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Country Development Strategy Statement

FY 1988

MOROCCO

ANNEX D

PRIVATE SECTOR EXPORT ASSESSMENT

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Agency for International Development
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A N N E X D

PRIVATE SECTOR EXPORT ASSESSMENT

M O R O C C O

COUNTRY DEVELOPMENT STRATEGY STATEMENT

(FYs 1987 - 1991)

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I. INTRODUCTION

USAID/Rabat has selected private sector development as one of the major cornerstones of its strategy in Morocco. Within the private sector, export promotion has been chosen as the program focus with the greatest potential impact on the future development of the country. This Private Sector Export Promotion Assessment summarizes the macro-economic factors in Morocco which make the private sector a favored vehicle for achieving Morocco's economic goals; justifies export promotion as the area which makes greatest sense for the near-term concentration of resources; describes the major constraints to and potential for the further development of the export oriented private sector; and summarizes the first major project designed to addresss some of these constraints and to obtain part of this potential. The project consists of three major components: (1) the establishment of a new, independent, public/private export credit insurance organization; (2) the creation of a special export pre-financing credit facility targeted at the small and medium sized entrepreneurs; and (3) marketing and production technology assistance through the Moroccan Center for Export Promotion (CMPE) and the International Executive Service Corps (IESC). This project in no way exhausts the possibilities in export promotion, but represents a solid first step toward helping the sector achieve its full potential.

USAID/Rabat completed its Private Sector Export Promotion Assessment by drawing on a number of sources. Consulting firms, including Coopers and Lybrand and First Washington Associates, were hired to complete a review of the relevant literature and to conduct indepth interviews of key individuals within Morocco's public and private sector. Individual consultants were also hired to look at specific aspects of the private sector as well as the institutions which promote this sector. Mission personnel have actively reviewed the work of these contractors and World Bank documents and other available publications. Mission staff have also conducted their own interviews of key Moroccans in the private and public sectors. AID/W fielded a Project Identification Mission to look at the wide range of possibilities for USAID's involvement and to narrow down the scope of activities. The Private Sector Export Promotion Assessment represents only the first step in an ongoing monitoring and analysis of Morocco's private sector.

II. BACKGROUND AND STRATEGY RATIONALE

Morocco is currently engaged in a major effort to restructure and stabilize its economy. Morocco's structural adjustment process is critical due to severe internal and external imbalances in the economy, as well as major shifts in global economic trends. The thrust of the adjustment process is two-fold· first, to reduce the role of the state in favor of market forces and the private sector, and secondly, to encourage exports as the key to economic growth. These new policy directions are ones which A.I.D. strongly supports and encourages. The greater reliance on market forces and the private sector offers new opportunities for donor assistance -- opportunities which are clearly consistent with the Agency's development goals. In an effort to lend greater support to Morocco's

reform program, USAID has identified export promotion as the focus of its private sector strategy.

A. The Macroeconomic Context

Morocco's current economic crisis stems in large part from policies pursued during the previous decade. In the context of unfavorable external events -- extended drought conditions, worldwide recession and unfavorable commodity price movements -- Morocco's policies led to severe internal and external imbalances in the economy. Real per capita income in Morocco grew by 1.8% per annum from 1975 to 1980, but then declined to negligible growth in the early 1980's. As a result of the rapid depreciation of the dirham against the dollar, per capita income measured in dollars fell below $750 in 1983, thereby making Morocco eligible for special concessional terms for development assistance.

During the 1970's, Morocco based its economic strategy on a combination of import-substitution policies and large-scale public investments in the economy. A dramatic rise in phosphate prices in 1974 gave Morocco the opportunity to double its export earnings and encouraged the government to take on massive investments in infrastructure. Domestic investment increased from 15 percent of GDP in 1972 to a high of 33 percent of GDP in 1977. Relying on public investment to stimulate growth, the government acquired 47% of total equity in the manufacturing sector. Growing public investment also generated large imports of intermediate and capital goods.

Morocco's protectionist policies created strong incentives to produce for the domestic market and discouraged export development. Sheltered by tariff barriers and subsidies, import substitution activities became 50% more profitable than investments in export industries. Industry geared toward the domestic market grew in this protected environment despite numerous inefficiencies and inappropriate uses of scarce resources.

