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Taming corruption: rent potential, collective action, and taxability in Morocco

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Abstract: Why do autocratic regimes contain bureaucratic corruption in some economic sectors but allow it in other areas? This paper examines variations in governance outcomes and perceptions across firms in Morocco based on a survey of 659 businesses. Three factors explain better public services and control of corruption: the magnitude of potential rents that firms can exchange with the administration, the collective action capacity of the sector vis-à-vis the executive, and the taxability of the industry. Firms in sectors with low rent potential are more likely to coordinate, claim, and obtain better governance in exchange for taxes, whereas high-rent companies find it difficult to sustain effective pro-governance collective action. The findings shed light on business–state relations in autocratic political regimes that have to balance revenue raising goals, policy commitments to selected sectors, and incentives for grand corruption.

1 Introduction

Why do autocratic regimes contain bureaucratic corruption in some economic sectors but allow it in other areas? This is a puzzle that still remains unsolved. Thus far, it has often been assumed that countries where bad governance flourishes do not exhibit internal variation across sectors or firms. Studies of policy-making in democratic contexts have explored both demand and supply side explanations to tackle this question. On the demand side, the capacity of firms to mobilize and articulate explicit governance demands has often led to gains.[1] On the supply side, especially under conditions of low administrative capacity and a pressing need to raise revenue, states resort to expedient measures and reward firms that pay taxes with collective goods, but ignore the ones that do not,

1 Campos and Giovannoni (2007); Doner and Schneider (2000); Duvanova (2013); Johnson, McMillan, and Woodruff (2002); Olson (1965, 1982); Pyle (2005, 2006); Woodruff (1998).

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allowing poor governance to thrive in non-compliant sectors.[2] These theoretical answers to the puzzle of governance variations in democracies get even more complicated in non-democratic polities where executives cannot make credible policy commitments to corporate actors.

This paper proposes a new theory of fiscal contracts between states and firms, understood as the benefits businesses obtain in exchange for tax compliance, and supports it with evidence from Morocco, a case characterized by significant variation in governance across time and economic sectors. Indeed, the Middle East and North Africa (MENA) region provides a unique analytical test, being trapped at the intersection of low capacity and vacillating political incentives for tax collection.[3] The non-democratic nature of most political regimes in the area has led to a weak civil society, close knit state-business connections, and extensive patronage networks. These factors shape fiscal contracts that favor taxpayers who can share rents rather than taxes. At the same time, despite fiscal advantages bestowed upon key elites, most governments rely on a cycle of legal ambiguity and arbitrary enforcement in order to control potential dissenters amongst influential taxpayers. A steady state of regulatory uncertainty continues to give firms opportunities to evade taxes, and leaders, reasons to selectively punish infringements in cases of political disobedience.

It is therefore surprising when some businesses and sectors obtain systematic governance benefits in exchange for taxes, while others do not. The paper explores this variation and argues that the provision of governance goods depends on a key variable: the magnitude of potential rents that can be exchanged between firms and the state. A firm's *rent potential* refers to its prospective gains or profits that the state is interested in appropriating a share of, in exchange for preferential treatment. I contend that firms in sectors with low rent potential are more likely to coordinate, claim, and obtain better governance in exchange for taxes, whereas high-rent companies find it difficult to sustain effective pro-governance collective action despite sporadic attempts. The theory also proposes a distinction between old and new rents that could *potentially* be exchanged between firms and states, and paradoxically finds that the latter render businesses more vulnerable.

Methodologically, only a cross-national test of the hypotheses can guarantee the external validity of findings and address generalizability concerns. However, studying non-democracies poses a major challenge. Firm level surveys containing governance questions often deviate from sample designs that make them

2 Gehlbach (2008).

3 Imam and Davina (2007).

comparable to similar data collected elsewhere.[4] Taking into account this shortcoming, the empirical strategy relies on a mixed methods approach. The study, therefore, combines a statistical analysis of 659 Moroccan businesses polled in the 2007 World Bank Enterprise Survey, with in-depth evidence from fieldwork conducted in 2009 and 2012 in Rabat.[5] Going beyond context-specific implications, the findings shed light on business–state relations in autocratic regimes that balance revenue raising goals and corruption incentives.

The article has four parts. The following section articulates a new theory and proposes a series of testable hypotheses. Section 3 presents and interprets the main findings of the statistical analysis. Section 4 compares three economic sectors drawing upon primary sources, followed by a brief conclusion in Section 5.

2 Theory and hypotheses

The fiscal contract between states and taxpayers, or who gets what, when and how in exchange for taxes, is one of the most important dimensions of political accountability.[6] Many studies have focused on the conditions under which citizens and firms are willing to comply with their side of the deal in democracies.[7] One of the strongest findings suggests that firms and citizens comply when they feel that they are equitably treated by the administration, compared to similar taxpayers, and when governments credibly commit to offering something concrete in exchange for taxes. The substance of the deal varies in different accounts of the contract. The common story of political representation linked to taxation suggests that taxpayers obtain political voice and voting rights that shape policy-making. Other narratives focus on more direct connections between taxation and benefits for taxpayers, and explore whether the club goods channeled by the state to specific constituencies are contingent upon tax compliance.[8] This paper analyzes governance goods as the main currency of exchange and the dependent variable of interest. This concept refers to a range of club goods exchangeable

4 This is the case of the most comprehensive firm-level cross-national dataset, the Enterprise Survey, produced by the World Bank. In some instances, the data has not been generated in accordance with the Global Methodology of sampling that would make cross-national findings reliable (World Bank 2007).

5 In Rabat, the evidence includes interviews with tax administration officials and academics.

6 Lasswell (1936).

7 Bräutigam, Fjeldstad, and Moore (2008); Cheibub (1998); Levi (1988); Timmons (2005).

8 Gehlbach (2008).

for fiscal compliance. Reliable public services such as water, electricity, telephone, and Internet connections are the most concrete benefits that businesses require to operate. Corruption control and a well performing judicial system that allows effective property rights enforcement serve as examples of less tangible governance goods that significantly improve the operating environment for firms. The theory presented in this paper operationalizes and tests the full range of governance goods that firms may obtain in exchange for taxes.

Non-democratic contexts complicate the fiscal contract in two ways. First, taxation fails to trigger political representation since the core features of decision-making cannot be fundamentally altered. Second, autocratic governments can rarely commit to offering future streams of benefits, often focusing their entire capacity toward extracting revenues from good taxpayers while neglecting a large majority. Nonetheless, even in autocracies there is a significant empirical variation across firms in terms of the governance goods states grant them in exchange for tax compliance. Why is this the case? Two main hypotheses have been proposed in the literature. First, the most vocal taxpayers who successfully solve their collective action problems should be able to receive some goods.[9] Firms participating in business associations, or having a high lobbying capacity, are more likely to secure benefits from governments. What exactly they lobby for and obtain from policy-makers is under debate. Whereas the earlier thinking on the topic emphasized the negative effects of lobbying such as particularistic benefits detrimental to social welfare, more recent research argues that in polities lacking well-functioning markets and institutions, business associations have a positive impact.[10] These business associations provide reputational checks, information exchange platforms, and policy gains for members.[11] In contexts of regime transitions marred by bad governance, business associations have successfully obtained anti-corruption gains.[12] Despite the fact that the collective action logic has been mainly studied in democratic contexts, even authoritarian leaders have to grant favorable policies to powerful interest groups in order to survive politically.[13]

Hypothesis 1: Firms with high collective action capacity are more likely to obtain governance benefits in exchange for the taxes they pay than firms that fail to act collectively.

9 Olson (1965).
10 Olson (1982, 2000).
11 Campos and Giovannoni (2007); Doner and Schneider (2000); Johnson, McMillan, and Woodruff (2002); Pyle (2005, 2006); Woodruff (1998).
12 Duvanova (2007, 2013).
13 Bellin (2000); Cammett (2007a); Haber, Razo, and Maurer (2003); Steinberg and Shih (2012); Truex (2014).

On the other hand, some downplay the role that collective action capacity plays in shaping fiscal contracts between businesses and states. Contrary to widespread beliefs, industry concentration as a variable that alleviates mobilization problems across firms is not always the determinant factor for obtaining better policies.[14] Other studies express skepticism that business associations can be effective engines of collective action in non-democratic contexts stifling civil society and civic rights.[15] Considering these caveats, some scholars challenge the collective action capacity hypothesis and argue that taxability matters more.[16] For example, the post-Soviet governments cultivated a particular type of fiscal contract with firms in order to rapidly raise revenue. In exchange for tax compliance, only large companies unable to hide profits were granted goods such as security, electricity, water, health, and education. Expanding this argument, leaders should be willing to foster a better business environment for firms that are easy to tax in the future, by taming corruption and protecting property rights.

Hypothesis 2: Businesses in taxable sectors where profits are difficult to hide are more likely to be rewarded by states with governance goods in exchange for the taxes they pay.

However, even if some firms and sectors manage to secure occasional policy gains because of collective action or taxability, non-democratic governments cannot credibly commit not to reverse such gains in the future. Autocrats face the classic “roving” vs. “stationary bandit” dilemma.[17] They can excessively extract formal and informal taxes in the current period, or they can foster future steady streams of revenues by improving the business environment in which good governance allows firms to thrive. Unlike their democratic counterparts, it is difficult for autocratic leaders to refrain from breaching contracts in the absence of mechanisms that tie their hands and solve time inconsistency problems.[18] When coupled with low tax collection capacity, the state’s “roving” efforts to extract in the current period may fail to trigger future governance benefits even for good taxpayers.

