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COMPETITION, STATE AIDS AND SUBSIDIES

Contribution from the Competition Council of Morocco

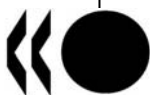
-- Session I --

This contribution is submitted by Mr. Abdeli BENAMOUR, President of the Competition Council of Morocco, under Session I of the Global Forum on Competition to be held on 18 and 19 February 2010.

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COMPETITION, STATE AIDS AND SUBSIDIES

-- Competition Council of Morocco --

1. Introduction

1. Competition, a fundamental pillar of the market economy, has been the cornerstone of the capitalist system and one of the determining factors in trade relations for modern world economies ever since the industrial revolution first took root.

2. Yet, one should point out that the supporters of the capitalist system are divided between the proponents of orthodox liberalism, who consider the market to be self-regulating and the interventionists, who hold that the capitalist system - and therefore the market and competition – has to be regulated on an on-going basis if growth, prosperity and social progress are to be ensured.

3. Moreover, since the end of the 19th century, the two schools of thought have succeeded each other in public management and, as far as some elements of each are concerned, even exist alongside each other. In fact, compliance with competition regulations by controlling such well-known practices as cartels, the abuse of dominant position and concentrations does not always explicitly cover state aid. The latter seems to be more the province of industrial policy. To put it another way, the competition balance and the economic balance do not always add up.

4. The issue then is as follows: competition, based on the idea of merit and the continuous process of creative destruction, encourages firms to be innovative and efficient.

5. With regard to state aids, although in some ways they are of no harm to competition, in others they can distort competition and generate distorted rents thereby decreasing the economic surplus since it can divert production and investment towards the least efficient units.

6. Apparently, then, state aid, in some ways, should be the fourth component of anti-competitive practices. However, it is not always treated as such, because it is supposed to serve a different purpose. The problem is, then, that aid can sometimes be justified; firstly, when it comes to investments which do not hinder competition and which are of benefit to all involved - such as infrastructural spending. Aid can also be justified when it comes to exemption from competition regulations, either on the grounds of social cohesion or on economic grounds relating to support for innovation, aid for start-up industries, regional development, or even for the purpose of strengthening the operation of the market itself and, hence, the competitive process in the developing countries.

7. In short, for many thinkers and players on the ground, competition and state aid, despite their apparent contradictions, are policies that somehow have to be reconciled. Moreover, the experience of the developing countries shows that some degree of priority has often been given to industrial policy and state aid.

8. Given the foregoing, and acknowledging that state aid policy may not always be in line with competition policy, in what domains can it be useful without making a travesty of the culture of market economy and competition that economic efficiency so sorely needs?

9. Taking Morocco and its experience in this area since its independence in 1956, as a case in point, there are three phases that are very relevant to this issue:

- The phase when state aid took precedence over competition (1956-1982);
- The phase of structural adjustment of the Moroccan economy, accompanied by liberalisation with the market economy and competition to the fore (1983-1998);
- Lastly, the phase of seeking a balance between an outline competition policy, considered as the cornerstone of the system, and state aid to support the imperatives of an emerging economy.

10. Let us try to look first of all at the first two of these stages, which could be qualified broadly as a period of extremes in state aid and competition that prevailed until the end of the nineties, before going on to look at the current decade, which is committed to seeking some sort of balance between competition policy and state aid.

2. The Phase of Extremes: From Seeking Accelerated Development through State Aid to Structural Adjustment with Competition Taking Precedence

11. We will successively review state aid policy which prevailed in the first 25 years following independence, then the period of liberalisation, starting with the structural adjustment policy in 1983 and lasting until the end of the 1990s.

2.1 Predominance of state aids from 1956 to 1982

12. When we look at the development of economic policy in Morocco over the quarter-of-a-century since independence, it has to be said that despite the fact that it had always opted for a market economy, unlike most third-world countries of the period, the size of its public sector economy in the widest sense of the term - with all its administrative, quasi-administrative and entrepreneurial machinery and state aid granted to both public and private sector enterprise - remained disproportionate, accounting as it did for 65 to 70 per cent of the size of the country's economy.

13. Turning specifically to state aid, this was delivered chiefly within the framework of a number of investment codes, the most important of which were the agricultural investment code and the tourism and industry investment codes. These codes were intended partly to encourage the private sector to take the place of intervention by the state, which remained the biggest economic player of the period, partly to promote more balanced regional development. Public resources allocated to economic development saw a very sharp increase (of about 800 per cent), rising from MAD 2.2 billion just after independence (approximately USD 300 million in today's terms) to MAD 17.9 billion (approximately USD 2.3 billion) in 1980.

