bird and Gendron 2007:112ff
36 Excises: some goods, with negative external effects and low demand elasticity, such as alcohol, tobacco, motor vehicles and fuel can be taxed with a higher rate than the standard VAT-rate, so called excises. The rationale behind excises is very different from that of VAT. While the latter should cover as many goods as possible the excise should be very selective and only target a few goods that have negative externalities. In many developing countries the excise system is inefficiently broad in its coverage (Tanzi and Zee 2001:8).
there is a trade-off between equity and efficiency.\textsuperscript{37} The Inverse Elasticity Rule argues that efficiency requires that tax rates are inversely proportional to elasticities.\textsuperscript{38} This means that goods with lower elasticity of demand should be taxed at a higher rate since this would not change the behaviours as much as taxing goods with high elasticity and it would therefore not have as great distortive impacts on the economy.\textsuperscript{39} Another efficiency argument in favour of differentiated VAT-rates is the Corlett-Hague rule, which suggests that goods that are more complementary to leisure should carry a relatively high tax in order to offset the tendency of the tax-system to induce substitution towards leisure.\textsuperscript{40} However, these ways of differentiating the rates may be contrary to what would contribute to achieving equity and simplicity. According to Diamond (1975), in order to achieve equity the aim should rather be to lower the VAT-rate for basic goods (that is often goods with low elasticity), since this would benefit the poor who use a large amount of their income on basic goods. However, a general counter argument to this is that it is a costly way to redistribute.

The rich may spend relatively less of their income on ‘basic food’, but they are likely to spend absolutely more and hence receive more benefit than the poor from such concessions.\textsuperscript{41}

It would hence be more efficient to compensate for the perceived regressivity of taxing food through some form or income-related credit to poor individuals. But such options are not always available in developing countries and hence there is a case for exempting basic food products on equity grounds in some cases.\textsuperscript{42}

Further arguments against differentiated rates are that they tend to distort choices and therefore have negative impacts on welfare, increase compliance costs and complicate matters for the administration. Lower rates on some goods require higher average rates to raise a given amount of revenue. If differentiated

\textsuperscript{37} Sorensen 2007:385
\textsuperscript{38} Rosen 2002:533
\textsuperscript{39} Bird and Gendron 2007:109
\textsuperscript{40} Corlett and Hague 1953 as quoted in Sorensen 2007:387
\textsuperscript{41} Bird and Gendron 2007:114
\textsuperscript{42} Ibid. 2007:127
rates are to be used anyway a guideline is not to let the differentiated rates deviate more than 40% from the standard rate.\textsuperscript{43}

**Exemptions**

The negative consequences of exemptions generally overshadow the equity gains. Exemptions also involve drawing lines between what should and what should not be exempt. There are always groups in society who have an interest in extending the exemptions to similar goods and this tends to increase rather than limit the number of exceptions. Exemptions can sometimes have very specific rules on where they apply; sometimes \textit{products} are exempt, sometimes \textit{users} and sometimes \textit{purchasers}. These types of specifications generally complicates matters for the administration, which has to verify the use of a certain good, are subject to potential abuse and generally do not have the intended positive impact on equity.\textsuperscript{44} Many developing countries have adopted multiple VAT-rates and exemptions for political reasons, but the cost of doing so may be higher in developing countries than in developed countries, and it should hence be carefully scrutinised before being implemented.\textsuperscript{45}

When it comes to VAT-exemptions for incentive purposes, the arguments are largely the same as the ones raised above against the use of exemptions for equity purposes. A quite common form of exemption for incentive purposes is tax-free zones where newly established enterprises are exempt from paying VAT for a number of years in order to create incentives for them to establish in the region. However, it has been shown that other factors are more significant in determining where enterprises decide to establish themselves, and that such exemptions are conducive to corruption and considerable reduction of the effectiveness of the tax administration. In many countries exemptions are kept because the policy makers think that they are costless, since their costs are not recorded anywhere, but as we have shown, they are not.

\textsuperscript{43} Bird and Gendron 2007:108ff
\textsuperscript{44} Ibid. 2007:125
\textsuperscript{45} Tanzi and Zee 2001:7
The following rules can be used to promote awareness of tax expenditures (exemptions, multiple rates and zero-rating):

i. *Keep it simple* – as few and simple as possible

ii. *Keep records* – over who receives what concession and over what cost it involves in revenue forgone.

iii. *Evaluate results* – data on each tax concession should be evaluated on a regular basis to examine whether the concession achieves the results it was aimed for. One way can be to establish a so-called tax expenditure budget as part of the annual budgetary process.46

To sum up, exemptions are generally undesirable in developing countries since they cost substantial revenue, add administrative and compliance problems, deviate from the principle of uniformity of treatment of all consumption expenditures, damage the integrity of the tax-system, facilitate evasion and corruption and are hard to remove once they are established. Due to exemptions, only around 30% of the theoretical consumption tax base is reached in developing countries.47

### 2.3 The “optimal design”

As we have seen so far, there is no consensus on how the most appropriate VAT-system should be designed; according to some theories the commodities with low elasticity should be taxed at a high rate for efficiency reasons; according to others with a low rate for equity reasons. Moreover, some argue that commodities that are complementary to leisure should be taxed at a high-rate in order to decrease the demand for leisure. For developing countries especially, what is actually feasible is limited by administrative constraints. Therefore, for the purpose of this study the “optimal VAT-design” will have the following characteristics:

- A simple and transparent structure;

46 Bird and Gendron 2007:128ff
47 Ibid. 2007:121ff
- a broad base;
- one or maximum two rates;
- a minimum of exemptions.

Simply put, the optimal VAT is one that raises revenue without discouraging economic activity.
3 The Moroccan Context

This chapter will present the Moroccan economy, liberal reforms and revenue consequences of trade liberalisation as well as some political economy implications of fiscal reform. The purpose is to put the issue of VAT in Morocco into context.