Can some firms obtain steady governance gains from autocratic governments nonetheless? Evidence shows that there are ways out of this trap. In some contexts, an incumbent political party with effective rules can provide strong guarantees that private investments will not be expropriated. For example, the Chinese Communist Party created fiscal incentives for local cadres to invest in privately

14 Barber, Pierskalla, and Weschle (2014).
15 McMenamin (2002); Orenstein and Desai (1997).
16 Gehlbach (2008).
17 Olson (1993).
18 Keefer (2005).

managed township and village enterprises without fear of policy reversals from the center.[19] In other cases, political leaders aligned their stakes with economic elites, thus reassuring them that their property rights will be protected. Haber, Razo, and Maurer (2003) showed that at the turn of the twentieth century in Mexico, politicians linked their own future to the performance of some firms, thus providing guarantees for policy stability. In a similar spirit, studies of business-state relations in Saudi Arabia found that the institution of economic familism that connects members of the monarchic elites to businesses managed to offer commitments that crucial rents will be protected despite broad reforms of the business environment.[20] These findings demonstrate that credible commitments can be self-enforcing for some firms even in autocracies.[21]

I argue that the magnitude of potential rents that could be exchanged between firms and state shapes the quality of business governance. Lower rent (or less tempting) firms are more likely to mobilize successfully and obtain governance goods in exchange for the taxes they pay. A firm's *rent potential* refers to its prospective gains or profits that the state is interested in appropriating a share of, in exchange for preferential treatment. In this bi-directional flow of benefits, businesses receive regulatory, procurement, or tax favors that allow them to improve their market position relative to competitors. In exchange, the state obtains a share of these rents in the form of bribes, campaign contributions, or political support. In autocracies, for example, firms' promises to remain apolitical and not to side with the opposition are a common currency of exchange. If the rent potential is large enough, there is no incentive for either firms or the state to abandon this mutually beneficial relationship. Therefore, strong individual incentives to conclude private agreements with the administration undermine collective action for governance goods. *Rent potential* is distinct from already consolidated (or old) rents. Whereas monopolies, duopolies, and state owned enterprises are already fully incorporated in the extractive mechanism of the state, expanding, emerging, or increasingly visible firms are new and promising sources of revenue. Several categories of businesses are trapped into these suboptimal incentives: large firms, companies with high profit margins gained rapidly, or un-coopted yet assertive firms perceived as important by a regime in search of political loyalty. In contrast, less tempting businesses are more likely to engage in collective action and claim governance benefits successfully.

19 Gehlbach and Keefer (2011).

20 Mazaheri (2013).

21 Haber, Razo, and Maurer (2003: p. 24).

2.1 Model

I combine these insights into a new theory derived from the core logic of the decision an individual business has to take with respect to the fiscal contract. A firm faces a lottery with two choices: (1) refuse to share rents and participate in collective action in order to articulate claims related to governance goods, $U(\overline{R})=U(CA)$, or (2) share rents, $U(R)$, in exchange for paying only a fraction of due taxes.

$$U(\overline{R})=U(CA)=pB_{g(t+1)}-(C_{ca}+\sum_{i=-n}^{0}T_{t+i}) \quad (1)$$

where $C_{ca}>0$ is the cost of joining a business association, $T_{t+i}>0$ is the total amount of taxes due between periods t-n (for arrears) and the current period t, and $B_{g(t+1)}$ are the future governance benefits, ranging from basic public services to corruption control and effective commercial courts. The probability of commitment that the government will respect the fiscal contract is captured by the probability, $p\in(0,1]$.

In contrast,

$$U(R)=\sum_{i=-n}^{0}T_{t+i}-\left(C_r+\frac{1}{\delta}\sum_{i=-n}^{0}T_{t+i}\right), \quad (2)$$

where $C_r>0$ is the share of rent to be paid to government officials in exchange for complying with a limited share of the total tax payable only $\left(\frac{1}{\delta}\right)$, where $\delta>0$. The value range for parameter δ proxies the full degree of administrative discretion during the encounter between firms and tax inspectors, as follows:

$$\delta=\begin{cases} 0<\delta<1, \text{ for tax overextraction} \\ \delta=1, \text{ for objective tax assessment}. \\ \delta>1, \text{ for tax underextraction} \end{cases}$$

The over-assessment of the total amount of taxes payable plus a share of rents illustrates the case of extreme administrative abuse, whereas under-assessment indicates that the administration collects only a certain fraction of total taxes due in exchange for an informal payment (or a bribe). This utility function implies that under conditions of high administrative discretion, there are incentives to informally obtain gains on the tax side, by not paying the full share in the current period, rather than paying all taxes due now and waiting for governance benefits that might never occur in the future ($\delta>1$). At the same time, under-extraction from some firms implies over-extraction from others ($0<\delta<1$) in order to maintain a constant level of collected taxes.

The formal details and solutions of the decision theoretic model are included in Appendix 1. Its comparative statics provide several insights and generate new hypotheses. First, the lower the costs of collective action compared to the informal payment (γ), the more likely it is that firms mobilize and obtain governance goods. This implication corroborates the classic Hypothesis 1. Second, both a low level of credible commitment (p) and a high discretion of the tax administration (δ) render a firm more likely to share its rents. Since taxability increases the frequency of interaction between firms and tax inspectors, allowing the latter more opportunities for discretionary tax assessments (δ) even for good taxpayers, the model generates a nuance of the classic Hypothesis 2, in line with the Olsonian "roving bandit" hypothesis:

Hypothesis 2a: In contexts with high administrative discretion, taxability is not likely to lead to governance rewards for firms.

The following quote illustrates the skepticism even good taxpayers express with respect to the fiscal contract:

> *Of course that I feel cheated by the tax office. It is not so much the fact that I pay a lot of taxes that upsets me, but rather that my contribution goes only toward paying bureaucrats who complicate my life, or toward financing a system of absurd price subsidies.*[22]

Third, the most interesting theoretical implications of the model show what kind of firms are more likely to successfully mobilize and obtain governance benefits, as well as the conditions under they can do so. There are three mathematical solutions to the basic model that assumes no pre-existing mobilization capacity ($C_r=C_{ca}$). The first solution suggests that if the total revenue that could be extracted from a firm is lower than half of the expected good $\left(0<\sum_{i=-n}^{0} T_{t+i} \leq \frac{pB_{g(t+1)}}{2}\right)$, firms are likely to opt for demanding governance rather than paying a bribe. The second solution illustrates the counterintuitive case of medium rent potential, $\frac{pB_{g(t+1)}}{2}<\sum_{i=-n}^{0} T_{t+i}<pB_{g(t+1)}$, where governance enhancing collective action can occur even if firms are allowed to keep a modest share of taxes by benefiting from favoritism, $1<\delta<\frac{\sum_{i=-n}^{0} T_{t+i}}{2\sum_{i=-n}^{0} T_{t+i}-pB_{g(t+1)}}$. Finally, the third solution shows how a high rent potential $\left(\sum_{i=-n}^{0} T_{t+i} \geq pB_{g(t+1)}\right)$ is likely to trap the

22 *Tel Quel*, 8–14 March 2013, 24, in author's translation.

firm into no governance gains, unless there is blatant abuse from the administration $\left(\delta < \frac{\sum_{i=-n}^{0} T_{t+i}}{2\sum_{i=-n}^{0} T_{t+i} - pB_{g(t+1)}} < 1\right)$. This solution showcases the everyday complicity of firms and state in maintaining a Pareto-suboptimal status quo.

Hypothesis 3: The higher the potential rents, the less likely firms are to demand and obtain good governance in exchange for taxes, in the absence of extreme abuse from the administration.

The model also suggests that even in cases of high collective action capacity ($C_r > C_{ca}$, and $C_r - C_{ca} = \gamma$), pre-existing business associations representing high-rent firms cannot discipline their members and enforce agreements, unless they are subject to extreme abuse from the administration ($\delta \leq 0.5$). On the contrary, vocal associations in low-rent sectors $\left(0 < \sum_{i=-n}^{0} T_{t+i} < \frac{\delta\gamma + \delta pB_{g(t+1)}}{2\delta - 1}\right)$ are better equipped to enforce contracts between their members and the state. In exchange, they are more likely to obtain governance benefits (Equation 7, Appendix 1). Therefore, another related implication is:

Hypothesis 3a: Because of the magnitude of individual fiscal stakes, associations representing high-rent firms are less likely to be successful at obtaining governance gains, in the absence of severe administrative abuse.

Thus, this theory suggests that the rent prospects of the firm are key for the nature of the fiscal contract between businesses and the administration. It also implies that the alternative hypotheses H1 and H2 need to be further disaggregated in order to explain variations in the incentives of the state to provide governance benefits to companies or not. Table 1 organizes all the implications of the model as ex-ante theoretical expectations.