14. In addition to this state aid, state intervention - other than in the social sector, which received moderate support - came in the form of fiscal incentives to the private sector up to and including total exemption from tax for agriculture.

15. Unfortunately, this interventionism was not matched by any degree of efficiency in public management. The outcome was conclusive neither on the social or the economic level.

16. As for the human development dimension, the fact of the matter is that Morocco had reached an extremely difficult situation whether in terms of standard of living, the inadequacy of its education system, the persistence of high illiteracy or the difficulties in accessing health and housing services. On an economic level, the results were also inconsistent and disappointing since, despite all of the government's interventions, the average rate of growth from 1972 to 1982 was no higher than 4.9 per cent (6.7 per cent from 1973 to 1977; 3.2 per cent from 1978 to 1982) while the average rate of inflation hovered around 9.5 per cent. The public account deficit hit around 12 per cent in 1982. Lastly, the external deficit (running at an average 12.3 per cent) was so high that import invoices could no longer be honoured on time.

17. Towards the end of the 1980s, Morocco was on the verge of defaulting on payments. This situation would justify the intervention of the IMF and endorse its injunctions through the implementation of a neo-liberal-based structural adjustment policy as of 1983. Moreover, this change in Morocco's circumstances coincided with the new wave of liberalism that was sweeping over every continent at the time.

2.2 *Structural adjustment policy: 1983-1998*

18. Morocco had very definitely set out on a new course, directed towards a more liberal policy. Economic efficiency was now being sought through competition rather than through state aid, although the public resources allocated to investment continued to increase (MAD 70.38 billion in 1990 as opposed to MAD 17.32 billion in 1978). This policy, based on fiscal restraint and structural reform, primarily through privatisation, produced a marked improvement in Morocco's macro-economic equilibrium. The budget deficit during the 1990s was seldom higher than 3 percent of GDP; the same was true for the rate of inflation. As for the external balance, although the trade deficit was persistent, it was more than offset by tourism revenues, transfers from Moroccan residents abroad and foreign investment. It is notable that from that point on, overseas reserves could cover six months of exports. The average growth rate was around 3 per cent.

19. At the sight of these results, we can be pleased in some regards, primarily with the macro-economic equilibrium; however, there are two major problems that must be highlighted. The first of these is the mass impoverishment of Moroccans. The explanation is that while adjustment and reform of the public finances enabled us to re-establish the macro-economic equilibrium, they inevitably exacerbated inequalities and increased poverty. The second point is that the average rate of growth, albeit positive, has remained relatively low as a result of the reduction in public finances and the impact of erratic weather patterns. In any case, this rate of growth does nothing to help make up lags or allow for the pressures of demographic growth, although the latter has declined somewhat.

20. These results, somewhat mixed when all is said and done, are not due simply to the structural adjustment policy and the choice of liberalisation. The fact is that, although the size of the state in the economy shrank slightly, the economy as a whole was still hampered by the problems of an administration that was unable to keep pace with follow-up and support for the new liberal strategy, by a justice system that was not up to the development of business or activities and by a climate of rampant corruption. This situation would lead, from the end of the 1990s, to a new approach to the problem of competition and state aid. It must be added that this period experienced a calm change of politics with regards to the country's political situation, and in particular a change of ruling with King Mohamed VI coming to power.

3. *The Dawn of the Third Millennium and the Balance between Competition Policy and State Aid Policy*

21. The 2000s would see a significant improvement on some sticking points. The liberal road map is now in place; privatisations are proceeding under better conditions, comparatively speaking; political governance looks to be relatively calm; the administration seems to be working somewhat better; which means that state efforts in terms of investment are now more evident in some areas, particularly infrastructure.

22. Morocco seems, perhaps, to be steering a course which, while wishing to make more room for competition policy, is trying to use state aid as leverage to promote the emergence of the market economy and cope with some of the pressures arising from the social situation and the development goal in general. Let us state that aid, subsidies, fiscal and other incentives still account for a major share of GDP. At the end of 2007, they amounted to around USD 8 billion (of which 45 per cent fiscal expenditure) or approximately 12 per cent of GDP.