3.1 The Moroccan Economy

Morocco is a lower middle-income country with a GNI of 90 billion USD and a GNI per capita of 2770 USD in 2009.\textsuperscript{48} The country is abundant in phosphates, iron ore, manganese, lead, zinc, fish and salt. The price fluctuations of these products have a great impact on Morocco’s economy. In addition to this the economy is dependent on agriculture, tourism, workers’ remittances and the production of textiles and clothing. The country is strategically positioned at the sound of Gibraltar with a geographical closeness to European, Maghreb and the sub-Saharan African markets, which makes it an effective platform for interregional trade and investment.\textsuperscript{49}

Since 2003 the economic policy pursued has improved macroeconomic stability with a generally low inflation rate, improved financial sector performance and good progress in developing the industrial and services sectors and improving the overall entrepreneurial environment. A major challenge for Morocco is the high illiteracy rate which amounts to 56% (2008) of the population over 15 years old and the relatively high unemployment rate (9.6%) especially among youths in urban areas where it amounts to around 30%.\textsuperscript{50}

\textsuperscript{48} Atlas Method. World Development Indicators Database, September 2009, World Bank Group
\textsuperscript{49} Morocco Rising, Foreign Affairs, Vol. 88, Issue 3, May/June 2009
\textsuperscript{50} Banque Mondiale Données [http://donnees.banquemondiale.org/pays/maroc]
In Morocco, 19% of the population is considered as poor according to the country’s own definition. The income share of the richest 20% is 47.9% while the income share of the poorest 20% is 6.5%.\textsuperscript{51}

The Economist Intelligence Unit describes the Moroccan bureaucracy as rather inefficient with widespread nepotism and corruption.\textsuperscript{52} The country was ranked 3.4 on a scale where 10 is completely free from corruption and 0 is highly corrupt, in Transparency International’s corruption perception index of 2010.\textsuperscript{53}

In the long-term, the main challenges for Morocco include decreasing the unemployment rate, especially for the youth, curbing corruption, expanding and diversifying beyond phosphates and low value added products as well as closing the income gap between the rich and the poor. With a better VAT-design, the likelihood that the government will be able to raise the revenues necessary to meet these long-term challenges will increase.

### 3.2 Liberal Reforms

As part of the comprehensive structural adjustment program in the early 1980s, Morocco took measures to integrate its economy into the global economy via liberalisation of import and the adoption of an export-oriented growth strategy.\textsuperscript{54} In the early 1980s, when it become evident that the policy of limiting imports through quotas, tariffs and prohibitions only contributed to inefficiencies and to illegal importation, the Ministry of Commerce, Industry and Tourism announced a far-reaching program of foreign trade liberalisation. As a result of these measures, by late 1980s, less than 10% of Morocco’s imports were subject to quantitative restrictions, which can be compared to 60% in 1983.\textsuperscript{55} In addition to this, customs duties were reduced during the same period from a ceiling of 400% to a maximum of 45%. Morocco also joined the General Agreement on Tariffs and Trade (GATT). In parallel to these import liberalising measures Morocco conducted

\textsuperscript{51} Banque Mondiale Données [http://donnees.banquemondiale.org/pays/maroc]
\textsuperscript{52} Country Report: Morocco, Economist Intelligence Unit, November 2009:4
\textsuperscript{53} Transparency International
\textsuperscript{54} Denoeux; Maghraoui 1998:58f
\textsuperscript{55} Ibid 1998:59
reforms to promote exports through the abolition of export duties and licences, the introduction of fiscal and financial incentives and the end of the state monopoly on the commercialisation of Moroccan products abroad. Foreign investment was promoted through a number of measures such as the establishment of a new investment code, and the law that made it mandatory for foreign investors to have Moroccan partners, was abolished. Reform were also made through a large privatisation process including firms in transport, petroleum distribution, petrochemicals, housing, hotels, textiles, oil refining and telecommunications.

In addition to these liberalising measures, further force to trade liberalisation has come from a number of multilateral and regional free trade agreements signed during the last few decades, including the Association Agreement with the EU in 1996, the free trade agreement with the US in 2004, with Turkey in 2006 as well as the Agadir Agreement with Jordan, Egypt, Tunisia in 2004. Morocco has also signed a number of trade and investment agreements with various countries in Africa, Asia, Eastern Europe and Latin America. The EU is Morocco’s most important trading partner, in fact more than three quarters of the country’s trade is with the EU.

3.3 Trade Liberalisation and VAT

As mentioned above, one key factor behind the current fiscal reform in Morocco is trade liberalisation. Tariff revenues have traditionally been an important source of revenue for Morocco’s national budget. They accounted for 4.5% of GDP in 1993 a few years before tariffs started being dismantled under the Association Agreement with the EU. From 1997 to 2010 annual revenue from tariffs fell from 4.3% to 1.7% of GDP, while revenue from the VAT on imports rose from 2.9% to 4.7% of GDP and total VAT-revenues from 5.3% to 8.1% of GDP.

Figure 2: Revenue from VAT and trade tariffs as percent of GDP

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56 Denoeux; Maghraoui 1998:59f
57 Augier; Gasiorek and Varela 2009:5f
58 Statistics provided by World Bank Morocco
However, despite trade liberalisation, trade tariffs have continued to generate a substantial share of budget resources, as most of the decline in import tariffs has been offset by a nearly 25% increase in imports.\textsuperscript{59} The loss of tariff revenue between 2000 and 2009 in absolute numbers has been limited (980 million MAD, 7.6%), while the loss in relation to GDP has been quite substantial (down 60%).\textsuperscript{60}

\section*{3.4 The Political Economy of Fiscal Reform}

The setting-up of a fiscal system is generally elaborated by a restricted group of persons, who cannot disregard certain categorical interests. As such, the fiscal law is the result of at least five actors: the government, the parliamentary groups, the fiscal administration, the representatives of the international institutions and the interest groups. These groups all follow their own, sometimes conflicting, rationales that can hurt the coherence of the fiscal system.\textsuperscript{61} When a tax reform is to be undertaken it can be helpful to identify the losers of the current system in order to get their support for the reform.\textsuperscript{62} It is also more likely that a certain

\begin{itemize}
\item \textsuperscript{59} World Bank, Best practices in customs reform, 2002:1-2
\item \textsuperscript{60} Statistics provided by World Bank Morocco
\item \textsuperscript{61} Jnah 2007: 53
\item \textsuperscript{62} Keen and Jousten 2005:8
\end{itemize}
group will accept reforms, such as the elimination of exemptions and other privileges, if there is a perception that the reform is fair and that other groups are losing their privileges too.\(^{63}\)

Moroccan entrepreneurs and professional organisations are relatively well organised when it comes to interest representation, often have direct access to the centre of power and their channels of influence are diverse. Other categories in society are less well organised, such as consumers, traditional farmers and the poorer part of the population in general. Although it might be less direct, these groups still have an impact on policy. The riots in the 1980s against the price increases on bread and other basic products are still very present in the consciousness of many Moroccan policy makers, and still strongly influence decisions in regard to products of basic necessity.\(^{64}\)

The Role of External Partners

Since the end of the 1990s the efficiency of development aid has been debated. It has become clear that the chances of achieving a successful reform are much larger if the external partners work in close cooperation with the policy makers of the country in order to adapt the reform to the specifics of the country. The country should keep the “ownership”\(^{65}\) of the reform and an external partner can never “buy” a reform if the program is not adapted to the specific country, since there is no “one-size fit all solution” in fiscal policy. Rather, the external partner can play the role of a catalyst of the reform and can contribute important technical advice.\(^{66}\) In the case of the fiscal reform in Morocco the major external actors have been the IMF and the EU. These two actors have complemented each other in the sense that the IMF has contributed its technical expertise in the field by making recommendations while the EU has contributed by setting up a

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\(^{63}\) Ibid. 2005:8

\(^{64}\) Brun, Chambas, Laurent 2007:319

\(^{65}\) According to the 2005 Paris Declaration on Aid Effectiveness "Developing countries set their own strategies for poverty reduction, improve their institutions and tackle corruption".