The phosphate boom proved short-lived, and the value of Morocco's phosphate exports dropped precipitously from 1974 to 1975. Problems quickly emerged when Morocco proved unable -- and to some degree unwilling -- to drop its ambitious investment program. Despite some cuts, the GOM never curtailed public investment to pre-1975 levels; investment as a percentage of GDP remained in the range of 21 to 23 percent. Furthermore, Morocco's import bill continued to grow in spite of poor export performance; imports rose 17 percent per annum between 1973 and 1977, while exports grew at only 0.6 percent per annum over the same period. The growing import bill was partially due to sharp increases in petroleum prices, but also reflected Morocco's multi-year investment commitments. Deepening world recession reduced Morocco's export earnings and hurt tourism receipts and remittances from migrant labor, both important sources of foreign exchange in the Moroccan economy. Moreover, the lengthy war in the Spanish Sahara put additional pressure on Morocco's finances.

Such trends in investment and trade created tremendous budgetary pressures. The Treasury deficit tripled from 1972 to 1977. The trade deficit steadily worsened through the remainder of the decade. Morocco met these deficits with heavy external borrowing, but as worldwide financial markets became increasingly tight, the cost of borrowing also grew as interest rates rose. Morocco's debt burden soon proved to be unsustainable.

The debt burden reached crisis proportions in 1983, at which time Morocco virtually halted imports, made cuts in its national budget, and entered into negotiations with the IMF to help resolve its external imbalances. Prior to beginning the initial $317 million Stand-By Arrangement, the GOM cut its projected bedget deficit for 1983 and deregulated prices (or reduced subsidies) on a wide range of consumer goods. Under the auspices of the IMF Stand-By, Morocco also reduced its budget deficits, significantly devalued the dirham and improved its balance of trade between late 1983 and March 1985.

During 1983 Morocco also began negotiations with the World Bank over the first Structural Adjustment Loan, called the Industrial and Trade Policy Adjustment Loan (ITPA). This loan, signed in January 1984, was the culmination of four years of analysis of Morocco's industrial incentive structure and contained measures to reduce protectionism, liberalize imports, and reduce the costs and administrative complexities of exporting. In return for taking such measures as reducing the maximum import duty from over 100% to 60%, cutting the special import taxes and reducing licensing requirements for imports, Morocco received $150 million to finance needed imports. A second structural adjustment loan for trade liberalization (IITA II) followed in the amount of $200 million. Details of these Structural Adjustment Loans are as follows:

Structural Adjustment Structural adjustment efforts under the World Bank's Industrial and Trade Policy Adjustment Loans have focused on dismantling the system of incentives favoring import substitution and reorienting the economy toward export markets. The structural adjustment program includes the the following economic policy measures:

Improved export incentives through exchange rate devaluation, trade liberalization and less strict administrative controls. The aim is to make export activity relatively more attractive for Moroccan producers than it has been in the past.

Reductions in import protection through lower tariffs and removal of import restrictions. The aim is to reinforce the incentives for export-oriented production by weakening the incentives to produce principally for the domestic market.

Fiscal reform through changes in direct and indirect tax codes, with particular emphasis on eliminating disadvantages to exporters. The aim is to reduce and rationalize taxation of capital.

Financial sector reform through increases in interest rates and development of short-term financing and rediscount facilities for exporters. The aim is make interest rates positive in real terms.

Price liberalization through deregulation and reduction of price controls. The aim is to improve the efficiency of resource use by making the economy more responsive to market forces.

In the area of trade policy reform, structural adjustment has meant a phased reduction of protectionist measures. The maximum import duty has been reduced to 60 percent and is scheduled to move to 45 percent in 1986 and to 25 percent in 1988. Import licensing requirements have also been lifted so that only a few items remain prohibited. At the same time, the Government of Morocco has taken a number of important steps to stimulate export growth. It has loosened administrative controls and reduced the paperwork required for the temporary import of items that are used as inputs in export production. The GOM has also taken measures to assure that exporters obtain preferential access to credit.

In spite of these reforms, Morocco has made slow progress in reducing its trade deficits. Table I below shows changes in the trade accounts from 1979-1985.