23. However, let us again state that the goal of competition is the backbone of the new road map; as a result, there is a tendency to be clearer about the considerations on which the new State aid policy is based. There are five main challenges that can be identified:

- Supporting the various sectoral development plans implemented by the government, such as the « *Plan Azur* » for tourism, the *Plan emergence* for industry, the *Plan verte* for agriculture and the *Plan bleu* for fisheries;
- Modernising a certain number of firms in order to engage them in the competitive approach and ensure that a genuine market emerges;
- Developing foreign investment and underpinning our external balance by encouraging exports and foreign investment as well as tourism and revenue transfers by Moroccans residing abroad;
- Helping job-generating firms that find themselves in difficulty;
- Helping the social strata that are unable to bear real-cost pricing as a result of the operation of the market.

24. Overall, analysing the situation from the standpoint of the Moroccan economy, which I've had occasion to observe more closely, one can identify potential pockets of State aid on a social level as well as in the domestic economy and international relations.

3.1 *The Social Dimension of State Aid*

25. State aids take two major forms. They reside primarily in social investment expenditure, which in no way hinders competition, but rather creates the conditions for a genuine market economy. It may well include investment allowing rural areas and peripheral cities access to electricity and drinking water. We can also say that awareness of social issues and poverty has never been so delicate. The latter form of state aid is in effect an exemption from competition rules - an exemption due to certain peculiarities of Moroccan society. The main difference is that even with a fully operational market, the best resulting price may be higher than the level of income of certain strata of the population. It then becomes necessary to subsidise certain consumer staples. That is what Morocco does through its « Caisse de Compensation ».

26. Aid provided by this means amounted to around MAD 30 billion in 2008 and the forecast for 2009 puts it in the region of MAD 14 billion, chiefly as a result of the fall in energy prices. We are currently in the process of debating this issue: Should we continue to subsidise products that benefit all, or institute free-market pricing and grant state aid in the form of direct revenue distributed to the economically vulnerable?

27. Needless to say that in addition to this type of structural support, Morocco's experience shows that action in the form of cyclical support may sometimes be needed as a result of global developments in the price of certain consumer staples or of the fluctuating agricultural cycle in Morocco or following the last global crisis.

3.2 *The Economic Dimension of State Aid*

28. On the economic level, too, there are state aids that do not inhibit competition and a number of exemptions of a structural nature to the principle of competition.

29. Regarding the first form of intervention, it regards fundamentally expenditure on infrastructure and economic reorganisation affecting both administration, education, the legal system and the upgrading of sectors of economic activity through the "Emergence" - "Azur" - "Green" and "Blue" plans... It also concerns the actions which constitute exemptions from competition policy. It may well include subsidies that affect agriculture, other priority sectoral plans, the informal sector, national champions and SMEs.

30. Turning first to agriculture, it has to be said that Moroccan agriculture, which covers 9 million hectares of land, of which 12 per cent are irrigated, suffers as much from the preponderance of small farms, three-quarters of them under 5 hectares, as from the erratic climate. The problem lies in very poor efficiency and the fact that although agriculture only accounts for 15 per cent of Morocco's GDP, it employs more than 45 per cent of the population. It is easy to see why state aid is needed at times, although it flies in the face of all economic sense and the principle of competition. The aid provided includes both factors of production and the total tax exemption of the sector. A tentative solution to such a problem would entail far-reaching reforms based on land consolidation and the emergence of viable farms, which would be a socially difficult and politically very demanding task.

31. Let us add that the other sectoral plans (for industry, tourism and fisheries, etc.) also benefit, chiefly in terms of investment, from tax concessions and major state-owned inputs.

32. As for the informal sector, it plays a very large role in the Moroccan economy; according to the latest survey by the High Commission for Planning (*Haut Commissariat au Plan*), unregulated SMEs number around 1.55 million, increasing by around 350 000 units per year from 1999 to 2007. This sector is a major actor in trade (57.4 per cent), services (20 per cent), industry (20 per cent) and the construction industry (5.4 per cent). It reportedly employs some 2.2 million people and accounts for 14.3 per cent of GDP. The informal sector includes firms which evade taxes and social security regulations and firms which engage in contraband activities. The problem, apart from the fact that certain practices are not within the remit of the competition authorities, is the trade-off between employment and fair competition. What should one do in a case like this? The question as yet remains unanswered.

33. Furthermore, similar problems arise even with legitimate SMEs; the latter play a key part in fostering employment and spreading innovation. Their development sometimes requires incentives, whether in the form of state aid or tolerance of certain anti-competitive practices, such as certain levels or types of cartel agreement. How far should this type of practice be tolerated?