Based on the comparative statics summarized above, I now test the theory with empirical evidence from Morocco. This case study has several advantages. First, unlike other countries in the MENA region, its hybrid political regime combines democratic features such as multiparty competition and elections with a high level of autocratic control exercised by the royal palace. Whereas the policy commitments of the executive are often uncertain, businesses have a strong tradition of mobilization and lobbying. Governance-seeking collective action, however, is a relatively new and selective phenomenon. Only some industries have managed to overcome the challenges of joint action against administrative abuse so far. Second, until recently the Moroccan economy was dominated by rentier relations connecting influential landowners, large urban businesses controlled by a handful of families, and the royal center of power. Nevertheless,

Table 1: Ex-ante theoretical expectations.

Independent variables	Model parameter	Expected effect on *Governance goods*
Potential rents	$\sum_{i=-n}^{0} T_{t+i}$	–
Taxability/administrative discretion	δ	±
Collective action capacity	γ	+
Collective action capacity* Potential rents	$\gamma * \sum_{i=-n}^{0} T_{t+i}$	–
Potential rents*	Degrees of administrative discretion	
Low potential rents	$\delta>0$	+
Medium potential rents	Abuse ($\delta<1$)	+
	Moderate tolerance	+
	Extreme tolerance	–
High potential rents	Tolerance ($\delta>1$)	–
	Moderate abuse	–
	Extreme abuse	+

times are changing. Mohammed VI has gradually altered the parameters of the traditional fiscal contract that characterized his father's reign to allow for pockets of competitiveness and entrepreneurship while maintaining selective rents in traditional sectors such as agriculture and construction. Rapid globalization and modernization have also helped this process, by empowering a new generation of vocal business leaders interested in good governance, and by promoting new sectors of the economy, promising much larger gains than traditional industries. Third, following the decline of the phosphate prices during the late 1970s, the state had to rely almost exclusively on corporate and income taxes to balance budgets. The low extractive capacity of the administration posed constraints to this process, and led to selective targeting of easy-to-tax firms only. These reasons allow the case study to explore variation in governance outcomes across sectors and time, driven by the variables of interest: rent potential, collective action capacity, and taxability. Whereas Hypotheses 1–3a can be tested with quantitative proxies from a firm-level survey, the individual incentives at work during the interactions with the tax administration suggested by the solutions of the theoretical model require an in-depth qualitative analysis of three sectors: textile and apparel; IT and telecommunications; and construction and real estate. This comparison illustrates how the rent potential and collective action capacities of business associations have led to three divergent governance outcomes.

3 Survey results

Operating within the constraints inherent in collecting micro-level data in hybrid regimes, I test the hypotheses on the World Bank Enterprise Survey conducted in 2007 in Morocco. The respondents are 659 businesses selected through a sampling procedure with three strata: firm size, sector, and geographic region.

3.1 Dependent variables

The theoretical hypotheses advanced by this paper attempt to explain variation in terms of the governance goods firms obtain in exchange for tax compliance. In order to distinguish between different types of governance goods that states provide, I construct two sets of dependent variables – capturing both objective measures of governance gains and subjective firm-level perceptions (see Appendix 2 for details). The first two objective dependent variables, *Governance gains*, and *Governance gains minus claims,* come from an original dataset. Since the theoretical model assumes that governance benefits in exchange for taxes can be obtained via collective action, the coding procedure followed three criteria. The first criterion asks if the industry mobilization related to the fiscal contract between firms and state was salient in the media and academic analyses between 1991 and 2015. In order to capture salience, the coding procedure uses *Maghress*, an online archive of 25 major Moroccan publications in French and Arabic.[23] This archive is also supplemented by three periodicals that feature economic issues (*La Vie Eco, Tel Quel,* and *Economia*). Additionally, several academic sources that focus explicitly on business-state relations provided in-depth information on the major waves of collective action in Morocco.[24] The second criterion requires that the business association leading the collective action episode made claims on behalf of the majority of firms active in its sector. Therefore, I select 14 associations that represent all the industries sampled by the Enterprise Survey (2007). Given the corporatist structure of the Moroccan economy, these associations/federations fulfill this criterion.[25] Finally, the third criterion selects only the mobilization episodes that involved explicit claims related to governance benefits in exchange for compliance with taxation, as distinct from lobbying demands. These

23 Available at www.maghress.com, accessed on September 1, 2015.
24 Cammett (2007a); Catusse (2008); Hibou (2004).
25 Table 5, Appendix 2 provides a full list of representative business associations.

three joint criteria led to the following quantitative indicators used as dependent variables.

Governance gains is computed as a product between the count of news items featuring each individual business association together with the search words "*contrat-programme*," and the dummy variable 1 or 0 depending on the actual adoption of a sectorial business-state contract around 2007 (the date of the survey). The *contrat-programme* in the Moroccan context is the only comprehensive package of incentives and benefits that the government commits to implement during a 5-year cycle in order to stimulate selected industries. Its negotiation by the sector-specific business association and the government often takes years, and not all economic sectors succeed in concluding a final deal. Thus, the dependent variable *Governance gains* simultaneously captures the intensity with which each association has been negotiating a *contrat-programme*, its policy comprehensiveness, as well as the actual conclusion of the contract. For example, representing the textile and apparel sector, AMITH appears in 261 media items related to the negotiation of a *contrat-programme* between 1991 and 2015, and signed one agreement in 2005, obtaining a final score of 261 (261*1).

Governance claims is an independent variable of collective action capacity that counts all news articles featuring each of the 14 sector-specific associations and three search words capturing the package of governance benefits they demand ("corruption," "judiciary," and "good governance" in French). AMITH is featured in 27 articles associating it with "corruption" claims, 89 articles with "judiciary," and 34 articles with "good governance" between 1991 and 2015. Adding them leads *Governance claims* to a score of 150 for textile and apparel firms. *Governance gains minus claims* computes the difference between the two variables above and normalizes it around the mean in order to record the gap between what the business associations demand in terms of governance benefits, and what they actually obtain as part of a *contrat-programme*. Figure 1 plots these dependent variables.[26]

The other two objective dependent variables are *Informal payments* and *Public service cuts*. The former is the percentage of annual sales that respondents estimate "similar" firms have paid in informal gifts to bureaucrats during the previous year, and comes from a standard question asked in the Enterprise Survey. The latter, *Public service cuts*, records the water and electricity cuts that firms have experienced in the recent past. In addition to the objective set of dependent variables, the paper also examines firm-level perceptions of governance goods.

26 For a complete variable description and list of acronyms, see Appendix 2.

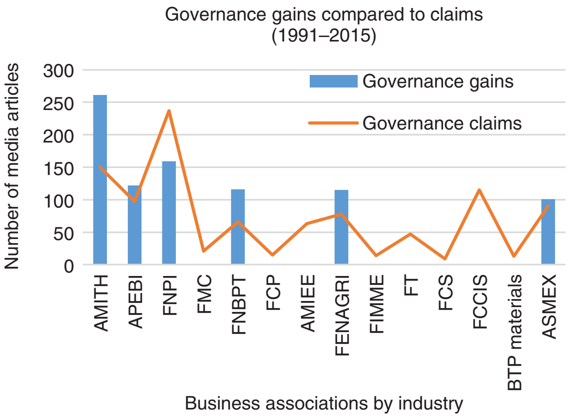

Figure 1: The difference between *Governance gains* and *Governance claims* by 14 Moroccan industry-specific business associations (1991–2015).

This analysis operates with *Governance obstacles* at both national and local level as the two subjective dependent variables of interest. At the national level, variable *Governance obstacles* is operationalized as the degree to which firms estimate to be affected by corruption and ineffective commercial courts, with 0 values meaning no obstacles for the operations of the firm, whereas increasing values imply that widespread corruption and ineffective courts are important obstacles. Variable *Governance obstacles (Local level)* move on to assessments of the overall performance of local governments and suppliers of electricity and water. Similarly, this perception variable is ordinal and ranges between 0 and 4. The higher its value, the more negative the firm's assessment.

3.2 Independent variables

In Morocco, all economic sectors are represented by business associations. Therefore, the coding procedure for testing Hypothesis 1 assigns non zero values only to mobilization histories that meet three simultaneous criteria: 1. they were salient in the media and academic analyses; 2. they involved explicit claims related to governance goods in exchange for compliance with taxation; 3. they covered a majority of firms active in the industry. Departing from other studies, this operationalization views mobilization in terms of the actual history of business-state relations, rather than using the simplifying assumption that membership in business associations automatically equals a vibrant engagement in collective action. For robustness purposes, the analyses use two indicators for *Collective* *action capacity.* The first one, *Governance claims*, has already been introduced above. It counts all the media-salient claims with respect to corruption, courts and good governance formulated by each sector-representative business association during 1991 and 2015.

The second proxy, *Collective action–dummy*, is a dichotomous variable that takes values of 1 if the firm's representative association has a strong track record of both lobbying and of demanding governance goods in exchange for taxes. Otherwise the variable takes a 0 value. This specification insures that there are no major discrepancies between the lobbying and pro-governance capacity of each organization. The lobbying claims are also a count variable recording the number of articles that feature each association and the search words "*lois de finances*," the major platform for business lobbying preceding the drafting and voting of the annual budget in the Moroccan parliament. Figure 2 plots both the lobbying and governance claim scores for the 14 sector-representative associations, and shows that two organizations have a significant lead, scoring more than twice the total claims of others on both dimensions: AMITH, representing the textile and apparel sectors, and FNPI, the business association of firms active in the construction/real estate sector. Therefore, firms in these industries obtain a score of 1 and constitute approximately 33% of the total sample.

