Morocco's Tax Dilemma: How an Outdated Tax System Hinders Economic Growth?

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Abstract:

Morocco's economic development is hindered by a burdensome and outdated tax system that stifles investment, discourages entrepreneurship, and exacerbates income inequality. Despite its strategic advantages in sectors like agriculture, tourism, and manufacturing, the country's high tax rates, inefficiencies, and corruption create significant barriers to growth. While three National Conferences on Taxation have been held (1999, 2013, and 2019) to address these issues, meaningful reforms have yet to be implemented. The failure to modernize the tax system has placed a heavier burden on consumers, businesses, and investors, hampering economic progress. Tax policy reform, including simplifying the tax code, reducing rates, and promoting transparency, is crucial for unlocking Morocco's economic potential, fostering innovation, and enhancing the country's global competitiveness.

Introduction:

Morocco stands at a pivotal moment in its economic development. With a strategic location, rich cultural heritage, and diverse sectors like agriculture, tourism, and manufacturing, the country has great potential. However, a burdensome and outdated tax system hampers its economic growth. Characterized by high rates, inefficiency, and corruption, the current tax policy stifles investment, discourages entrepreneurship, and widens income inequality.

Despite the urgent need for reform, the government has yet to address these issues. Similar to the developing countries that do not have energy resources, taxation is the main contributor to the Moroccan state budget. The Moroccan tax system defines a set of imbalances and problems, both at the level of taxation method, prices, and the high tax pressure. After some needed reforms in the 1990s, Morocco's tax system didn't know any sweeping reforms, and taxes continue grimly to be very high and complex compared to other developing countries.

Since 1999, Morocco has organized three National Conferences on Taxation (1999, 2013, and 2019) to contribute to the modernization and simplification of the Moroccan tax system. During the most recent National Conference in 2019, discussions centered on the outcomes of two decades of debate over tax system reform. Participants questioned whether the recommendations made during the previous two conferences, aimed to overhaul the Moroccan tax system, had been effectively implemented and were visible to all. Yet, it was visible that nothing had changed and that the tax burden had become heavier on consumers, companies, and investors. As well as retarding the economic growth of the country.

A well-designed tax policy is essential for fostering a healthy economy, and in Morocco, the need for tax reform has never been more urgent. Morocco’s current tax system with its high rates and complexity, stifles innovation, discourages entrepreneurship, and places an undue burden on businesses and individuals alike. This hampers economic growth and limits the country’s competitiveness in an increasingly globalized market. Tax policy reform is crucial to reducing these barriers, allowing for a more dynamic private sector and encouraging foreign investment. By simplifying the tax code, lowering tax rates, and promoting transparency, Morocco can create an environment that rewards hard work, supports small businesses, and unleashes the full potential of its economy.

A Closer Look at Morocco's Flawed Tax System

All tax systems should respect the basic principles of taxation. The base should be broad, meaning that the burden should be distributed widely and in a neutral manner, which means that no group or industry should be favored over another. In Morocco, these principles are not respected. Morocco's tax base is relatively tight and skewed. There is a significant gap between the potential tax base (what the country could collect with an efficient tax system) and actual tax collection (what it does collect). A small portion of taxpayers shoulders the bulk of taxes: 80% of VAT is paid by just 1.6%, and 80% of corporate tax by 0.8%. Only 46% of companies file corporate tax returns, with just 33% reporting gains.[1] Contributing factors include high tax rates, exemptions, evasion, and avoidance.

Despite efforts to lower taxes, Morocco still has some of the highest tax rates in the Maghreb and all of Africa, including a top personal income tax of 38%[2], a 31% [3]corporate tax, and a 20% VAT rate[4]. Employers and employees also contribute to social security, effectively acting as a payroll tax that raises hiring costs and pushes workers into the informal economy. Additionally, Morocco imposes high customs duties, excise taxes, and other indirect taxes, which increase consumer prices and reduce purchasing power.

Businesses in Morocco face a total tax and contribution rate of 45.8% of profits, far above the MENA average of 32.7%,[5] and spend an average of 155 hours annually on tax compliance. According to the OECD Revenue Statistics in Africa 2023 report, Morocco's average total tax rate is 49.3%, ranking 38th out of 53 African countries and exceeding the global average of 40%.[6] Also, the tax burden is very high in Morocco. Morocco's tax-to-GDP ratio of 27.1% is significantly higher than the African average (15.6%) and the Latin American and Caribbean average (21%).[7] The highest tax-to-GDP ratio for Morocco was 28.7% in 2008, with the lowest at 20.3% in 2000.[8] Morocco's tax structure collection also reveals some interesting insights into the distribution of tax