34. The same question also arises with national champions: some of them spur on the economy through research, innovation and competition.

35. This raises a number of questions: how does one aid research and competitiveness yet make the right trade-off between the latter and barrier-free competition? How does one avoid the slippery slope towards preferential treatment for influential members of economic organisations under the guise of aid for innovation and exports?

36. Lastly, alongside these structural situations, circumstances arising from the economic cycle – as was the case with the latest crisis – may justify regulations that curb or restrain competition principles. This was why a comprehensive aid plan for the textile sector was implemented in Morocco. The question in this case is the following: how is one to ensure that the crisis is not used as a pretext to return to permanent protectionist practices?

3.3 *Competition, Regulation and International Economic Relations*

37. Let us point out that since the WTO agreements, we have been witnessing an unprecedented liberalisation of trade. Liberalisation has been reinforced by numerous multilateral and bilateral agreements. The problem that this poses touches on a number of issues that are causing significant difficulties for international trade relations and North-South relations. The three main such issues are: agricultural subsidies, exports and social dumping and the positioning of cartels and certain major multinationals.

38. First, agricultural subsidies, which concern both Morocco and its partners: It should be noted that under “advanced status” arrangements, Morocco secured a grace period of 10 years to upgrade its agri-food and fatstock production since these activities essentially concern Morocco’s large and poor peasant-farmer population. In contrast, modern agriculture as it is termed - basically citrus fruit and vegetable production - is efficient, but is more affected by Europe’s common agricultural policy, which poses problems - despite the fact that quotas were raised some time ago – with barriers to entry and the subsidy mechanisms for its own agriculture.

39. This is a major socially and politically sensitive issue for all countries. In actual fact, under the free-trade agreements signed with the North, these subsidies seem to handicap, first and foremost, certain countries of the South. It has to be said that while the subsidies that developing countries resort often have a social or survival component, the state aid provided for agriculture in the countries of the North makes competition just as hard for the production of the countries of the South. The main issue that arises with this aid are the limits of this transition period.

40. The second problem concerns the promotion of exports and social dumping; let us add that promoting exports in countries that do not yet have a culture of competitiveness sometimes requires a degree of support, chiefly incentive support. How far can one tolerate such practices?

41. As regards social dumping, more specifically, the practices concerned are low wages and non-compliance with social security requirements. Clearly, this causes unfair competition at the expense of certain countries. Nevertheless, let us be clear that while such practices exist in certain sectors, they cannot be lumped together with objective situations where low wages are a factor in competitive production. Otherwise, why not call into question the technological lead of the industrialised countries?

42. Moreover, in the case of Morocco, for instance, the guaranteed minimum wage level (SMIG) compared with the French SMIG is perhaps rather more to the advantage of French exports since the ratio is approximately 1:5 while the ratio for per capita GDP is about 1:9.

43. Lastly, one might mention the case of cartels and large multinational firms; this is a major transnational problem which works to the disadvantage of the countries of the South. Some cartels and large multinational enterprises make use of certain State aids and their subsidiaries to carve up the markets of developing countries between them, taking advantage of their well-known lack of competition regulation. What should one do, in this case? And at what level?

4. **Conclusion**

44. In conclusion, despite the objective difficulties arising from all of these issues, it can be said that Morocco’s economic and social policy during the decade now coming to an end has been more prudent as regards seeking a balance between competition policy and state aid policy, growth policy, social welfare policy and the fight against poverty. It has preserved the fundamentals; the average growth rate is around 5.5 per cent; the budget deficit is being kept within acceptable limits; the trade deficit, with the exception of some difficulties arising from the latest crisis, is offset by tourist revenues and transfers from Moroccans

abroad as well as by foreign investment. All of this is being achieved against a background of major inland and maritime construction projects as well as major industrial and tourism projects. It can also be noted that the number of social action projects is increasing. Is that to say that the choices being made are totally cohesive and that there are no large projects still to be implemented? It seems to me that among Morocco's technocrats there is still a prevailing culture that favours state aid, with all that entails such as efficiency difficulties, over competition policy; likewise, despite all the efforts made on an economic and social level, there are still serious problems with the trade balance deficit, the education system, administrative management, the justice system, the persistence of certain isolated areas of poverty, and escalating corruption, which - although it spares some circles at senior levels of the administration - seems to be affecting broad swathes of society.

45. Hence, we are at the end of a process of major managerial achievements taking account of both competition policy and state aid policy. The coming decade, along the same lines, will probably be the period that sees major structural reforms.