

ASSESSMENT OF THE FTA BETWEEN MOROCCO AND TURKEY: CASE OF TEXTILE INDUSTRY

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ABSTRACT

The purpose of this paper is to analyze the Free trade agreement (FTA) between Morocco and Turkey and evaluate its impact on the Moroccan textile and clothing sector. A partial equilibrium model namely SMART developed by the World Bank is used to simulate how tariff changes can impact trade flows (trade creation and trade diversion), tariff revenues, and consumer welfare. The results show that despite the trade diverted and the new trade created, this agreement has failed to absorb the sector's trade deficit between the two countries estimated at 379.2 million US Dollars in 2014, even less to generate a significant welfare. The net welfare estimated will not exceed 0.27 million US Dollars.

Keywords: Textile and clothing, FTA, Morocco, Turkey, SMART

INTRODUCTION

The mutual benefits of trade between nations are well established in the literature. In the last two decades, the world economy was marked by two major trends: globalization and proliferation of regional trade agreements. These trends are partly attributable to industries' concerns to achieve economies of scale and the desire to improve their competitiveness at international level. These trends also enabled countries to specialize and to export goods and services in which they have a comparative advantage while importing goods and services in which they lack comparative advantage.

After years of protectionism, Morocco was engaged, for strategic choices and under the pressure of external factors, in an accelerated process of economic liberalization, trade openness and integration in the world economy. The opening process of the Moroccan economy started with the accession to the GATT in 1987 followed by the ratification of an arsenal of agreements and conventions. These include primarily: the WTO agreements in 1995, the Association Agreement with the European Union and the one with the European Free Trade Association in 2000, the Agadir agreement for the establishment of a free trade zone with Tunisia, Jordan and Egypt in 2007, the free trade agreement with the USA (2006), the GAFTA Greater Arab free Trade agreement (2005), and finally the free trade agreement with Turkey (2006).

With these trade openness agreements, Morocco has set the goal to improve its integration into the global economy and to stimulate the economic growth and increase a preferential access to external markets. Further, the contribution of these trade agreements to the development of the Moroccan economy is heavily influenced by the negotiations and by the broader policy stance of its government, the flexibility of the economy and the extent to which supply can respond to any new demand that has been created. Exports made within the framework of the free trade agreement accounted only for 25 % of Morocco's export to the EU. This share is 61% with the United States, and 21% with the countries of the

Agadir Agreement. On the other hand, 46% of EU imports from Morocco are part of the FTA with the region. This share is 45% with the United States, and 52% with the countries of the Agadir Agreement.

Always according to the Moroccan Exchange office, 63 % of the total imports from Turkey are part of the free trade agreement with this country, in contrast only 36 % of the total exports to Turkey are made within the framework of this agreement. In 2014, Turkey was the eighth partner. The imports from Turkey have constituted 75% of the total Morocco's trade with that country. Regarding the share of exports, it stood at 25% in 2014 against 24% the previous year.

It is noteworthy that the growth of trade between Morocco and Turkey has undergone a remarkable change after the implementation in 2006 of the free trade agreement. In fact, trade increased from 176 million US dollars in 1998 to 488 million US Dollars in 2005 and 2.2 billion US Dollars in 2014, an average annual growth rate of between 17.10% between 1998 and 2005 and by 38% between 2006 and 2014. Imports were well past 137 million US Dollars in 1998 to 401.5 million US Dollars in 2005 (an average annual growth of 18.47% over this period) then to 1.65 billion US Dollars in 2014. Regarding exports, they grew from 37 million US Dollars billion in 1998 to 87 million US Dollars in 2005 (at a rate of 17.26%) and 547 million US Dollars in 2014 (Source: Trade map).

The Moroccan trade balance accused an average annual deficit of nearly 720 million US Dollars during the period of 2007-2014 against only 223.7 million US Dollars during the period of 2000-2006. This deficit reached 1.07 billion US Dollars in 2014 against 656 million US Dollars in 2007. This is due in large part to the low competitiveness of the Moroccan products. Morocco is certainly less competitive than Turkey in particular because of the high cost of energy, too heavy social expenses, the inefficient supply chain and the financing that is still difficult to get.

The objective of this study is to assess the impact of the FTA between Morocco and Turkey on the Moroccan textile and clothing sector using a partial equilibrium model and how the changes in tariffs impact the tariffs revenues of Morocco and what's are their effect on trade creation, trade diversion, and consumer welfare.