Hypotheses 2 and 2a proposed that taxability, or the ability of the state to tax firms, leads to potential governance rewards for good taxpayers. Studies proposing this argument have operationalized it with self-assessments of firms' leeway in hiding revenues from the tax administration. However, this measure fails to include the efforts of the latter to extract, independently of the opportunities firms

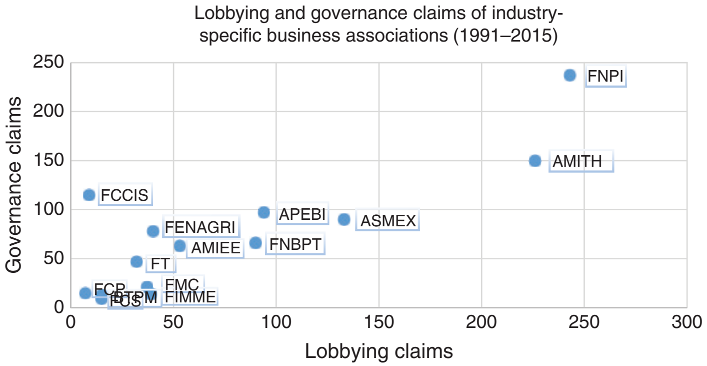

Figure 2: Collective action history of Moroccan industry-specific business associations (1991–2015).

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have to conceal revenue.[27] The formal model suggests that the level of administrative discretion (δ) a taxable firm encounters during the concrete interactions with the tax administration determines whether collective action is likely to occur and lead to governance goods. The "roving bandit" incentives of autocrats under conditions of low state capacity imply that even the most taxable sectors of the economy are in danger of tax over-assessment or under-assessment. Because taxability is a difficult concept to adequately capture quantitatively, I use two proxies. The first one, *Tax Collection Rates by City* is based on data from the Moroccan tax administration, and evaluates its performance across the cities the surveyed firms were sampled from. The second proxy measure of taxation efforts, *Tax audits,* assesses how committed the administration is in terms of making firms comply. The low capacity of the Moroccan state de facto means that collection efforts concentrate mostly on taxable firms, justifying the selection of this variable. Variable *Tax audit* is coded 1 if the firm has been audited during the previous fiscal year, and 0 otherwise. About 20% of all companies have received at least one audit. Additionally, because the process of auditing itself is not informative enough about the true value of model parameter (δ) indicating administrative abuse or tolerance during tax collection procedures, Section 4 of the paper will present qualitative evidence regarding concrete encounters between firms and the tax administration.

The key independent variable, *Rent potential*, captures the magnitude of prospective rents that a firm could exchange with state officials. The theory distinguishes rent potential from old or consolidated rents, and argues that new temptations matter more for the true nature of the fiscal contract. The more value added a company generates, the higher and/or quicker its profit margins are, the more opportunities for informal revenue settlement with officials. In order to test rent potential in a comprehensive manner, I use several alternative measures. The first one, *Profit margin,* is an ordinal variable with scores between 1 and 3. Industries characterized by decreasing pre-tax unadjusted operating profit margins such as textiles and food receive a low score, while manufacturing sectors such as apparel, chemical companies, machinery, and electronics with steady profit margins obtained a score of 2. Rapidly expanding service industries (commerce, IT, and construction/real estate) obtained a maximum score of 3. This coding draws on two sources. First, a global dataset of pre-tax operating profit margins provides cross-national averages per industry.[28] Second, these profitability rankings were compared to the sectorial value added rates for 2000–2007, reported by the Moroccan Ministry of the Economy and Finance.[29]

27 Lieberman (2002).

28 Damodaran (2015).

29 Ministère de l'Economie et des Finances (2015).

Both datasets concur on the high-performing industries (IT/telecommunications and construction/real estate development) that reached over 20% pre-tax profit margins, as well as on the second ordinal category of steady profits ranging between 8 and 12% (the apparel, chemical, mechanical equipment, and electronics sectors). Globally, as well as in Morocco, the food sector recorded low and decreasing profits (around 5% as an average profit margin for producers and wholesalers). Two industries have been scored based on their time-varying performance in the Moroccan economy. If the textile and leather sector has been highly profitable during the 1990s, its margins have been rapidly decreasing. From a 4.5% share of the total economic value added in 2000, the sector's contribution decreased to about 2.7% in 2008. Both enterprise creation and employment fell by 30% and 17%, respectively, during the decade. Therefore, in order to capture the relative evolution of profitability and rent potential, textile received a score of 1. In contrast, commerce was assigned a value of 3 despite a relatively low global return because of its rapid expansion in the domestic economy of Morocco. With a total share of 11.4% of the total economic value added induced by a rising middle class, the sector ranks at the top of rent potential, close to real estate/construction and IT/telecommunications.

Second, *Firm size* controls for the total number of employees, and records whether the firm is small, medium, or large (over 100 employees). Variable *International market orientation* is ordinal and takes values according to the type of primary markets firms operate in. Local markets receive a score of 1, national markets, 2, and international markets, 3. *Asset specificity* counts the total number of land plots that a firm owns. Variables *Competitiveness* and *Monopoly/Duopoly* assess the competitive environment of the firm, and allow the analysis to distinguish between new potential rents and old consolidated rents such as pre-existing monopolies. The former is an ordinal variable. The higher the value, the more competitors the firm has in its main operating market. The latter is a dummy variable with values of 1 representing firms with no competition or with only one competitor. Finally, in order to capture the latent dimensions of rent potential, I have also built a comprehensive index based on a Principal Component Analysis (PCA) of eight independent variables: firm size (ordinal), employment, total sales, profit margin, sales increase during the previous year, total value of machines and equipment, international market orientation, and monopoly/duopoly status. The higher the values of this index (*Rent potential (PCA)*), the more likely it is that the firm will enter the special fiscal contract hypothesized by the theoretical model. Additionally, all regression models control for firm age, city, and industry.

3.3 Findings

Tables 2–4 present the main findings. The analyses use OLS, Ordered Probit and Poisson regressions with fixed effects for geographical location and industry.[30] The evidence for the taxability/administrative discretion hypotheses (H2 and H2a) is mixed (Table 2). Companies that have experienced a tax audit during the previous year are likely to pay, on average, 1.03% more informal gifts to bureaucrats than firms that have not. Firms residing in cities with high collection rates are likely to be rewarded with better public service quality, as they are likely to experience significantly less water and electricity cuts from local providers. Overall, there is no statistical evidence that taxability leads to collective action-induced governance gains. Firms that the state targets for revenue extraction are more likely to pay informal gifts, but receive some rewards in terms of public services if they reside in a high-collection municipality. The latter finding is in line with previous evidence.

Both *Collective action capacity* and *Rent potential* receive strong support. For every 10% increase in the governance claims that business associations formulate for a particular sector, the firms it represents were likely to obtain 18% more gains through a *contrat-programme*, and 10% more gains compared to claims. The results are equally strong and significant with respect to informal payments to bureaucrats. Firms in sectors represented by vocal business associations paid, on average, 1.05% less administrative bribes out of their annual sales than firms in sectors with more passive associations. Finally, *Rent potential* has the strongest statistically significant impact on the likelihood of governance gains on all its dimensions. A firm active in a high and expanding profit margin sector obtains, on average, 91% less governance gains than firms in a steady profit industry, as well as over three times less gains compared to the governance claims formulated by its business association. Along similar lines, businesses whose main products targeted international markets were 146% less likely to obtain large gains compared to claims. The results hold for large firms as well, although the magnitude is less surprising. Overall, a one-unit increase in the *PCA index (Rent potential)* that takes into account all dimensions of rents triggers 0.16% more informal payments paid to officials. Thus, Hypothesis 3 receives very strong support.

For robustness purposes, Table 3 shows the firm-level perception results that corroborate the objective findings. The scales of the dependent variables are inverted, meaning that lower values indicate less governance obstacles, whereas higher values refer to firm perceptions of significant corruption or ineffective commercial courts. This implies that positive signs of the coefficients should be

30 The results hold with random effects, clustered standard errors, and HLM models as well.

Table 2: Governance gains, informal payments to officials, and public service quality.

	(1) **Governance gains**	(2) **Governance gain compared to claims (Gains – Claims)**	(3) **Governance gains compared to claims (Gains – Claims)**	(4) **Governance gains compared to claims (Gains – Claims)**	(5) **Informal payments**	(6) **Public service cuts (Water and electricity)**
Taxability						
Tax audits	−0.0147 (0.00962)	−0.0274 (0.0328)	−0.0297 (0.0503)	0.0158 (0.0157)	1.030*** (0.143)	−0.0590 (0.221)
Corporate tax collection rates					6.402*** (1.756)	−4.491*** (1.286)
Collective action capacity						
Collective action claims (log)	1.763*** (0.0237)	1.038*** (0.0540)	1.020*** (0.0655)	0.880*** (0.0205)		
Collective action (dummy variable)					−1.052*** (0.329)	0.444 (0.305)
Rent potential						
Profit margin	−0.647*** (0.0138)	−1.413*** (0.0408)				
Number of employees (log)			−0.0399** (0.0167)			
International market orientation				−0.900*** (0.0152)		
Rent potential (PCA index)					0.162*** (0.0372)	0.0418 (0.0437)
Constant	−2.598*** (0.107)	−2.314*** (0.251)	−4.392*** (0.406)	−4.074*** (0.106)	−5.992*** (1.635)	
Fixed effects – industry	Yes	Yes	Yes	Yes	Yes	Yes
Fixed effects – city	Yes	Yes	Yes	Yes	Yes	Yes
N	402	568	386	386	278	295
R-sq	0.969	0.912	0.687	0.969	NA	NA
Model	OLS	OLS	OLS	OLS	Poisson	Ordered probit

Ordered probit cuts ommitted for clarity.
Standard errors in parentheses.
*p<0.10; **p<0.05; ***p<0.01.