\(^{66}\) Brun, Chambas, Laurent 2007: 320
programme, in cooperation with the Moroccan authorities, of concrete steps to be taken as well as by giving financial aid.\textsuperscript{67}

\textsuperscript{67} Revenga Cendoya 2010-11-02
4 Fiscal policy and VAT in Morocco

This chapter will start by giving a brief presentation of the history of Moroccan fiscal policy. However, its main purpose is to present the current fiscal system, the objectives of the 2005 reform as well as the changes that have been carried out so far.

4.1 History of Moroccan Fiscal policy

At its independence from France in 1956, Morocco inherited a tax system that was modelled on the French system. For the next twenty years, this system largely remained intact. Following a large increase in government spending as a proportion to GDP in combination with only a small increase in government tax revenue as a proportion to GDP, Morocco accumulated a large external debt between the late 1970s and the early 1980s. It had also transformed into a narrow based, high-tax rate country and the dependence on trade taxes was very high.\(^{68}\)

The origin of the country’s economic boom can be traced back to 1973-74 when the world price of phosphates tripled. Due to Morocco’s abundance of the mineral and the fact that it was a leading exporter it benefited enormously from the price upsurge. It was during these years the government started some of its spending programmes. However, as the phosphates boom was short-lived, it had to finance its enlarged public sector by heavy borrowing from abroad.\(^ {69} \) The government eventually realised that the only way, to stop this development of ever increasing indebtedness, was to improve the revenue capacity of the tax system. At this stage the International Monetary Fund (IMF) and the World Bank started to get involved and began to shape the reform process by conducting a thorough analysis of the tax system and giving proposals for reform. The primary aim of these

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\(^{68}\) Sewell; Thirsk 1997: 229ff

\(^{69}\) Denoeux; Maghraoui 1998: 56
reforms was to broaden the tax base and achieve lower marginal and average tax rates. Among other things, Morocco introduced a new VAT in 1986. Long debates took place when the initial VAT-rates were to be set which resulted in a compromise between the government and the parliament. This compromise contributed to complicating the VAT-system by creating long lists of goods and services under special rates undermining one of the principal objectives of the reform, namely the simplification of the system. At first the VAT was a disappointment as it actually resulted in a drop in yield of GDP. The main problem was the proliferation of VAT-rates and the related administrative complications this involved. Another issue, which still remains, was the buffer rule, which had the effect that firms with an excess of input tax credits were unable to use them and were therefore subject to an unintended higher effective tax rate.

4.2 The Aim of the Reform

The aim of the current VAT-reform, that was initiated in 2005 and that is still ongoing, is to modernise the system, to reinforce its efficiency and to manage the loss of trade tariff revenue by mustering economically neutral revenue to the government. The idea is to progressively implement a modern VAT, which is in line with the best international practices, with the objective of reducing the economic distortions inherited by the current system, and increasing the yield of the indirect taxes. The expressed goal is to move towards two rates and a minimum of exemptions.

The Time Aspect – a Progressive Reform

Representatives from the IMF made a visit to Morocco in 1978 with the aim of finding the principal weaknesses of the Moroccan fiscal system, and to figure out

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71 Jnah 2007: 49f
72 Brun, Chambas and Laurent, 2007:311
73 Direction Générale des Impôts – Bilan des Réformes de la TVA, 2010:2
how the fiscal revenue could be increased in order to ease the fiscal deficit. The objective was to make the Moroccan fiscal system more progressive, efficient, equitable and more modern\textsuperscript{74}, more or less the same as the objective of the current reform, three decades later. The Director General of the DGI declared in January 2005 that the VAT-reform should be programmed for three years and that it should reduce the number of rates and exemptions and enlarge the tax base. According to the Director General the plan was to cancel all new exemptions and reserve the zero rate for exports and international transports only.\textsuperscript{75} It is now five years since the VAT-reform was initiated and the Moroccan VAT-system still has a long way to go to achieve the above goals. For the budget law of 2011, no changes in VAT have been proposed. The need for time for reflexion has been evoked as an argument for this. It can also be understood in the context of the slowdown in the economy following the recent global economic crisis.\textsuperscript{76}

\section*{4.3 The Fiscal System}

The Moroccan economy is very heterogeneous with two sectors; one is modern, productive and produces relatively high revenues, while the other is traditional and almost only produces for auto-consumption. This implies a difficulty in creating a fiscal system that is equitable and that works both for the market and the “survival” oriented parts of the economy.\textsuperscript{77}

Morocco’s fiscal system is made up of direct taxes, indirect taxes, registration and stamp taxes and customs duties. The direct taxes consist of business tax (IS), general income tax (IR), the patent and the urban tax, while the indirect tax is made up of VAT and excise taxes.\textsuperscript{78} VAT, IS and IR are the three large taxes that form the base of the Moroccan fiscal system.

\textsuperscript{74} Bensouda 1992:73f
\textsuperscript{75} Lazrak 2005:7
\textsuperscript{76} Messaoudi 2010-11-11
\textsuperscript{77} Jnah 2007: 67f
\textsuperscript{78} Qarqori 2003:5
VAT-design in Morocco

The standard VAT-rate is set to 20%. In parallel with this, there are three reduced rates of 7, 10 and 14%. Moreover, there is a specific fixed VAT for alcohol and valuable metals (gold, silver, platina). 79

It is a common feature in countries that apply VAT to have a clear division of commodities taxed under various rates. In Morocco, no such division exists; for example different types of food are taxed under different rates and some are exempt, e.g. raw sugar and some types of olive oil are exempt, powdered milk and canned sardines are taxed at 7%, cooking salt, pasta and rice are taxed at 10% while tea and margarine are taxed at 14%. Rates can also vary depending on how the product is produced. For example locally produced craft carpets are exempt from VAT, while other carpets are taxed under the standard rate. 80

According to the standard rule VAT is levied on all commercial, industrial, crafts operations, services rendered in Morocco, operations conducted by a consultant (profession libérale) and on imports, except those granted a special

79 Boussetta; Riyad 2000 : 65
80 The complete list of the commodities taxed under the various rates is available in the Moroccan Tax Code, Code Générale des Impôts [www.maghrebarabe.org/admin_files/code_10_fr.pdf]
exemption as listed in the Tax Code (Code Général des Impôts). An excise tax of 30% was previously levied on luxury goods. This was eliminated in 1993 due to the problems with smuggling that it implied.