RELEVANT LITERATURE

For a long time, the economic integration was considered as a movement towards a freer trade and, therefore, should be beneficial and welfare enhancing. This opinion was contradicted in 1950 when Jacob Viner showed that the net impact of a regional trade agreement on welfare is uncertain and depends on some circumstances. This early theoretical and empirical literature that started in the 1950s with Viner's seminal work [9] opened new ground by advancing the idea that the net welfare effects arising from the formation of an FTA are ambiguous. In a simple partial equilibrium model under perfect competition, an FTA will increase the level of trade between members at the expense of less efficient domestic producers (trade creation) but also of more efficient third countries (trade diversion). The net effect (welfare) of an FTA on trade depends thus on the relative size of these two effects.

Before the full integration into the WTO multilateral system, the textile & clothing sector has experienced extended periods of protectionism mainly in Europe and the United States which represent the two big world markets.

A number of studies were carried out to estimate the results after the elimination of quotas under the ATC. The estimates varied somewhat depending on model specifications, but they had in common that a large part of the total estimated gains of the Uruguay Round – ranging from 20 per cent to 50 per cent of the total arise from the elimination of quotas on industrial goods, of which the ATC is the most important component [6].and [4].

The welfare gains from elimination of quotas are estimated to account for 42 percent of total gains of Uruguay Round liberalization in the static model and 65 per cent in the dynamic model. The welfare gains are, however, concentrated in the importing countries, while there is a small welfare loss in the exporting countries in the static version of the model. At the other hand, we also note an income gain in exporting countries in the dynamic version. The reason why there is a welfare loss in exporting countries in the static version is that the rise in exports is not sufficient to compensate for the loss of quota rents [4].

The Agreement on textile and clothing “ATC” quota phase-out (2005) had a negative impact on the MENA-4 countries (Morocco, Egypt, Tunisia, and Jordan). Morocco was the country who experienced the largest decline (-7.4 percent) even if the market of Morocco’s most important partner, the EU, has increased by 3.7 percent in value and 4.9 percent in ¹volume. These declines occurred against the background of a dramatic increase in Chinese exports (41.5 percent), a significant rise in Indian exports (18 percent) and a good performance of exports from Turkey (3.8 percent) and Bulgaria (2.3 percent) [7].

The Trade creation and diversion effects can be estimated empirically in a number of ways. For ex-post analyses, the gravity model is the best-suited model for estimating trade creation and diversion. For ex-ante studies, both partial and general equilibrium models are widely used. Despite some drawbacks, the partial-equilibrium model has the advantage of working at a much-disaggregated product-level. Another, more complex, model is based on computable general equilibrium models (CGE) that take into account all the inter-sectoral and international linkages that are affected by changes in trade policies as a result of FTA formation. [1]

Other reserachers examine the impacts of regional trade agreements (RTAs) on commodity trade [10]. They focus particularly on trade creation and diversion effects based on the estimation of the gravity equation for commodities trade, dealing with zero-trade flow and endogeneity problems, and showed that partial scope (PS) RTAs and RTAs among developing countries tend to cause trade diversion. They suggest that the trade diversion is likely to be due to the remaining tariffs on imports from third parties (non-members of the RTA), while trade creation would be induced by various factors besides the reduction in tariff rates.

Many studies applied the gravity equation to assess the effect of RTAs on commodity or sectorial trade. [2] and [3] estimated NAFTA’s trade creation and trade diversion effects by using commodity trade data. To the best of our knowledge, there are no published studies that focused on the empirical analysis of the impact of free trade agreements signed by Morocco with turkey. The assessment of such FTA should be done through the estimation of the trade creation and diversion effects of this agreement

(1) (Morocco, Tunisia, Egypt and Jordan after the End of the Multi-Fiber Agreement, Report No. 35376 MNA, December 2006)

METHOD

The most critical point to answer the thesis question in applied trade policy analysis is choosing the appropriate methodology. For the problem at hand, the most suitable approach is a partial equilibrium as in our analysis we will focus only on the textile and clothing sector.

Smart is a partial equilibrium modeling tool included in WITS that is used to simulate how tariff changes can impact trade flows, tariff revenues and consumer welfare. It focuses on one importing market and its exporting partners and assesses the impact of tariff changes.

WITS (World Integrated Trade Solution) is a software developed by the World Bank, in close collaboration and consultation with various international organizations including, United Nations Conference on Trade and Development (UNCTAD), International Trade Center (ITC), United Nations Statistical Division (UNSD) and World Trade Organization (WTO). WITS is an analytical tool able to produce aggregated statistics and to simulate the impact of tariff changes as well as on trade flows, tariff revenues and consumer welfare.

For the purposes of this study, it is proposed that the WITS/SMART model [5] will be the applied partial equilibrium framework. WITS uses a set of various databases ranging from bilateral trade, commodity trade flows and different levels and types of protection. WITS also integrates analytical tools that support simulation analysis. The SMART simulation model is one of the analytical tools in WITS used for simulation purposes. SMART contains in-built analytical modules that support trade policy analysis, covering the effects of multilateral tariff cuts, preferential trade liberalization and tariff changes.