Table 3: Firm-level perceptions of governance obstacles.

	(1) Governance obstacles	(2) Governance obstacles	(3) Governance obstacles	(4) Governance obstacles	(5) Governance obstacles	(6) Governance obstacles	(7) Governance obstacles
	(Firm-level perceptions of corruption and ineffective litigation procedures in commercial courts)						
	National level	National level	National level	National level	National level	National level	Local level
Taxability							
Tax audits	0.770*** (0.132)	0.763*** (0.132)	0.420** (0.209)	0.701*** (0.223)	0.720*** (0.223)	0.809*** (0.233)	0.455** (0.218)
Corporate tax collection rates by city	−3.691* (2.159)	−3.619* (2.199)	−3.580 (2.735)	−4.355 (3.498)	−5.038 (3.494)	−5.266 (3.572)	−6.176** (2.762)
Collective action capacity							
Collective action claims (log)	−0.494** (0.215)	−0.452** (0.216)	−0.451* (0.244)	−3.741 (116.6)	−3.917 (134.1)	−3.857 (134.0)	−0.00755 (0.711)
Rent potential							
Profit margin	0.874* (0.523)						
Firm size (more than 100 employees)		0.257** (0.116)					
Asset specificity			0.201** (0.0878)				
Competitiveness				0.246** (0.125)			
Monopolies/Dupolies					−0.774** (0.362)		
Rent potential (PCA index)						0.0988** (0.0485)	−0.0414 (0.0441)
Firm age	0.002 (0.00309)	0.001 (0.00316)	−0.004 (0.00465)	0.002 (0.00447)	0.002 (0.00447)	−0.000 (0.00463)	0.000 (0.00438)
Fixed effects – industry	Yes	Yes	Yes	Yes	Yes	Yes	Yes
Fixed effects – city	Yes	Yes	Yes	Yes	Yes	Yes	Yes
N	434	432	192	188	188	182	210
Model	Ordered probit	Ordered probit	Ordered probit	Ordered probit	Ordered probit	Ordered probit	Ordered probit

Ordered probit cuts ommitted for clarity.
Standard errors in parentheses.
*p<0.10; **p<0.05; ***p<0.01.

Table 4: High-rent collective action: governance gains and firm-level perceptions of governance obstacles.

	(1) Governance gains compared to claims	(2) Governance obstacles	(3) Governance obstacles
		(Firm-level perceptions of corruption and ineffective litigation procedures in commercial courts)	
	(Gains – Claims)	National level	Local level
Taxability			
Tax audits	−0.0402 (0.0304)	0.709*** (0.126)	0.202 (0.139)
Corporate tax collection rates by city		0.391 (0.868)	−3.259* (1.969)
Collective action capacity			
Collective action claims (log)	3.925*** (0.305)		
Collective action (dummy variable)		−1.103* (0.610)	−0.446 (0.409)
Rent potential			
Profit margin	6.790*** (0.855)	−0.282 (0.226)	−0.380** (0.169)
Profit margin* Collective action capacity	−1.532*** (0.160)	0.492* (0.252)	0.495** (0.250)
Firm age		0.002 (0.00295)	−0.001 (0.00334)
Constant	−17.10*** (1.557)		
Fixed effects – industry	Yes	Yes	Yes
Fixed effects – city	Yes	No	Yes
N	568	487	414
R-sq	0.924		
Model	OLS	Ordered probit	Ordered probit

Ordered probit cuts ommitted for clarity.
Standard errors in parentheses.
*p<0.10; **p<0.05; ***p<0.01.

interpreted as triggering perceptions of higher corruption and ineffective courts, whereas negative signs go in the opposite direction.

Keeping all variables at their means, firms with a lower or decreasing profit margin are 23% less likely to be affected by corruption in their everyday business activities than firms in fast expanding economic sectors with high gains. Similar marginal effects also hold for large firms that are 6% more likely than small and medium size enterprises to report significant corruption and dissatisfaction with commercial courts. The more effort the tax administration puts into tax collection, the more likely it is that firms subject to it report higher levels of corruption and court-related dissatisfaction. Businesses that have experienced a tax audit are 20% more likely to report governance-related challenges than firms that have not been inspected. Nevertheless, each extra-percentage of taxes that the administration collects from a municipality seems to offer some rewards to its firms, as they are 26% less likely to report a high level of corruption and ineffective courts. Finally, mirroring the objective findings reported in Table 2, the participation of firms in mobilization activities seeking governance goods leads to less acute firm-level perceptions of corruption and ineffective litigation, although the result does not hold across all models. Thus, the perception-based models confirm the results of the objective specifications and give strong support to the hypotheses of this study.

Last but not least, Hypothesis 3a introduced a special case of the *Rent potential* theory. This suggested that even in cases where a vocal business association has the capacity to seek governance goods, its efforts are likely to be hampered by its high-rent member firms. Table 4 presents the regression models for three different dependent variables where *Collective action capacity* is interacted with the *Profit margin* category businesses belong to. The higher the profit margin category of its constituent firms, the less likely vocal associations are to secure *Governance gains* compared to claims. Additionally, its members are significantly more likely to perceive governance obstacles as affecting their activities.

Figure 3 below illustrates the effect of a vocal business association (*Collective action capacity-dummy*) on the predicted probabilities of reporting a low level of corruption, conditional upon *Rent potential*. The graph suggests that participation in collective action makes a difference for low-rent firms, reducing their corruption perceptions with about 17%. However, confirming Hypothesis 3a of this paper, high-rent potential firms engaging in collective action are about 31% more likely to report corruption when surveyed. It thus seems that the conditional argument put forward by Hypothesis 3a receives empirical support.

The final section of the paper selects three leading economic sectors with divergent outcomes of governance benefits in exchange for taxes: textile and apparel, IT and telecommunications, and construction and real estate. The

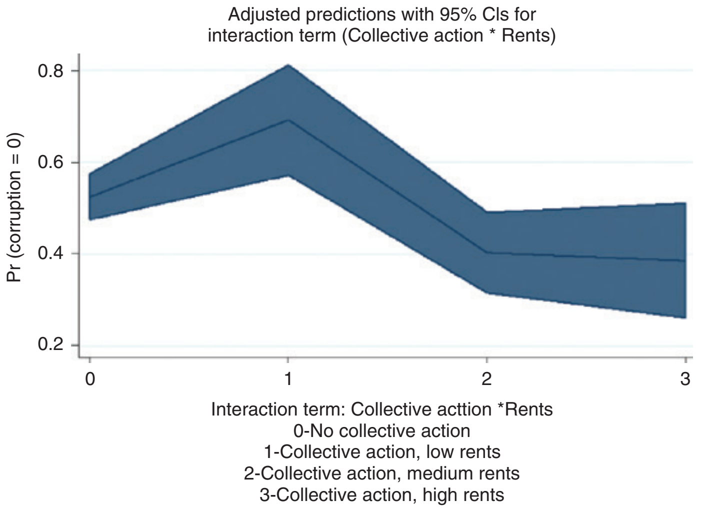

Figure 3: The joint effect of *Collective action capacity* and *Rent potential* on the probabilities of firms reporting a low level of corruption.

analysis illustrates how rent potential, collective action capacity, and taxability led to this variation. Additionally, only an in-depth qualitative analysis can shed light on the implications of the theoretical model related to how firms with different levels of rent potential react to administrative discretion.

4 Taxation, rent potential, and governance gains across three economic sectors

Both scholarly and popular discourses on fiscal choices, patronage, and corruption in Morocco have often invoked the *Makhzen*, a deep state with hard-to-dismantle roots, gravitating around the Sherifian monarchy and including the bureaucracy, the army, and the executive.[31] Historically, the *Makhzen* treated taxpayers unequally. Its members and protégés were granted significant exemptions and favorable fiscal terms, whereas tribes and poorer taxpayers saw their fiscal burden expand. In a vicious cycle, any new political threat to the central power called for additional exemptions and privileges, further eroding the already

31 Catusse (2008); Hibou (2004); Leveau (1985); Waterbury (1970).

narrow tax base. According to one scholar, "(…) taxation expresses less a specific economic relation than a political one, which is thus by nature differentiated, fluctuating, and perpetually open to renegotiation."[32] Domestic elites ranging from top military cadres, politicians and rural notables, all the way to famous athletes partook in an elaborate system of personalized privileges offered in exchange for political loyalty. This traditional constituency formed the skeleton of a neo-patrimonial economy that continues to carry major implications to this day and that started only recently to be under scrutiny.[33]

In order to survive, large industrial firms also developed a patronage relationship with the state that on the one hand allowed for the downward negotiation of tax burdens, and on the other hand, trapped them in a continuous state of fragility derived from overdependence on the administration. This low equilibrium led to the accumulation of significant tax arrears, as well as to a lack of transparency with respect to size and distribution of these liabilities by sector and type of firms. In terms of administrative discretion, until recently, a controversial procedure (the feared Article 4 of the Code of Fiscal Procedures, also known as EESF – *l'Examen de l'Ensemble de la Situation Fiscale*) allowed tax auditors to ignore a firm's balance sheet altogether, and to assess the total level of taxes payable based on a subjective examination of a taxpayer's "ostentatious" display of wealth, including physical assets such as homes or cars. This ambiguous mechanism of tax collection lacked clear rules of implementation, thus carving a large space for discretionary audit results. Additionally, there was virtually no possibility of legally contesting the tax administration's final decision following this assessment.