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[1] The Ministry of Economy, Finance and Administration Reform. Mr. Mohamed Benchaaboun, Minister of Economy and Finance, stated on Thursday, May 2nd, 2019, in Rabat https://www.finances.gov.ma/en/Pages/detail-actualite.aspx?fiche=4882

[2] Morocco Personal Income Tax Rate - Trading Economics, source: Direction Générale des Impôts, Morocco https://tradingeconomics.com/morocco/personal-income-tax-rate

[3] Morocco Corporate Tax Rate - Trading Economics, source: Direction Générale des Impôts, Morocco https://tradingeconomics.com/morocco/corporate-tax-rate

[4] VAT rate on goods and services in Africa 2022, by country, Statista, Published by Saifaddin Galal, Jun 30, 20241 https://www.statista.com/statistics/1248622/vat-rate-on-goods-and-services-in-africa-by-country/

[5] Morocco - Total Tax Rate (% Of Profit) Trading Economics, source: World Bank on September of 2024. https://tradingeconomics.com/morocco/total-tax-rate-percent-of-profit-wb-data.html

[6] OECD/AUC/ATAF (2023), *Revenue Statistics in Africa 2023*, OECD Publishing, Paris, https://doi.org/10.1787/15bc5bc6-en-fr.

[7] Ibid.

[8] Revenue Statistics in Africa 2023 ─ Morocco, OECD https://www.oecd.org/content/dam/oecd/en/topics/policy-sub-issues/global-tax-revenues/revenue-statistics-africa-morocco.pdf

revenues. In 2023, 27% of tax revenue came from VAT and 24% from social security contributions. Non-tax revenues were 2.8% of GDP, below the African average of 5.8%.[9]

The Moroccan tax code is also associated with set-asides for the politically connected. The complex system of tax exemptions is closely tied to cronyism, where politically connected individuals and businesses benefit disproportionately from favorable tax treatment. These exemptions, rather than being uniformly applied to stimulate economic growth, often serve to protect the interest groups with close ties to the government.[10] The result is an uneven economic playing field, where small and medium-sized enterprises (SMEs) struggle to compete against larger companies that enjoy tax breaks due to their political connections. It is, also full of a range of exemptions that distort business decisions.[11] In particular, the VAT rate varies significantly from the standard rate of 20%; there are reduced rates for transport and solar energy (14%). For gas, banking, financial and catering services (10%), and water and animal feed (7%)[12]. In addition, some goods and services are exempt, such as those rendered to companies established in free trade zones and agricultural materials and equipment. In 2016 alone, 407 exemptions existed to incentivize economic activities, particularly agriculture and fishing, food industries, real estate, or financial intermediation[13].

The tax exemption system in Morocco creates significant economic distortions, such as rate reductions, deductions, allowances, lump-sum taxation, and liquidity facilities. These tax preferences often result in the misallocation of resources, fostering a form of cronyism that distorts the business environment. Rather than being guided by market demand, investments are funneled into politically favored projects,[14] diverting capital and effort from initiatives that would better serve consumers. Consequently, this damages the prosperity of a nation as the finite resources of an economy are being inefficiently managed and diverted from projects that can deliver much greater benefits to society and enhance overall prosperity.

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[9] Ibid.

[10] Saadi, Mohammed Said. "Moroccan Cronyism: Facts, Mechanisms and Impact." Working Paper 1063, Economic Research Forum, November 2016.

[11] Legatum Institute. "Economic Openness Morocco Case Study 2020." Legatum Institute, 2020.

[12] “Morocco: Tax System” Santander Trade Markets. Available at: https://santandertrade.com/en/portal/establish-overseas/morocco/tax-system

[13] “Morocco: Selected Issues,” IMF Country Report No. 18/76, November 2017, p.7

[14] Saadi, Mohammed Said. "Moroccan Cronyism: Facts, Mechanisms and Impact." Working Paper 1063, Economic Research Forum, November 2016.

The Economic Case Against High Taxation: A Burden on Developing Economies

Taxation is often presented as a necessary tool for governments to raise revenue, fund public services, and redistribute wealth. However, much of the economic literature suggests that taxation—especially when excessive or poorly designed—can have significant negative effects on economic performance. Economists like Laffer (1974), Romer (1986), and Scully (2006) argue that high tax rates reduce revenues, investment, and capital flows, slowing growth. Ibn Khaldun observed that excessive taxes discourage productivity and diminish state revenue in the long run. Similarly, Adam Smith noted that high taxes stifle industry and raise costs. Research by Romer (1986) and Lucas (1988) shows that high taxes affect both short- and long-term growth, while Levine and Renelt (1992) showed that taxes on trade and social levies reduce growth when investment is factored in.