State Subsidies – ‘Caisse de compensation’

Although subsidies cannot be considered to be on the revenue side of the fiscal system, which is the expressed focus of this study, but rather on the expenditure side they will be discussed below in the context of vertical equity. The Caisse de Compensation is a fund that was established in 1941 with the aim of increasing the purchasing power of the poorest through subsidisation and stabilisation of the prices of some essential commodities.

Exemptions

There are two types of exemptions in Morocco; exemptions with right to deduction (zero rating, article 92 in Code général des impôts) and exemptions without right to deduction (simple exemptions, article 91). There are various rationales behind these exemptions; social reasons, for products that are considered as basic products for daily consumption, such as bread and couscous etc; exemptions for fiscal reasons to avoid double taxation, such as fiscal stamps etc; exemptions for cultural reasons such as magazines, newspapers, non-bound books and also paper that will be used to print publications, newspapers or books etc. and exemptions for administrative, practical or technical reasons such as international transportation and small retailers etc.

The products that are under zero-rating are exempt primarily for economic reasons in order to promote exports, industrial and agricultural investments, fishery and tourism. Also, products that are exported are exempt according to the

81 Abdelali 2003:169
82 Messaoudi 2010-11-11
83 Le Maroc envisage une réforme de la Caisse de Compensation, Magharebia, 2008-01-04
84 Bensouda 1992:97ff
international principle that exports should be exempt and imported goods should be taxed the same way as domestically produced goods.\textsuperscript{85}

All agricultural activities are exempt until 2013, so are a large number of domestic consumption products as well as the retailers with a turnover below 2 million MAD.\textsuperscript{86}

VAT Reforms Implemented

Changes in VAT have been made since the end of the 1980s; these changes have been accelerated since the current VAT-reform that started in 2005. From 1986 to 2010, 132 amendments were introduced to the initial text on VAT, seven exemptions were removed and three rates were either eliminated or modified (12%, 19%, 30%). In 1996 the standard rate was increased from 19% to 20%, whereas in 1997 a new, reduced rate of 10% was introduced.\textsuperscript{87}

The first stage of the current reform was the introduction of measures to enlarge the tax base by limiting the number of new exemptions, eliminating a number of already existing exemptions and readjusting the tax rates of certain operations. This stage was followed by other modifications including; simplification of the structure of the rates; progressive reclassification of exempt goods and services and those under reduced rate; improvement of the system for reimbursement of VAT-credits; raising of the tax threshold to 500.000 MAD for small producers;\textsuperscript{88} and adoption of a threshold of liabilities and threshold of exemptions that is compatible with the IR.\textsuperscript{89} In the below table some examples of VAT reforms made since 2005 are presented:

| 2005 | Taxation of certain goods which were previously exempt, such as cooking salt at a rate of 10%, readjustments and harmonisation of the taxation of certain goods, such as |

\textsuperscript{85} Bensouda 1992: 105.  
\textsuperscript{86} Projet de Loi de Finances pour l’Année Budgétaire 2009, Rapport économique et financier, 2009 :184  
\textsuperscript{87} Direction Générale des Impôts – Bilan des Réformes de la TVA, 2010:17  
\textsuperscript{88} ibid. 2010:2  
\textsuperscript{89} Projet de Loi de Finances pour l’Année Budgétaire 2009, Rapport économique et financier, 2009 : 184
<table>
<thead>
<tr>
<th>Year</th>
<th>Description</th>
</tr>
</thead>
<tbody>
<tr>
<td>2006</td>
<td>Previously exempt products became taxable, such as powdered milk for human nourishment at a rate of 7%, butter, except butter produced by the <em>artisanat</em>, at 14%, driving school fees and gambling at 20%. Some products that were previously taxed at 7% were increased to 10%, such as financial operations; rice flour and starch; pasta; food made for children and operations conducted as part of a profession by a lawyer, interpreter, notary or veterinary. Some products that were previously taxed at 7% were increased to 20%, such as bicycles, tyres and inner tubes for bicycles, and from 14% to 20%, such as coffee, soluble coffee extracts and jams.</td>
</tr>
<tr>
<td>2007</td>
<td>A special exemption with right to deduction was granted to the Al Akhawayne University of the city of Ifrane. The exemption of capital goods and equipment was limited to 24 months after the start-up of new enterprises. Beyond this period, purchases of such goods became taxable with right to deduction. As a measure to harmonise with the rate for electric energy, the rate applicable to solar water heaters was reduced from 20% to 14%.</td>
</tr>
<tr>
<td>2008</td>
<td>The reimbursement period for the VAT was reduced from four to three months. An exemption was extended to imports of military machinery and equipment acquired by the National Defence Administration.</td>
</tr>
<tr>
<td>2009</td>
<td>There was a rise in the exemption threshold for small manufacturers and small service providers from 180 000 to 500 000 MAD. Introduction of exemptions without right to deduction for anti-cancer and anti-virus medication (hepatitis B and C) and with right to deduction for services acquired by the Mohammed VI Foundation for the promotion of social work and educational training as well as for up to 50% on the construction of mosques.</td>
</tr>
</tbody>
</table>
The rate applied to petroleum products and oil was increased from 7% to 10%, which was expected to generate over 350 million MAD of revenue. Exemptions on interest on loans to local governments were abolished and a rate of 10% was introduced.

Source: Direction Générale des Impôts – Bilan des Réformes de la TVA 2010

### 4.4 The Modernisation of the Fiscal Administration

The fiscal administration has been going through a reform process since the beginning of the new millennium. Many of the operations have been decentralised to the 15 regional offices. In some large regional offices special services for large and medium sized enterprises have been created. The administration has hence moved from an administration divided by type of tax to an administration divided by categories of taxpayers. The reform has also aimed to establish a single contact for the taxpayer. In addition to this, the service to the taxpayer has been improved by the creation of a help centre in every regional office. In 2010 a system of electronic declaration and payment was introduced for companies with a turnover above 100 million MAD and from 2011 it will be introduced for enterprises with a turn over above 50 million MAD. A unique fiscal identification for all parts of the administration has made an automatic exchange of information in real time possible. This will also make it easier to rationalise the collection of taxes as well as the fiscal control. More generally, the new tax code which entered into force 1 January 2007 is one single document for the VAT, IS and IR. This is important progress in terms of visibility and communication. Every year a new version of this document is published.