Business associations and lobbying activities have a long tradition in Morocco. After independence, domestic interest groups such UMA, *Union Marocaine de l'Agriculture*, contested the direct taxes perceived as abusive in the colonial past and paved the way for long-lasting fiscal privileges for agriculture. In the early 1980s, this economic sector was completely exempted from direct taxation, one of the most controversial fiscal policies still in place.[34] While lobbying the government in order to obtain favorable tax policies has been common practice for business associations representing all industries, explicit forms of collective action demanding better governance, property rights, and protection from corruption are a relatively new phenomenon. Because of its novelty, analysts have interpreted it as signaling a new type of fiscal contract between firms and state.[35] Empowered by this development, various economic sectors reacted differently

32 Hibou (2004: p. 211).

33 Brouksy and Monjib (2009); Leveau (1985); Waterbury (1973).

34 Akesbi (2008); Transparency Maroc (2009).

35 Cammett (2007b); Catusse (2008); Hibou (2004).

in terms of mobilizing and standing up to the state as opposed to carrying out the tradition of direct settlements with the administration. As Figure 1 shows, the textile and apparel industries obtained more governance gains than claims by engaging in collective action, whereas construction/real estate firms achieved an opposite result. The IT and telecommunication sector's governance benefits stand in the middle.

4.1 Textile and apparel

In the beginning of the 1990s, trade liberalization, as well as radically opposed group identities, generated a deep division amongst factions of AMITH (*l'Association Marocaine des Industries du Textile et de l'Habillement*), the business association representing the interests of this sector. The textile sector was one of the old "rent" pockets of the economy, dominated by well-connected families who had protectionist preferences. In contrast, the more recently emerging apparel companies featured business entrepreneurs with significant new rent potential, whose main concerns were industrial upgrading and export competitiveness.[36] Despite these initial cleavages, by 1995 AMITH changed its membership strategy. If in previous years, its members were primarily large textile firms, it gradually started to accept emerging garment exporters who did not have personalized channels of negotiation with the state.[37] In terms of the fiscal contract with the administration, the two sets of firms had surprising trajectories. The textile companies, despite their preexistent political connections, have become increasingly subject to corporate taxation and social security contributions. Apparel exporters either took advantage of loopholes in the gray areas of unclear taxation laws, or attempted to force the government into providing governance goods by withholding taxes.[38]

Spearheaded by AMITH, textile and apparel became the first industrial sector that mobilized effectively and demanded governance goods in exchange for taxes. In 1996, firms active in these sector had a tough test of their collective action power as they were directly accused of fiscal infringements during a major Antifraud Campaign (*Campagne d'Assainisssement*) initiated by the King himself and waged with repressive tactics. The official rationale for the campaign revolved around 50% of the total amount of taxes remaining uncollected.[39] The initial trigger of this episode was the infringement of the AT

36 Cammett (2007b).
37 Cammett (2007a: p. 152); Catusse (2008).
38 Cammett (2007a).
39 Hibou (2004).

(*Admissions Temporaires*), customs duty waivers for inputs granted to firms that exported the final product within 6 months. The government accused apparel firms of engaging in tax evasion and black market trade, an episode largely perceived as a direct act of political aggression from a monarch who was contemplating a political opening, while preventing businesses from allying with the opposition.

Both AMITH and CGEM (*Confédération Générale des Entrepreneurs Marocains*), the peak business association, strongly defended the interests of their members and managed to secure real governance gains in the end. The final pact with the government granted a general fiscal amnesty. The concrete terms of the agreement stipulated that corporate accounts would be exempt from all fiscal audits for a period of 4 years (1994–1997) in exchange for paying a turnover tax between 0.16 and 0.65.[40] In a sense, this was a public good since the deal extended to all firms, beyond those directly targeted during the campaign. Additionally, in response to the good governance demands of AMITH, the government clarified tax laws, customs procedures, offered pro-business concessions, and created several commercial and appellate courts. The monarch himself, in a symbolic attempt to signal credible commitment of this renewed fiscal contract, invited all key political actors to a ceremonial signature of a gentlemen's agreement.[41]

During the early 2000s, AMITH became an increasingly assertive political actor. The association published an open letter to the Prime Minister demanding better governance for the sector in exchange for paying taxes and was instrumental in lobbying the government to support industrial upgrading in order to prioritize the industry as one of the few truly global sectors of the Moroccan economy. In 2002, the association and the government signed a new agreement, followed by an Emergency Plan 3 years later, that promised a reform of the tax system, as well as the sharing of social security and electricity costs between firms and state.[42] This famous episode provides an illustration of the theoretical predictions from Table 1. Lower and medium rent potential firms in the textile and apparel sectors, helped by an assertive business association, were able to mobilize and secure significant governance gains even when they have previously benefited from tax favors from the administration in the form of non-enforced breaches of customs-duty waivers.

40 Hibou (2004: p. 204).

41 Symbolically, Hassan II invited the largest business association, CGEM, the Minister of Interior, as well as all the governors and *wallis* in the country to take part in the elaborate gentlemen's agreement ceremony.

42 Cammett (2007b).

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4.2 Construction and real estate development

Whether textile and apparel obtained more governance gains than claims because of a combination of lower rent potential and high mobilization capacity, the construction and real estate sector illustrates the opposite case. Historically, in the case of Morocco, old business and political elites with close ties to *Makhzen* controlled the raw material and construction firms. Real estate, however, has been a story of business acumen and mobility. Some of the largest business groups such as *Addoha* achieved initial success as real estate developers during the 1980s. Real estate profits became increasingly appealing over time. In the early 2000s, a combination of demand and supply-side factors such as generous state-led incentives for social housing, the ambiguity or absence of urban development plans, the expansion of the Moroccan middle class, and quick gains driven by the rural-urban migration, allowed politically connected market entrants to amass significant fortunes over very short periods of time. The Price Earning Ratio (PER) for real estate companies listed at the Casablanca Stock Exchange reached a stunning average of 120, and contributed largely to the sharp increase of MASI (Moroccan All Share Index) during the late 2000s. In fact, business prospects in real estate have become so favorable, that many of the most influential land owners and business leaders in Casablanca and Rabat expanded their activities toward this star sector.

Fiscally, between 2000 and 2008, the whole industry boomed on an unprecedented scale and received large tax advantages. In Morocco, real estate alone ranks second after agriculture in terms of tax exemptions.[43] Despite large margins of profits, developers paid few taxes. Two factors were responsible for this state of affairs. First, large shares of profit in this sector are relatively easy to hide. Second, as the theoretical model predicts, it was more advantageous for high-rent firms to settle their due taxes directly with the administration, to accumulate large amounts of arrears, and to avoid tax audits rather than to comply with taxation and mobilize for non-credible promises of a better business environment.[44] As a result, the nature of interactions between the tax administration and real estate/construction firms impacted negatively the audit process. Regional tax offices eliminated real estate developers from auditing targeting, did not require the correction of income and profit declaration despite persuasive evidence of under-assessment, and reimbursed VAT taxes for firms with long standing tax arrears.[45]

43 Conseil économique et social, Maroc 2012. FNPI has challenged the extent of tax exemptions reported by the administration.

44 Cour des Comptes, Maroc (2011).

45 Cour des Comptes (2011: pp. 26–30).

Because of these strong individual incentives, governance–seeking collective action in this sector lagged behind. Construction and real estate in Morocco have been initially represented by around seven associations, ranging from the cement industry (FMC) all the way to an association of architects (ONA). Until 2006, real estate developers were represented by two different organizations – ULPIM (*Union des Lotisseurs et Promoteurs Immobiliers du Maroc*) and FNI (*Fédération Nationale de l'Immobilier*). By the end of the year, the two entities merged, creating the FNPI (*Fédération Nationale des Promoteurs Immobiliers*), the business association relevant for the argument of this paper. FNPI stands out in terms of pre-existing collective action capacity used to secure lobbying gains. Figure 2 shows that it has been featured in the media 243 times for fiscal demands formulated during annual budget debates, and 237 for governance claims. These records place it at the top of mobilization capacity across all sector specific associations. Nevertheless, despite its unprecedented assertiveness, the governance gains it secured through a *contrat-programme* concluded with the government in 2008 lagged behind its claims. The theoretical model of this paper (Solution 2 of Equation 7) helps us explain this puzzle, as the high-rent potential of firms eroded the strong pre-existing collective action capacity of FNPI.