Other notable studies in this field include Engen and Skinner (1996), who found that a 1% increase in tax rates reduces GDP growth by 0.2-0.3%, and Feldstein (2006), who argued that the deadweight loss from taxation increases with the square of the tax rate. Barro and Redlick (2011) also estimated that cutting average marginal tax rates by 1% could raise GDP by 0.5% over two to three years.

Some of the most fundamental arguments against high taxation in the economic literature are:

- **Disincentive Effect of High Taxation**

High taxes reduce incentives for work, investment, and innovation, especially in developing countries where entrepreneurial activity and investment are crucial for job creation and poverty reduction. Studies like Christina Romer and David Romer (2010) show that a tax increase equivalent to 1% of GDP reduces real GDP by about 3% over three years. In the context of developing countries, which are already struggling with low productivity and high poverty rates, the economic damage from high taxes can be severe.

- **High Taxation and Informal Economies**

High taxes drive businesses into the informal sector, avoiding taxes and regulations. Schneider and Enste (2000) found that countries with high tax burdens tend to have larger informal sectors, which limits the government's ability to collect revenue and provide services. In many developing countries, this creates a vicious cycle: high taxes push businesses underground, leading to lower tax revenues, which prompts governments to raise taxes further, exacerbating the problem. Informal businesses also face limited access to credit and markets, further hindering economic growth.

- **The Impact on Investment and Capital Formation**

High taxes discourage both foreign and domestic investment. Investors often move capital to lower-tax countries, hurting growth in capital-scarce nations. Lower taxes attract more foreign direct investment (FDI), boosting productivity and employment, as shown by Desai, Foley, and Hines (2004).

- **Distortionary Effects of Taxes**

High taxes distort economic decisions, misallocating resources and reducing productivity. Sector-specific taxes can lead to overinvestment in favored areas and underinvestment in more productive sectors, harming economic efficiency in developing economies.

- **High Taxation and Poverty**

One of the most critical challenges facing developing countries is poverty alleviation. High taxes exacerbate poverty by reducing disposable income and job opportunities and slowing economic growth. In many developing countries, tax systems are regressive, with the poor paying a higher percentage of their income than the wealthy, often due to reliance on indirect taxes like VAT. High VAT rates disproportionately hurt low-income households, increasing poverty and reducing consumption, as Emran and Stiglitz (2005) found that poor people spend more of their income on essential goods and services. Furthermore, high taxes on businesses, particularly SMEs, limit job creation, increasing unemployment and inequality. Lowering the tax burden on companies can stimulate growth and reduce poverty.

How does Morocco's tax policy structure retard economic growth?

An analysis of the tax burden, drawing on cross-country comparisons, shows that Morocco's tax rates and income taxes are relatively high compared to peers. Morocco's high tax rates and the heavy tax burden influence the tax revenues, capital inflows, outflows of multinational companies, and investment. According to a recent study about the tax burden effects on economic growth in Morocco, the author's estimation of the relationship between the tax burdens during 46 years in

Morocco shows that when the overall tax burden increases by 1 point, the economic growth rate falls by 0.12 point[15].

There are several ways in which Morocco's high tax rates and complex system significantly impede economic growth:

- **Reduced Business Profitability:** A high corporate tax rate of 31% for large companies directly reduces the profits businesses can reinvest for growth or distribution to shareholders, diminishing the incentive for business expansion and job creation.
- **Compliance Costs:** The tax system complexity imposes substantial compliance costs on businesses. The 155 hours spent annually on tax-related activities represent lost productivity and resources that could otherwise be directed toward value-creating activities.[16]
- **Informal Economy:** High tax rates push businesses into the informal sector to avoid taxation. Morocco's informal economy accounts for about 30% of GDP, with two-thirds of jobs in the grey economy, according to the High Commission for Planning (HCP).[17] Nearly all agricultural jobs (97%), contributing 14% to GDP, are informal. The government estimates the informal economy costs $3.4 billion annually in lost tax revenue. Informal workers earn five times less than formal employees and work 145 more hours per year, with formal employees being 3.7 times more productive.[18] This informality leads to reduced tax revenue, unfair competition, and inefficient resource allocation.
- **Stifling Investment:** Morocco's tax system poses major barriers to both domestic and foreign investment. The 20% capital gains tax, higher than in many emerging markets, discourages investment in stocks and financial instruments, making Morocco less attractive for portfolio investment.[19] While there are tax incentives for certain sectors, they are often complex and limited, restricting broader economic activity. Despite efforts to attract foreign direct investment (FDI), Morocco's high tax rates make it less competitive, with $1.1 billion in FDI in 2023 compared to Egypt's $9.8 billion, which benefits from a more competitive corporate tax rate of 22.5%.
- **Discouraging Personal Savings:** Morocco's tax system negatively impacts personal savings essential for long-term economic stability and growth. The progressive income tax, with rates as high as 38%, reduces disposable income and hinders individuals' ability to