There has also been an important change with regard to the human resources of the tax administration. Previously many public servants had no higher
education but were autodidacts. In 2005 a large reform was carried out where many of the civil servants were offered attractive packages to leave and younger and more qualified personnel was hired. The recruitment became more adapted to the needs of the administration while the wage-bill was decreased. However, it should be mentioned that this reform has not been free from criticism.

When it comes to audit and control, the Moroccan tax administration has started a new system of risk management that builds on the identification of enterprises with a low risk of error in their accounts. These companies can in fact be reimbursed for their VAT credits within 24 hours. These companies are only checked occasionally, which saves resources for checking of other enterprises that are estimated to have a higher risk of error.

4.5 Fiscal Expenditure

Starting from 2005, as a fiscal transparency measure, the Moroccan government publishes an annual report of tax expenditures i.e. how large the loss of income for the state is as a result of exemptions and reduced rates. This annual report of fiscal expenditure has shed light on the budgetary decision process and contributed to better targeted exemptions in recent years. In 2005, the first year the report was published, the fiscal expenditure amounted to about 15.5 million MAD, which was equal to about 3.4% of GDP and 15.7% of government tax revenue. Out of this, around 53% related to VAT. In 2009, out of the reported expenditure, VAT represented 33% of the total tax expenditure, which was estimated to be around 14.3 million MAD.

The following table shows the principal beneficiaries from fiscal expenditure (more than 1000 million MAD) in 2009:

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95 El Massnaoui 2010-11-02
96 Messaoudi 2010-11-11
97 Keen; Jousten 2005: 11
98 Direction Générale des Impôts – Bilan des Réformes de la TVA, 2010:20
Table 2: Principal beneficiaries from fiscal expenditure 2009

<table>
<thead>
<tr>
<th>Designated sectors</th>
<th>Fiscal expenditure in million MAD</th>
</tr>
</thead>
<tbody>
<tr>
<td>Real estate</td>
<td>1084</td>
</tr>
<tr>
<td>Agriculture and fishery</td>
<td>2644</td>
</tr>
<tr>
<td>Electricity, gas and petrol</td>
<td>2123</td>
</tr>
<tr>
<td>Food industry</td>
<td>2353</td>
</tr>
<tr>
<td>Public services</td>
<td>2110</td>
</tr>
<tr>
<td>Health and social</td>
<td>1032</td>
</tr>
</tbody>
</table>

Source: Direction Générale des Impôts – Bilan des Réformes de la TVA 2010
5 Evaluating the Moroccan VAT-system

[T]ax policy reform is not a luxury that can be deferred indefinitely. Not least to assure the private sector with some certainty as to future tax arrangements, a clear and plausible strategy for fundamental reform needs to be developed […].\textsuperscript{99}

This chapter, while building on the results presented in the previous ones, will evaluate the VAT-system in Morocco. The analysis will take as a point of departure the principles of equity, simplicity and neutrality, which are key principles when developing the “optimal” tax system, i.e. as mentioned in chapter 2 of this paper, a tax system that raises revenue without discouraging economic activity, with a simple and transparent structure, a broad base, one with a maximum of two rates and a minimum of exemptions.

5.1 Major Challenges of the VAT-design

In a report from 2005, by request of the Moroccan authorities for technical assistance, the IMF called for an urgent need for tax reform. Several issues lay behind this call for reform, including the continued high non-discretionary spending, expected diminishing incomes from one-off privatisation receipts, as well as dwindling revenue from customs duties following the liberalisation of trade.\textsuperscript{100} The structural problems evoked by the IMF were especially evident in the case of VAT. The IMF also evoked an apparent lack of understanding among operators of how a tax system works and suggested an outreach program and

\textsuperscript{99} Keen; Jousten 2005:5
\textsuperscript{100} ibid. 2005:5ff
training for actors involved; operators, parliamentarians, journalists and the general public.101

The Moroccan tax system is generally characterised by high statutory rates on a tax base that is reduced by a large number of exemptions, vast complexity and widespread informality. This creates distortions that are potential impediments to growth. As economic integration with the global economy intensifies, the negative impact of these distortions will become increasingly important.

The weaknesses of the Moroccan VAT can be summarised as follows:

i. An excessive number of rates (five rates of 0, 7, 10, 14 and 20%).

ii. A large number of exemptions costing the government an important amount in lost revenue every year.

iii. No apparent logic behind which commodities are taxed under reduced rates or exempt.

iv. The existence of restrictions on VAT-refunds when an enterprise has structural excess credits.

v. VAT is, in some cases, used as a measure of protectionism to discriminate against imports.102

101 Keen; Jousten 2005:8
102 Ibid. 2005:18
5.2 VAT as Part of Government Revenue

Despite the many, still remaining, shortcomings of Moroccan VAT, judging by the government revenue from VAT, this particular tax has become an increasingly efficient instrument with which to raise revenue for the government. The total VAT-revenue increased from 20 billion MAD in 1999 to more than 61 billion in 2008 and of this 58% was raised through VAT on imports. The average annual growth rate of VAT-revenue between 2005 and 2008 was 20% and the VAT-revenue as part of total fiscal revenue increased from 29.5% to 33% and its proportion of GDP increased from 6.2% to 8.9% during the same period.

Figure 5: Revenue from VAT: total, import and domestic

Source: Moroccan Tax Authorities, “Evolution des recettes fiscales totales”

103 Evolution des recettes fiscales totales 1998-2009” Data provided by DGI
104 Direction Générale des Impôts – Bilan des Réformes de la TVA 2010
5.3 Rates and exemptions

Since the introduction of VAT in Morocco, exemptions have continued to spread to new areas. It was not until 2005 that the trend started to change. This, in addition to the large number of rates and the non-inclusion of some areas of activity in the scope of the VAT, such as agriculture, explains the expensive VAT-management and the weak economical neutrality of it.  

The numerous rates and exemptions also compromise the simplicity of it and account for a large part of the state’s expenditure.

The exemptions create a break in the chain of deductions, which impacts its neutrality. Although some exemptions may be socially justified, it has become increasingly clear that the cost of administering the VAT in its present form is very high. The fiscal expenditure report is an essential instrument to keep records over who receives what concession and what cost it involves in revenue forgone. It is also a basis to make possible a thorough evaluation of whether the exemptions serve the aims that they were intended for.

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105 Direction Générale des Impôts – Bilan des Réformes de la TVA 2010: 17
106 Ibid. 2010: 20
Some measures have been taken by the government, as mentioned in the previous chapter, with the long- to medium-term goal to reduce the number of rates to two (most probably the standard rate of 20% and the reduced rate of 10%) and eliminate all the exemptions except those for exports and international transports. Although the Moroccan VAT-system still consists of five rates, it should be noted that 86% of the VAT-revenue originates from the two rates that are most likely to be kept, namely that of 20% and the reduced rate of 10%. With the gradual readjustment of the goods taxed under the various rates each year, the VAT is progressively moving towards a two-rate system.\(^\text{107}\) The diagram below shows the amount of revenue originating from the various rates for 2004 and 2008.