The real test for this sector came in 2007, as the tax administration found itself under increasing budgetary pressure for revenue collection. This challenged the tenuous fiscal contract between state and real estate developers, and brought the business association representing the sector to the forefront of a new deal. In 2008, the administration asked for the help of FNPI to raise taxes, leading to an agreement through which individual firms were to adjust their corporate taxation declarations upwards. Unlike AMITH for the textile and apparel industries, FNPI was not able to enforce this agreement because of the strong incentives of firms to reach individual agreements rather than commit to contributing to the common pool of revenues that the association promised it would raise.[46] Despite being represented by a strong and assertive business association, because of voluntary profit declarations and weak penalties for high-rent firms active in the sector, the administration ended up collecting a sub-optimal amount of current taxes and arrears.[47]

The theory proposed by this article also implies that high-rent firms are likely to mobilize and obtain governance goods instead of retaining taxes only in situations of blatant abuse from the administration (Table 1). After 2010, as the financial crisis made revenue collection imperative, real estate and construction firms

46 1.8 Billion MAD collected between 2008 and 2011. At the same time, the practice of fiscal amnesty became more common for real estate and banking after 2007 and raised questions related to procedural fairness in the case of high-rent firms (Cour des Comptes, Maroc 2011: p. 39).
47 *Idem*, 39.

found it increasingly difficult to prevent the administration from over-assessing taxes. Simultaneously, the not-so-distant waves of the Arab Spring pushed the regime into granting concessions to vocal groups. The expanding discretion of the tax administration during crisis, combined with the prospect of credible policy commitment, led to renewed attitudes toward governance-seeking collective action even for high rent firms. Thus, FNPI started to demand better governance more assertively, acting beyond its traditional lobbying activities. As a result, in 2012, its mobilization efforts led to the path-breaking creation of a Taxpayers' Rights Chart, a significant check on administrative abuse of the tax administration benefiting all firms.

4.3 IT and telecommunications

Unlike the traditional textile sector or the high-rent construction/real estate firms, IT and telecommunications showcases a mix case of tax extraction and governance rewards. From the point of view of the rent potential, the group of firms representing this sector has been quite heterogeneous. In 2006, its three main subsectors (fixed telephony, Internet services, and international connections) were characterized by different degrees of competition and deregulation. On the one hand, the duopoly market of mobile telephony was divided between *Maroc Telecom*, with a market share of around 67%, and its only competitor, *Méditel*. On the other hand, the Internet and international connectivity market were quite competitive. In 2007, for example, the International Union of Telecommunications placed Morocco lower than Jordan but higher than Egypt, Syria or Tunisia in the MENA region rankings of market deregulation.[48] IT firms experienced an intense period of expansion during the 2000s, allowing a rapidly increasing profit margin. At the end of 2007, the number of mobile telephony users exceeded 20 million, establishing a record market expansion of over 25% per year. Simultaneously, the fixed telephony market doubled, whereas the pool of Internet users increased by five times in only 3 years. During the same period, the number of narrowband users for wireless Internet and Internet without subscription grew by more than 510% in 1 year alone.[49]

This dramatic market expansion, unmatched by any other sector, had implications for revenue collection and the business-state fiscal contract in line with

48 Renaud (2006: p. 72).
49 ANRT (2007: p. 1–3).

the expectations of the theoretical model. In the duopolistic market, *Maroc Telecom (IAM)* has become one of the largest taxpayers in the country, contributing around 3.1 billion MAD to the state coffers in 2008. In fact, as its total sales increased by more than four times between 1999 and 2013, the sector as a whole established itself as the largest fiscal contributor in Morocco.[50] In the competitive market segments, the tempting profit margins of new IT and telecommunication firms, as well as their relative independence from political power, were not matched by their collective action capacity. If the duopolistic *Méditel* and *Maroc Telecom* were able to exercise lobbying influence, firms active in the competitive markets had less effective resort to a direct channel of governance-seeking mobilization because of their rent potential coupled with lower organizational aplomb. The business association representing these industries, APEBI (*Fédération des Nouvelles Technologies de l'Information, des Télécommunications et de l'Off-shoring*), placed a great emphasis on good governance, but was less assertive vis-à-vis the executive, compared to both AMITH and FNPI. During the early 2000s, its leader, also heading Transparency International Maroc, put anti-corruption at the top of APEBI's agenda. Nonetheless, the organization's influence in terms of both lobbying and pro-governance claims lagged behind. Whereas a large number of sector-specific business associations had already institutionalized direct negotiations with the tax administration since the beginning of the decade, APEBI took steps in this direction in 2011. In the media salience database accompanying this paper, its lobbying activities surrounding the annual budgets are mentioned by 94 articles between 1991 and 2015, less than half of those featuring AMITH's or FNPI's efforts. Similarly, only 97 articles associate APEBI with governance, court effectiveness, and anti-corruption issues (Figure 2). Thus, the IT and telecommunications sector illustrates a mixed fiscal contract strategy. While the established duopolies in some market segments such as *Maroc Telecom* and *Méditel* became major taxpayers, the fast rising profit margins of the new entrants on the competitive markets as well as lower pre-existing collective action capacity, led to a medium level of governance gains compared to claims (Figure 1).

The brief comparative stories of governance gains in exchange for taxes across these three sectors showcase the different paths of fiscal contract between firms and state. Whereas in the textile and apparel sector, lower rent potential and a vocal business association led to governance gains from the state in exchange for taxes, the initial attempts of FNPI regarding the real estate and construction firms were far more modest because of stronger individual incentives of high-rent companies to undermine pre-existing collective action. This suggests that the mere

50 In 2008, the IT sector accounted for the significant share of 12.5% of all corporate tax receipts.

existence of a business association is necessary but not sufficient for securing public services, governance gains, or protection against corruption. The IT and telecommunications sector illustrates a mixed situation in which tax extraction and governance gains for duopolies co-exist with strong rent-sharing incentives in the competitive sectors of the market.

5 Conclusion

This paper asked what makes non-democratic states provide better governance for some business sectors but not for others. The extant literature tells us that the ability of firms to mobilize and their track record of paying taxes makes states more responsive to governance demands. To explore this question, the paper proposed a new theory of fiscal contracts between the state and businesses and tested it against alternatives with both quantitative and qualitative evidence. The argument is that the magnitude of rents that states potentially exchange with businesses is a crucial explanatory variable. In contexts with high administrative discretion, strong incentives to offer rents rather than pay formal taxes prevent fast growing firms from acting collectively in order to secure uncertain governance benefits to be reaped in the future. The concept of "potential" rents also accommodates shifting fiscal contracts and reshuffles occurring within privilege networks. New industries with fast rising profit margins are paradoxically at an increased risk of not receiving governance goods compared to "old rent" sectors.

Empirically, several findings confirm the theory. First, taxability improved public services in line with previous findings, but led to less governance goods as firms preferred immediate gains on the revenue side of the fiscal contract. Second, lower-rent companies with a track record of effective collective action have managed to secure gains, whereas high-rent companies failed to do so in the absence of extreme administrative abuse, irrespective of the vocal business associations representing them. The last section of the paper examined three sectors that achieved divergent governance outcomes. Textile and apparel firms with lower rent potential and high mobilization capacity received governance gains, whereas the high-rent construction and real estate developers undermined pro-governance collective action. The intermediary case of IT and telecommunication firms demonstrated the co-existence of two different sets of fiscal contracts for duopolies and competitive firms.

This study suggests that policy reformers and international donors interested in good governance outcomes should pay attention to the changing rent potential across economic sectors in order to understand the evolution of sub-optimal equilibria. One of the limitations of this study is its narrow empirical scope, being a country-specific analysis. Future work attempting to test these hypotheses cross-nationally is thus essential in order to establish the generalizability of findings.

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Appendix 1

A decision theoretic model

A firm faces two choices:

$$U(\overline{R})=U(CA)=pB_{g(t+1)}-\left(C_{ca}+\sum_{i=-n}^{0}T_{t+i}\right) \tag{1}$$

$C_{ca}>0$ is the cost of joining a business association, $T_{t+i}>0$ is the amount of taxes due between periods *t-n* (for arrears) and the current period *t*, and $B_{g(t+1)}>0$ is the governance benefit.

$$U(R)=\sum_{i=-n}^{0}T_{t+i}-\left(C_{r}+\frac{1}{\delta}\sum_{i=-n}^{0}T_{t+i}\right) \tag{2}$$

$C_r>0$, is the share of rent to be paid to government officials in exchange for a fraction of the total tax payable $\left(\frac{1}{\delta}\right)$, and $\delta>0$.

Thus, when the firm faces the two alternatives, it prefers to take up action in order to demand public services, contain corruption, and claim property rights enforcement only if:

$$U(CA)>U(R)\Rightarrow \tag{3}$$

$$pB_{g(t+1)}-(C_{ca}+\sum_{i=-n}^{0}T_{t+i})>\sum_{i=-n}^{0}T_{t+i}-\left(C_{r}+\frac{1}{\delta}\sum_{i=-n}^{0}T_{t+i}\right) \tag{4}$$

By solving the equation, the firm will stop paying a rent share and engage in governance enhancing collective action when:

$$C_r > C_{ca} - pB_{g(t+1)} + \left(2 - \frac{1}{\delta}\right) \sum_{i=-n}^{0} T_{t+i} \quad (5)$$

If $C_r = C_{ca}$, the firm will prefer to engage in collective action when:

$$pB_{g(t+1)} > \left(2 - \frac{1}{\delta}\right) \sum_{i=-n}^{0} T_{t+i} \quad (6)$$

This implies that the share of governance good produced by paying taxes, $\alpha = \frac{B_{g(t+1)}}{\sum_{i=-n}^{0} T_{t+i}} > \frac{\left(2 - \frac{1}{\delta}\right)}{p}$. The parameter α also has empirical implications for the dependent variables of this study. For cases of severe administrative abuse, $0 < \delta <= 0.5$, firms will mobilize even for modest collective goods, such as public services. For medium administrative abuse expressed as tax over-assessment ($1 > \delta > 0.5$) and tax tolerance, or under-assessment ($\delta > 1$), mobilization will occur only for sizeable governance goods as a share of total taxes.