[15] The Tax Burden and Economic Growth in Morocco: Empirical Analysis, Mohamed Karim, Mohamed Bouzahzah, Othmane Erguigue, December 2020, Journal of Economics and Public Finance 7(1):p1

[16] World Bank, Doing Business 2020 - Economic Porfile: Morocco https://www.doingbusiness.org/content/dam/doingBusiness/country/m/morocco/MAR.pdf

[17] Eljechtimi, Ahmed. "Informal Labour Accounts for Two-Thirds of Morocco Jobs, Statistics Agency Reports." *Reuters*, May 30, 2023, 10:03 PM. https://www.reuters.com/world/africa/informal-labour-accounts-two-thirds-morocco-jobs-stats-agency-2023-05-30/#:~:text=The%20productivity%20of%20formal%20workers,central%20bank%20said%20in%202019

[18] Ibid.

[19] PwC. "Morocco: Individual - Income Determination." Last reviewed July 26, 2024. https://taxsummaries.pwc.com/morocco/individual/income-determination#:~:text=Capital%20gains%20earned%20from%20the,3%25%20of%20the%20selling%20price.&text=Where%3A,loans%20for%20investment%20financing%2C%20and

save, contributing to a gross savings rate of only 28% of GDP in 2023—lower than many of its peers.[20] Additionally, the limited tax incentives for savings, while available for long-term plans, are less attractive compared to those in more developed economies, failing to foster a strong savings culture among Moroccans.

The Case for Tax Reform in Morocco

As we have seen, economic literature argues that high tax rates can impede economic growth and development, particularly in emerging economies. High corporate and capital gains taxes may deter investment, slowing capital formation and economic expansion. Taxes can also distort incentives, reducing efficiency by discouraging work or promoting tax avoidance. Excessive taxation often pushes economic activity into the informal sector, lowering government revenue and productivity. Complex tax systems create administrative burdens, diverting resources. High personal income taxes can cause brain drain as skilled workers emigrate.

Given these insights, a thorough tax reform is essential for realizing Morocco's economic potential. The reform should prioritize critical areas such as:

- **Simplification of the Tax System:** Morocco's tax system is overly complex, with a myriad of taxes, exemptions, and special rates. Simplifying the tax code by reducing the number of taxes and eliminating unnecessary exemptions would make it easier for businesses and individuals to comply with tax regulations. A simpler tax system would also reduce the administrative burden on the government, allowing it to focus on more critical issues such as improving public services and infrastructure.
- **Reduction of Tax Rates:** High tax rates discourage investment, entrepreneurship, and labor participation. Reducing corporate income tax, tariffs, VAT, and personal income tax rates would incentivize businesses to invest, innovate, and create jobs. Lower tax rates would also attract foreign direct investment (FDI), boosting Morocco's economic growth and competitiveness.
- **Broadening the Tax Base:** While reducing tax rates is essential, it must be accompanied by efforts to broaden the tax base. This means reducing tax exemptions, closing loopholes, and improving tax compliance. By broadening the tax base, the government can maintain or even increase revenue while lowering tax rates, creating a more equitable and efficient tax system.

[20] World Bank. "Gross Savings (% of GDP) - Morocco, Low & Middle Income." World Bank National Accounts Data, and OECD National Accounts Data Files. https://data.worldbank.org/indicator/NY.GNS.ICTR.ZS?end=2023&locations=MA-XO&start=1975&view=chart

- **Implement a Flat Tax:** A flat tax, where all taxpayers pay the same percentage of their income in taxes, could be considered a way to simplify the tax system and reduce the administrative burden on businesses and individuals.
- **Improving Tax Compliance and Enforcement:** Tax evasion poses a significant challenge in Morocco due to the intricate nature of the tax system and the steep costs associated with compliance. Enhancing tax compliance and enforcement strategies by implementing technology and data analytics could effectively diminish tax evasion and boost revenue collection. This approach would enable the government to decrease tax rates while maintaining adequate revenue.
- **Encouraging Formalization of the Economy:** A significant portion of Morocco's economy operates in the informal sector, which is largely untaxed. Encouraging formalization through tax incentives, reduced compliance costs, and improved access to credit would expand the tax base and increase revenue. Formalization would also provide workers with better social protection and access to public services, improving overall economic welfare.