![Figure 4: VAT-revenue by VAT rate 2004 and 2008](image)

Sources: DGI and Morocco: 2009 Article VI Consultation IMF Country Report 10/58

The number of exemptions has also been reduced gradually. For example the exemptions on tea, rice and salt have been eliminated over the last years, as we have seen in table 1. Between 2006 and 2009 the number of derogations was reduced by 64 measures, which broadened the tax base and contributed a value of 6.6 billion MAD.\(^\text{108}\)

\(^{107}\) Direction Générale des Impôts – Bilan des Réformes de la TVA, 2010: 21

\(^{108}\) Ibid. 2010: 19
However, what is most striking when studying the Moroccan VAT-system is the apparent lack of logic and order behind what type of commodities are taxed under the various rates. As already mentioned, different food products are taxed under different rates or are exempt; some products are taxed differently depending on where and how they are produced and who is using them. Olive oil produced by the *artisanat* (as crafts) is exempt from VAT while other types of cooking oils are taxed at 10%. Decorative candles are taxed at 20% while other candles are exempt. There is a long list of commodities that are exempt when used exclusively in agriculture (article 92:5 in the Tax Code). These kinds of rules create difficulties in practice in drawing the line between what should be exempt and what should not. E.g. what is a decorative candle and what is not? What are modern facilities when it comes to steam baths and what is not? Who decides?

There are no further definitions in the Tax Code.

When examining the changes that have been made since 2005 in the table above there is still no apparent clear logic behind. In some cases it also seems to be some special interests behind the changes, like the exemption for the University of Al Akhawayne in Ifran. If simplicity were the objective, either all universities or none should be exempt. This type of classification (or lack thereof) of commodities is very difficult for the tax administration to handle and for the enterprises that need to stay up to date on every little change made, keep records and report to the tax authorities. The most important reform to be made in Moroccan VAT is therefore, in the view of the author of this paper, the establishment of a clear and simple logic behind the categories of commodities to be taxed under the various rates. There is no evidence of attempts to move in this direction in the changes made so far and a similar objective has not been explicitly mentioned in any policy paper or discussion with the Moroccan authorities during the course of this study.109

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109 Although it has fallen outside the scope of this paper to study it in more detail, one possible explanation behind this apparent lack of clear categories could be the relatively strong influence of different interest groups in the Moroccan society.
Generalisation of the VAT and VAT as a Measure of Protectionism

Bearing in mind the high rate of illiteracy in Morocco and the remaining constraints of the administration, a generalisation of the VAT to all economic sectors including the agricultural sector, the small retailers and small producers may not be feasible in the short-term. However, in a medium to long-term perspective a generalisation of the VAT in combination with intensive training programmes in accounting, compulsory billing and cash registers would be desirable as it would enlarge the tax base and it would be likely to reduce the possibilities of fraud.\textsuperscript{110}

Some Moroccan VAT-rates explicitly discriminate against imported goods, for example through the VAT-exemption of Moroccan dates, figs, raisins and the favourable VAT rate for a category of small cars which are only produced in Morocco. According to WTO-rules, VAT should treat domestic and imported goods in the same way and any protectionism should be transparent and explicit in tariffs.\textsuperscript{111}

Reimbursement of VAT-credits and the Tax Administration

Ideally, the VAT should be neutral, without impact on the decisions of the economic operators.\textsuperscript{112} A simple system with as few rates and exemptions as possible as already developed above is the best warrant for this. Another issue that impacts the neutrality of the VAT is the time it takes for the tax administration to refund the companies’ tax credits, since it impacts the finances of a company. On this issue, there have been significant improvements over the last years. Initially there was no specified delay in which the tax administration had to reimburse the companies. This was later fixed to six months, then to four, and in 2008 the delay was further shortened to its current level of three months.\textsuperscript{113}

\textsuperscript{110} Messaoudi 2010-11-11
\textsuperscript{111} Keen; Jousten 2005: 18
\textsuperscript{112} Naanaa 2001:2
\textsuperscript{113} Direction Générale des Impôts – Bilan des Réformes de la TVA 2010
An issue that is still prevailing is the restrictions on VAT-refunds when an enterprise has structural excess credits. This compromises the fundamental principle behind VAT, which is to tax consumption and not production.\textsuperscript{114}

While measures have been taken to modernise and make the administration more efficient the number of hours spent by enterprises to prepare, file and pay taxes has not decreased; it was a steady 358 hours per year between 2005 and 2009.\textsuperscript{115} The most probable reason behind this is that the new measures are still being implemented and the reforms have not yet started to have an impact. The complex and seemingly arbitrary rules, as discussed above, probably also plays a role in the time spent on tax administration.

\section*{5.4 Equity}

As equity is a rather normative concept, it is not completely uncomplicated to use. The discussion below will make use of two dimensions of the concept, horizontal and vertical equity as defined in chapter 2.

\subsection*{Horizontal Equity}

The fiscal burden of the VAT is not distributed in an equitable way between the different sectors of the economy, due to the fact that some sectors are not included in the tax base, for example the agricultural sector. This compromises the horizontal equity of the VAT, as it does not tax equal economic capacities equally. The agricultural sector was initially supposed to be included in the VAT from 2010, but this deadline has now been postponed to 2013. The non-inclusion is defended by the fact that a large proportion of the population is still active in the agricultural sector and that this sector employs many people in the lower income groups. The VAT-exemption of the agricultural sector is a very delicate issue and although the authorities have started to discuss the possibility of

\begin{footnotesize}
\textsuperscript{114} Keen; Jousten 2005: 15
\textsuperscript{115} World Bank Data on Morocco [http://data.worldbank.org/country/morocco]
\end{footnotesize}
including this sector in the VAT in the future, no concrete steps have yet been taken to move in that direction.

The horizontal equity is also compromised by the fact that there is a large informal sector in Morocco, just like in many other developing countries. The informal sector constitutes an “economy of survival” for a proportion of the active population. It offers a possibility for a large number of unemployed to obtain essential revenue, which to a certain extent absorbs unemployment.\textsuperscript{116} According to the Statistical Department at the Moroccan Ministry of Finance, the informal sector contributed to a 50 billion MAD VAT-revenue loss in 2000.\textsuperscript{117} However, it is difficult to measure the size of the informal sector and therefore it is impossible to know whether it has increased or decreased in size over the last couple of years. Theoretically, there are reasons to believe that a more simple and neutral VAT with a minimum of red tape will create incentives for companies to exit the informal sector and enter the formal one, due to among other things the right to deduction of the VAT paid on inputs.