Formally, equation (6) has three solutions:

Solution 1: $0 < \sum_{i=-n}^{0} T_{t+i} \le \frac{pB_{g(t+1)}}{2}$.

Solution 2: $\frac{pB_{g(t+1)}}{2} < \sum_{i=-n}^{0} T_{t+i} < pB_{g(t+1)}$ and $0 < \delta < \frac{\sum_{i=-n}^{0} T_{t+i}}{2\sum_{i=-n}^{0} T_{t+i} - pB_{g(t+1)}}$, or $1 < \delta < \frac{\sum_{i=-n}^{0} T_{t+i}}{2\sum_{i=-n}^{0} T_{t+i} - pB_{g(t+1)}}$.

Solution 3: $\sum_{i=-n}^{0} T_{t+i} \ge pB_{g(t+1)}$ and $0 < \delta < \frac{\sum_{i=-n}^{0} T_{t+i}}{2\sum_{i=-n}^{0} T_{t+i} - pB_{g(t+1)}} < 1$.

If $C_r > C_{ca}$, then

$$C_r - C_{ca} = \gamma > 0,\ \alpha = \frac{B_{g(t+1)}}{\sum_{i=-n}^{0} T_{t+i}} > \frac{\left(2 - \frac{1}{\delta}\right)}{p} - \frac{\gamma}{p\sum_{i=-n}^{0} T_{t+i}} \quad (7)$$

Equation 7 illustrating pre-existing collective action capacity has two solutions:

Solution 1a: $0 < \sum_{i=-n}^{0} T_{t+i} < \frac{\delta\gamma + \delta pB_{g(t+1)}}{2\delta - 1}$, and $\delta > 0.5$

Solution 2a: $\delta \le 0.5$

Appendix 2

Summary statistics and variable description

Table 5: Summary statistics.

	Count	Mean	SD	Min	Max
Dependent variable					
Governance obstacles (perceptions of corruption and ineffective commercial courts)	498	1.436747	1.19123	0	4
Local governance obstacles (perceptions of ineffective municipality and public service providers)	415	1.843373	0.856658	0	4
Governance gains (log)	403	4.975689	0.4180088	4.61512	5.616771
Governance gains compared to claims (normalized)	570	−6.74e-09	1	−2.009504	1.632335
Informal payments to government officials (% of annual sales)	610	0.634426	2.538853	0	20
Public service cuts	457	0.1870897	0.2700464	0	1
Independent variables					
Tax audits	658	0.1975684	0.3984676	0	1
Corporate tax collection rates by city	658	0.9031915	0.0616774	0.8	0.94
Collective action claims – governance (log)	570	4.442415	0.8436543	2.70805	5.780744
Collective action claims – lobby (log)	570	4.497425	0.9688132	3.401197	6.317165
Collective action – dummy variable	659	0.3292868	0.4703112	0	1
Profit margin (ordinal)	647	2.018547	0.7379344	1	3
Number of employees (log)	465	4.109329	1.214665	1.94591	8.411833
Asset specificity – number of land plots	293	0.9829352	0.8892714	0	9
International market orientation	465	0.268817	0.443822	0	1
Firm competitiveness	316	3.639241	0.6194555	1	4
Monopoly or duopoly	316	0.0506329	0.2195947	0	1
Rent potential (PCA index)	301	6.81e-10	1.737096	−3.468352	5.076394
Firm age	659	21.70561	17.12962	0	94

Variables *Governance gains*, *Governance gains compared to claims*, and *Collective action capacity (Governance and Lobby claims)* come from an original media-salience dataset collected by the author. These variables count the number of articles featuring 14 business associations and variable-specific search words listed below. The source is *Maghress* (www.maghress.com), a media archive of 25 major Moroccan newspapers in Arabic and French published between 1991 and 2015. The business associations have been selected to match all the industries sampled in Enterprise Survey, as follows:

Table 5 (continued)

Sector	Business association	
Food production	FENAGRI	Fédération Nationale de l'Agroalimentaire
Texile and apparel	AMITH	Association Marocaine des Industries du Textile et de l'Habillement
Machines and equipment	FIMME	Fédération des Industries Métallurgiques Mécaniques et Electromécaniques
Machines and equipment	FT	Fédération du Transport
Chemical industries	FCP	Fédération de la Chimie et de la Parachimie
Electronics	AMIEE	Association Marocaine des Industries Electriques et Electroniques
Commerce	FCS	Fédération du Commerce et Services
Commerce	FCCIS	Fédération des Chambres de Commerce, d'Industrie et de Services
Commerce	BTP materials	Association des Importateurs de Matériel de BTP
Foreign trade	ASMEX	Association Marocaine des Exportateurs
IT and telecommunications	APEBI	Fédération des Nouvelles technologies de l'Information, des Télécommunications et de l'Off-shoring
Construction and real estate	FNPI	Fédération Nationale des Promoteurs Immobiliers
Construction and real estate	FMC	Fédération des Industries des Matériaux de construction
Construction and real estate	FNBPT	Fédération Nationale du Bâtiment et Travaux Publics

Dependent Variables

Governance gains: The variable is computed as the product of two dimensions: (1) a dummy variable taking values of 1 if the sector-specific association has signed a *contrat-programme* with the government between 2005 and 2008, and 0 otherwise; (2) the number of *Maghress* media articles featuring the business association and the search words "*contrat-programme*."

Governance gains compared to claims is the difference between variable *Governance gains* and *Collective action – governance claims* (see below), centered around the mean.

Informal payments to government officials (%)*:* Question j7a (Enterprise Survey) asking respondents to assess what percentage of its annual sales a similar firm is likely to pay each year in informal gifts to officials in exchange for bureaucratic favors.

Public service cuts: Average of questions c6 and c15 (Enterprise Survey) asking whether the firm experienced electricity and water cuts during the previous year. The variable is ordinal and ranges from 0 to 1.

Governance obstacles (National level): Average of questions j30d and j30f from Enterprise Survey asking whether litigation procedures in commercial courts and corruption raise obstacles for the firm. The variable is ordinal and ranges from 0 to 4, higher value indicating significant obstacles.

Governance obstacles (Local level): Average of questions h17c and h17d (Enterprise Survey) asking the respondents to assess the performance of the municipal government and of the local providers of electricity and water. The variable is ordinal and ranges from 0 to 4, higher values indicating more dissatisfaction.

Independent Variables

Tax audit is a dichotomous variable with values of 0 (no visits from tax inspectors during the previous fiscal year) and 1 (at least one audit during the previous fiscal year) (question j3 Enterprise Survey)

Corporate tax collection rates by city is the percentage of collected vs. planned corporate taxes for the Moroccan cities sampled in the Enterprise Survey. Source: Data from the Moroccan Tax Administration (Rabat 2013)

Collective action capacity (Governance claims): The number of *Maghress* articles (1991–2015) featuring each of the business associations listed above and three search words: "*corruption*," "*justice*," and "*bonne gouvernance*."

Collective action capacity (Lobby claims): The number of *Maghress* articles (1991–2015) featuring each of the business associations listed above and the search words "*lois de finance*."

Collective action capacity (dummy) – A dichotomous variable taking values of 1 for textile, apparel, real estate and construction, and 0 for other sectors, based on the sectorial score clusters presented in Figure 2.

Profit margin: Ordinal variable with values 1–3 grouping all the sectors sampled in Enterprise Survey by pre-tax unadjusted operating margins. Sources: Damodaran 2015, and the Moroccan Ministry of the Economy and Finances.

Asset specificity: The number of land plots owned by the firm (question h1 in Enterprise Survey)

Firm size: An ordinal variable taking values between 1 (small firms with less than 20 employees) to 3 (large firms with over 100 employees), and an alternative recording the total number of employees (questions a6a and l1 in Enterprise Survey)

International market orientation: A dummy variable with values of 1 if the main market of the firm is international, and 0 if it is local or national (based on question e1 in Enterprise Survey)

Firm competitiveness: An ordinal variable asking how many competitors the firm had during the previous year. It takes values 0–4, where 0 means no competition and 4, more than 5 competitors (question e2 in Enterprise Survey)

Monopoly or duopoly: A dummy variable that takes values of 1 if the firm had no competition or only one competitor during the previous year (based on question e2 in Enterprise Survey)

Rent potential (PCA index): A Principal Component Analysis index derived from eight variables: firm size, employment, total sales, profit margin, sales increase during the previous year, total value of machines and equipment, international market orientation, and monopoly/duopoly status.

Firm age: Number of years the firm has been active (based on question b5 of Enterprise Survey)

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