How Could Tax Reform Unleashing Morocco's Economic Potential?

Comprehensive tax reform in Morocco would yield significant benefits for the economy and society. These benefits include:

- **Increased Economic Growth:** By reducing the tax burden on businesses and individuals, tax reform would stimulate investment, innovation, and entrepreneurship, leading to higher economic growth, increased job creation, and improved living standards for all Moroccans. A 2005 study of cross-country tax data by Young Lee and Robert Gordon showed that a one-point reduction in the corporate tax rate could increase a country's annual GDP growth by as much as two-tenths of a point, meaning a more significant reduction of 10% could provide yearly gains of one to two GDP percentage points.[21] Applying this to Morocco, even a modest reduction in corporate tax rates could significantly boost economic growth.
- **Attraction of Foreign Investment:** A more competitive tax system would make Morocco a more attractive destination for foreign investors. Increased FDI would bring capital, technology, and expertise to the country, boosting productivity and competitiveness. Countries that have implemented business-friendly tax reforms have seen significant increases in FDI.[22] Two cross-country studies find that a decrease in the effective corporate tax rate of 10 percentage points is associated with an increase in foreign direct investment

[21] Young Lee and Roger H. Gordon, "Tax Structure and Economic Growth," Journal of Public Economics, 89:5-6 (June 2005), 1027-1043.

[22] Morisset, Jacques, and Neda Pirnia. "How Tax Policy and Incentives Affect Foreign Direct Investment: A Review." - World Bank Group https://documents1.worldbank.org/curated/pt/876691468766534050/128528323_20041118125923/additional/multi-page.pdf

equivalent to between 1.6 and 2.1 percent of GDP (Djankov and oth ers 2010; Van Parys and James forthcoming).[23]

- **Reduction of Informality:** Tax reform that encourages formalization would reduce the size of the informal economy, increasing tax revenue and improving working conditions for employees. Lower tax burdens on businesses could lead to increased hiring. A study estimates that a 10% decrease in the total tax rate is associated with a 1% increase in the business entry rate.[24]
- **Greater Equity and Social Justice:** By broadening the tax base and reducing tax rates, tax reform would create a more equitable tax system, reducing the tax burden on low- and middle-income individuals, promoting real social justice, and reducing economic inequality.
- **Improved Government Efficiency:** Simplifying the tax system and improving compliance would reduce the administrative burden on the government, allowing it to allocate resources more effectively, leading to better public services, infrastructure, and overall governance.

The case for tax reform in Morocco is compelling, yet several challenges exist. One significant obstacle is the political will and public support necessary for reform, as it often entails changing long-established policies and confronting vested interests. Building public backing through education and outreach is crucial for successful implementation. Another challenge is ensuring fiscal sustainability; while reducing tax rates is desirable, it must be balanced with responsible government spending to avoid fiscal imbalances. Additionally, Morocco's position in the global economy means that its tax policies must remain competitive with those of other nations. Any tax reform should consider global tax trends and best practices to ensure Morocco remains attractive to investors.

[23] See OECD (2007) and Mooij and Ederveen (2008) for an overview of the earlier literature on corporate tax rates and foreign direct investment.

[24] Bruhn, Miriam. Reforming Business Taxes: What Is the Effect on Private Sector Development? Viewpoint. file:///C:/Users/Admin/Downloads/678060VP00PUBL0rming0Business0Taxes.pdf

Conclusion

In conclusion, Morocco's taxation policy presents significant challenges to the country's economic well-being, hindering both private sector growth and overall economic development. The current system is overly complex, inefficient, and disproportionately burdensome on businesses and individuals, reducing investment, innovation, and job creation. High tax rates and an uneven tax burden across sectors discourage entrepreneurial activities and limit competitiveness, particularly for small and medium-sized enterprises. Furthermore, the informal economy thrives under these conditions, depriving the government of essential revenue while exacerbating social inequalities.

The moment for reform is upon us. As Morocco aims to establish itself as a prominent economy in Africa and a link between Europe and the continent, having a competitive and efficient tax system is not merely advantageous—it is crucial. Lowering tax rates, expanding the tax base, and streamlining compliance processes would promote formalization, attract foreign investment, and cultivate a more vibrant, competitive market. These reforms will drive economic activity and bolster fiscal sustainability through improved revenue collection. The long-term economic outlook for Morocco depends on adopting a more liberal, market-oriented approach to taxation that encourages innovation, entrepreneurship, and economic inclusivity. By taking bold steps towards tax reform, Morocco can unlock its full economic potential and create a more prosperous future for all its citizens.

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