Although it is impossible to know whether these companies were already existing companies deciding to register at the tax authorities or if new companies entering the market, an increase in the number of companies registered for VAT over the past couple of years can be noted. Between 2006 and 2007, the number of companies registered for VAT increased by more than 13% and between 2007 and 2008 it increased by almost 11%.\textsuperscript{118}

Over the last years there has been an amnesty for enterprises that have not paid their taxes in order to get more companies to register at the tax authorities, without punishing them for previous years of not paying tax.\textsuperscript{119} However, limiting tax evasion will certainly remain one of the key challenges for the Moroccan fiscal administration for years to come bearing in mind the size of lost government revenue that it implies. A limitation of tax evasion would allow the tax authorities to lower the tax rates, which would probably contribute to limiting the tax evasion even more and a positive trend would be started.

\textsuperscript{116} Jnah 2007:69
\textsuperscript{117} Naanaa 2001:6
\textsuperscript{118} Population fiscale, statistics provided by the DGI
\textsuperscript{119} Messaoudi 2010-11-11
Vertical Equity – Subsidies, Reduced Rates and Exemptions

The numerous reduced rates and exemptions in the Moroccan VAT-system as well as the subsidies were initially created to obtain vertical equity.\(^{120}\)

However, the state subsidies have become increasingly criticised for being inefficient and old-fashioned.\(^{121}\) One of the major problems with state subsidies in general is that it challenges the government’s ability to plan its expenditure. The cost of the state financed subsidies in Morocco rose from 10.9 billion in 2007 to 24.8 billion MAD in 2008, following the rise in world oil prices and certain other commodities.\(^{122}\) Another drawback with subsidies is that the price mechanism, which would normally impact the quantity demanded of a certain commodity, is not functioning. Normally an increase in the world market price of oil would impact how much consumers would use their cars. Still, when the government fixes the price, consumers’ behaviour does not adapt to the world market price fluctuations and the bill for the government grows. Moreover, although the intention of the subsidies was to create vertical equity, the rich are likely to profit more from it in absolute terms than the poor, i.e. the same logic as that of VAT-exemptions is valid. According to an article in Morocco Business News, the richest 20% of the population benefit from 75% of the subsidised fuel, while the poorest 20% only benefit from 1% of it.\(^{123}\)

Over the years, the exemptions have multiplied in Morocco. What the Moroccan government might not have paid enough attention to when introducing these exemptions is that VAT is a “blind tax” meaning that it taxes everyone the same, regardless of their abilities to pay. VAT is therefore not an efficient instrument to create vertical equity. It should rather be used as a way to raise government revenue; vertical equity must be achieved by other means. As already argued above, although poor people benefit relatively more in relation to their income from reduced rates and exemptions on basic products of large consumption, the rich are likely to benefit absolutely more from it. Moreover, the

\(^{120}\) Naanaa 2001:2  
\(^{122}\) Morocco: Macroeconomic Policy - Fiscal Policy, African Economic Outlook  
\(^{123}\) Morocco Business News, "Caisse de Compensation not to be abolished", 2008-09-04
people living in the most extreme poverty are not likely to buy any products for consumption; instead they are likely to produce their own commodities for auto-consumption, which means that they do not benefit at all from the reduced rates and exemptions. Therefore, if the aim is to achieve more vertical equity it would be more efficient for the Moroccan government to develop other, more targeted ways to achieve this. The increased government revenue that would be the result of an elimination of most exemptions and reduced rates could be used to direct more targeted aid to the poorer part of the population rather than giving exemptions to all social groups.\textsuperscript{124} As put in the previously cited IMF-report from 2005:

Experience strongly suggests that the exemptions and reduced rates applied to some basic commodities are far less effective in alleviating poverty than would be direct spending measures (on basic health, education and infrastructure for example).\textsuperscript{125}

However, when making this argument, it must also be said that it would be a real challenge to develop an advanced system of social security and to identify those who are in real need of targeted support, especially as long as corruption is a widespread phenomenon in the society. As mentioned above corruption is still common in the Moroccan bureaucracy, even if measures to counter this have been initiated.\textsuperscript{126}

As expressed by the Director of the Research and Development Department at the DGI, high VAT-rates might be accepted in certain European countries, such as in the Scandinavian countries, due to the relatively high quality of public services with guaranteed and equitable access provided to the general public. In a country like Morocco, where the public services are deficient, it would be difficult to get the general public to accept the introduction of a single high VAT-rate. In the short term a progressive abolition of unjustified exemptions and a reduction in the number of VAT-rates as a way to create a more coherent fiscal system, without

\textsuperscript{124} Keen; Jousten 2005:8
\textsuperscript{125} Ibid. 2005:16
\textsuperscript{126} Mainly through the Central Authority for Corruption Prevention, ICPC, that was created following the Moroccan ratification of the UN Convention against Corruption in 2007.
impacting the overall tax burden on the households and enterprises is more likely to be successful. In the medium-term, with an improvement of the public services through the large efforts that are currently being made, this is likely to create a mentality among the general public that is more open to higher VAT-rates.\textsuperscript{127}

In fact, there have been some initiatives moving in the direction of more targeted poverty reduction the last years, even though this is something organised outside the normal channels of the public sector. King Mohammed VI launched the National Initiative for Human Development (INDH) in 2005, in cooperation with some foreign actors, to help poor people economically under the condition that they send their children to school. This 2 billion USD programme has improved social welfare by a successful rural electrification, gradual replacement of urban slums with decent housing etc.\textsuperscript{128}

The Results of a Simulation

The Moroccan government body for strategic studies and statistics, the Haut-Commissariat au Plan, has made a simulation of the impact on the economy of an adjustment of the standard VAT-rate from 20\% to 16\% and a regrouping of the reduced rates of 7, 10 and 14\% to one single reduced rate of 10\%. The simulation was based on a general equilibrium model using social statistics from 2007. According to the results of this simulation, in 2015 the lowest income class would decrease in size from the situation of 12.3\% in 2007 to 10.9\%, a decrease by 126055 people, the middle class would increase from 54.4\% to 55.1\%, an increase of 81750 people, and the upper class would increase from 33.3\% to 34.0\%, an increase of 44305 people. Consumption, investment, employment and GDP growth would be positively affected while the government revenue would be negatively affected.\textsuperscript{129}

Although, according to the results of this study, the impact on the size of the lowest income group is not radical it is interesting to note that this group would

\textsuperscript{127} Messaoudi 2010-11-16
\textsuperscript{128} World Bank website – Morocco Projects and Operations
\textsuperscript{129} Haut-Commissariat au Plan, Simulation d’impact des mesures fiscales: - baisse du niveau de l’impôt sur les sociétés – réaménagement de la taxe sur la valeur ajoutée
decrease in size and so would unemployment. Unfortunately this study does not reveal anything about the impact of an abolition of exemptions and how this would impact the economy and the poorest groups.