The underlying theory behind this model is the standard partial equilibrium framework that considers dynamic effects to be constant. Like any partial equilibrium model, these strong assumptions only allow trade policy analysis to be undertaken one country at a time. Despite of this weakness, WITS/SMART can help estimate trade creation, diversion, welfare and revenue effects.

All the trade flows are provided by TRAINS (trade analysis and information system). TRAINS is a data depository and analytical tool integrated into WITS. Trade information derives from several sources ; the international trade center ITC provides trade flows statistics of more than 5300 Products of the Harmonized system from the most aggregated level (HS 2 Digits) to the tariff line level(HS 6 digits). Other sources of trade flows statistics are used by TRAINS like UN COMTRADE data base. The tariffs and non-tariffs measures come from WTO integrated database IDB. Further, TRAINS offers the possibility of using others recognized nomenclatures such as the standard international trade classification SITC, the international standard industrial classification ISIC or the broad economic categories BEC.

In this paper, we will use Harmonized system HS classifications for textile and clothing industries. In the HS nomenclature, textiles refer to products classified under HS 50-60 and apparel HS 61-63.

RESULTS AND DISCUSSION

To examine the future impact of this agreement on bilateral trade between Morocco and turkey in textile and clothing sector, we used a partial equilibrium simulator SMART included in WITS (World Integrated Trade Solution) available on the World Bank website. The simulation focuses only on the Moroccan market with its exporting partners and estimates how the complete tariffs abolishment will impact trade flows between Morocco and its partners, the government revenues (tax revenues) and the consumer welfare.

This simulation was carried out using the last trade flows data available (data of 2014) on a group of products belonging to the chapters 50 to 63 of the Harmonized System. All the elasticities values used in the model are provided by the software SMART. For reasons of simplicity, and as Morocco is a small country, the elasticity of Turkish supply is assumed to be infinite. Like all industrial goods, the elasticity of substitution used is estimated to be 1.5. This simulation is based on demand elasticity calculated by the statistic department of the Moroccan authorities and are also integrated into WITS.

The total Trade effect of this agreement on the textile and Clothing sector is estimated to approximately 12 million US Dollars which represent 3 % of the actual trade. The share of the trade created is estimated to roughly 65 % (7.9 million US Dollars), while the trade diverted represents nearly 35 % (4 million US Dollars) of the total trade effect. The products “Carpets and other textile floor coverings” (HS 57) and “Cotton” (HS 52) monopolize more than 50 % of the newly generated trade with turkey.

The total trade creation effect is estimated at approximately 8 million US Dollars. As for the total trade effect , the largest share of the trade created will be ensured by the products of the chapters HS 57 “Carpets and other textile floor coverings” , HS 52 “Cotton ”and 62 “Articles of apparel, accessories, not knit or crochet” with a total amount of 3.6 , 1.15, and 0.86 million US Dollars respectively.

However, the total trade diversion effect is estimated at roughly 4 million US Dollars. The diversion is likely due to the remaining tariffs on imports from third countries (non-members of the FTA).

The products of the chapter HS 52 “Cotton” represent the largest share of the total trade diverted with more than 27 %. The countries that would be the most affected are China with 909,937 US Dollars followed by Spain with 825,108 US Dollars and Italy with around 625,543 US Dollars. These three main countries represent more than 59 % of the total trade diverted

With the total dismantlement of tariffs, Moroccan government losses in term of tax revenues are estimated to approximately 8.8 million US Dollars. Following the diversion of trade from third countries (who didn’t form FTA with Morocco) to turkey who is benefiting from the total removal of tariffs on textile and Clothing exports.

To complete our assessment, it is recommended to weigh up the welfare gains or losses from the formation of this FTA with Turkey. For the case of the agreement with turkey and especially now (after the 10 years of progressive dismantlement) that rates are completely removed , This FTA will not bring any significant net welfare as the government losses are relatively larger and are estimated at more than 8.8 million US Dollars. According to the results of the simulation, the net Welfare will remain positive probably because of a large share of the trade is diverted from European countries which already formed an FTA with Morocco and thus there is no additional loss in government revenues. The net welfare will not exceed 272,358 US Dollars.

To Summarize, this agreement is more beneficial for Turkey than Morocco. It is clearly confirmed by the trade balance for the textile sector that shows a net deficit of around 380 million US Dollars in 2014. Furthermore, Moroccan operators did not benefit from this agreement to boost their exports to the European Union by respecting rules of origin [8] and using the diagonal cumulation of origin stipulated in the Pan-Euro- Mediterranean protocol and without losing the preferential treatment.

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