**Winners and Losers in the Current System and of the Reforms**

To establish who is actually carrying the burden of a tax, the elasticity of demand and supply must be known. This is very hard to measure and therefore the following argumentation will build on assumptions or “informed guesses” of the elasticity of the various products.

As we have seen in table 1 above there has been an introduction of VAT on some commodities that were previously exempt such as salt, pasta and rice. One can assume that the elasticity of demand of salt is low, bearing in mind that it is an essential product for cooking and that all human beings need a certain amount of salt to stay healthy. In that sense, consumers are likely to be negatively affected and the poorer groups in society relatively more, as the price increase constitutes a larger part of their income.

Turning to some of the other products evoked above, at first sight rice and pasta might be considered as basic products with low elasticity. However, in Morocco, this is not really the case as they are not ‘traditionally Moroccan’ products. Instead, the less abundant groups in society are likely to substitute these products with others such as bread, couscous and semolina that are still exempt. Additionally, since these products are usually imported, no domestic producers are likely to be negatively affected.

Taking an overall look at the changes made since the reform started in 2005, the poorer groups in society are likely to have been most negatively affected in relative terms since many of the exemptions that were abolished were on basic products. On the other hand, as argued above, in the long run it is better if efforts to create vertical equity are concentrated on other more targeted ways of helping the poorest. In the long run a generalisation of the VAT, even if it implies taxing basic products, is in the interest also of the poorest, since this would mean more resources for the government to redistribute.

Looking at the more general picture of the different sectors benefiting from fiscal expenditures (table 2) one can note that the agricultural sector is benefitting the
most, followed by the food sector and then electricity, gas and petrol, public services, real estate and then the health and social sector. From an equity perspective it can be considered justified to have exemptions in the food, health and social, and real estate sectors (given that the concessions concern social housing). As we have seen above, subsidising petrol is not a very efficient way to help the poorest. As regards the agricultural sector there is no simple answer to whether it can be considered justified or not. In Morocco there are many small farmers, and many belong to the lower social groups. On the other hand, the very rich farmers benefit from the VAT-exemptions as well. It would surely be less costly to help the farmers who are in real need by targeted transfers, rather than exempting the whole agricultural sector. Finally, as regards the public services sector, it is very difficult to say anything at all since this is a very broad category and it is impossible to evaluate it without knowing exactly what is included.
6 Conclusions – Policy implications

The purpose of this study has been to evaluate the VAT-system in Morocco in the context of trade liberalisation, especially following the VAT-reform that was initiated in 2005. Questions of particular interest have been the impact on government revenue and equity indicators (horizontal and vertical) following the VAT-reform. The findings of this study suggest that Morocco has started a path of reforms which have given some concrete results including: no increase in the number of exemptions, progressively more commodities taxed under the two rates of 20% and 10%, efficiency improvements in the administration, measures to facilitate the payment of taxes taken, common identification number for each registered company established, faster reimbursement from the tax authorities of VAT-credits, increased exemption threshold for small manufacturers and small service providers and an increased number of companies entering the formal sector. In relation to the research questions the following results have been obtained:

i. Increased tax ratio of GDP: the implemented VAT-reform has been successful in increasing government revenue. The revenues from VAT have increased by 47% since the reform process started. There has only been a slight decrease in the trade related revenues between 2005 and 2009 in absolute terms and the increased revenue from VAT largely outweighs this slight decrease. Consequently, in the quantitative sense of it, the overarching aim of this study to evaluate whether the VAT-system in Morocco can effectively handle the fiscal challenges imposed by trade liberalisation; the answer is undoubtedly yes.

ii. As regards vertical equity one can presume that the purchasing power of the poorest has decreased as a result of the abolition of some exemptions and the increased VAT on some basic products of large consumption. On
the other hand, as we have argued, VAT is not the most efficient way to create vertical equity and if the money spent on exemptions and subsidies was instead used as a direct transfer to the poorest groups this would be a more efficient way to redistribute welfare. Although much remains to be done to achieve vertical equity, some initiatives to help the poorest have been taken through the INDH.

iii. As regards horizontal equity, the fact that the number of companies registered for VAT has increased indicates that the black economy has diminished in size. However, this cannot be verified as it might also be due to new companies being created. Given that some of these companies did exist previously and have now entered the formal sector, this has increased the horizontal equity of the economy.

Much still remains to be done in order to create the “optimal VAT-system”. The latest reform process has been going on for five years and the government needs to show leadership and political will in order to achieve its objectives.

i. First and foremost, a clear and logical structure needs to be established for the VAT-design and the reforms-process in order to simplify the system and enhance its legitimacy.

ii. The process of reducing the number of rates needs to be continued until only two or possibly one rate remains. The same is valid for the number of exemptions that needs to be restricted to an absolute minimum. The agricultural sector needs to be included in the VAT base.

iii. Morocco also needs to abolish its extensive and expensive programme of subsidies and develop more targeted methods to create vertical equity. In order to achieve this Morocco needs to build up a social security system that is targeted to those who are in real need.

Finally, what lessons can be learned from the case of Morocco? Some essential and concrete measures that have been taken in Morocco could serve as examples for other developing countries about to conduct a fiscal reform. One such measure is the establishment of the fiscal expenditure report. This report has made the
costs of the exemptions and the reduced rates visible, and the possibility for political and economical actors to evaluate their effectiveness in achieving their intended aims has increased. The system of risk management in the control of VAT-payers is an efficient way of using the limited auditing resources of the tax administration. The progressive reform is also likely to facilitate the reform process in making it possible to evaluate each step of reform taken and in that way limiting the protests from risk-averse actors. It is important to involve the civil society and to inform the general public of the reform process and its aims, something that, according to some authors, have taken place in Morocco.  

On the other hand, the measures that have been taken so far in the reform process lack an apparent logic and the table of implemented changes seems to reveal that, in at least one case, special interests have been influential in the process. If this is the case and a perception is spreading that some specific actors or institutions are gaining privileges this may complicate the reform process by making other groups less inclined to accept it.

For an outsider coming to study the Moroccan VAT-system and reform-process, the most obvious weakness is the apparent lack of a clear structure in the system and the lack of a comprehensible strategy for the reform. Measures need to be taken to make the design as well as the reform process more transparent and coherent. Hopefully Moroccan policy-makers will address this issue in the near future.

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