Table I
Balance of Trade
(billions of dirhams)

Year	Exports	Imports	Balance of Trade	Exports as % of Imports
1979	7.6	14.3	- 6.7	53.2
1980	9.6	16.8	- 7.1	57.4
1981	12.0	22.5	-10.5	53.5
1982	12.4	26.0	-13.6	47.9
1983	14.7	25.6	-10.9	57.5
1984	19.1	34.4	-15.3	55.6
1985*	20.6	36.7	-16.1	56.1

* estimated on the basis of ten-month trade data and Ministry of Finance import projections

By July, 1985, the GOM had slipped from the IMF's proposed targets and conditions for a second Stand-By Arrangement. However, the GOM took corrective measures and an Agreement was reached in September 1985 for this second Stand-By to be in effect until February, 1987. The Paris Club also met in September after Morocco and the IMF had reached agreement on the Stand-By. At this meeting, the donors agreed to a rescheduling of Morocco's public debt through February, 1987.

While Morocco has in a few instances missed IMF targets, it has continued to make significant progress toward the large majority of them. For example, the GOM's budget deficit has been cut from 12.3% of GDP in 1982 to 6.1% of GDP in 1985. This budget discipline will continue in 1986 with commitments and expenditures closely monitored by the Ministry of Finance. The trade gap has not been closed as fast as predicted on the basis of progressive dirham depreciations, which have been carried out as agreed. Growth of manufacturing exports has been rapid, however, meeting the ambitious program expectations.

Nonetheless, it is still early to see the results of many of Morocco's structural adjustments efforts. Growth in total exports for 1985 is expected to fall short of expectations, although exports of manufactured goods are growing rapidly. Manufactured exports grew by 29% in dirhams in the first ten months of 1985, thereby compensating partially for the decline in earnings from phosphate derivatives. Furthermore, the government has made significant progress is stabilizing import growth during a period of declining import duties and other barriers; this should enable Morocco to make some small improvements in the overall balances of trade for 1985 and 1986.

B. Strategy Rationale

In keeping with AID's establishment of the private sector as one of the four pillars of development, USAID/Rabat decided to actively pursue a private sector strategy in early 1985. The private sector in Morocco is a dynamic one and has a great potential to contribute to the further development of Morocco. Moreover, recent policy changes in Morocco as well as the structural adjustment program strongly favor the growth of the private sector and the greater reliance on this sector to solve development problems heretofore tackled, but not always solved, by the government alone. Given the debt-servicing problems of Morocco and the necessity to transform an essentially inward looking economy to an outward looking one, the USAID/Rabat Mission has decided to initially focus on private sector export promotion.

This focus on export promotion is sound for a number of reasons. First, the trade and financial imbalances described above have become the principal economic preoccupation of the Moroccan government[they are the primary factors determining Morocco's ability to service its debt and to finance investment for long-term economic development. Sustained economic growth can be restored only when the structural adjustment process has been successfully completed and Morocco can compete successfully in the world economy.

USAID believes that a major opportunity exists to assist Morocco in its efforts to make adjustments that will create a stronger and more market-oriented economy. The key to Moroccan recovery is growth in exports and a concomitant reduction of the trade deficit. The most promising avenue for reducing the deficit is through a strong series of GOM measures to create a favorable policy and institutional environment, supplemented by export promotion. Under current austerity conditions, growth in real per capita income remains stagnant and private consumption will remain compressed for several more years. Given depressed revenue levels within Morocco, economic recovery cannot be fueled by the domestic market. An export orientation is critical to a return to overall economic growth.

Second, empirical analysis suggests that Morocco's private export-oriented enterprises tend to be the most efficient users of capital resources in Moroccan industry. The highest average levels of capital productivity appear to occur in export-oriented industries such as clothing, leather and shoes. By contrast, lower average levels of capital productivity tend to arise in such industries as sugar, paper and printing, rubber and plastics, which are oriented toward the domestic market. Moreover, despite some variation, export-oriented industry shows reasonably strong levels of gross profitability. Morocco's and USAID's concern over efficiency of investment calls for particular attention to export-oriented industries.

Third, export-oriented industries appear to have the greatest potential for near-term job creation. In general, Morocco's export-oriented industries are relatively labor-intensive as measured by capital to labor ratios. Rapid increases in export production might therefore be expected to generate employment increases at a relatively rapid pace.

Fourth, export-oriented industries -- particularly those in the manufacturing sector -- have already demonstrated their ability to respond quickly to improved incentives. For example, exports of manufactured goods increased by 23 percent in real terms in 1981-1982, as compared to real growth of only 5 percent between 1977 and 1980. This performance, which occurred in unfavorable domestic and international economic conditions, was in part a response to a devaluation of Morocco's exchange rate. This reflects the high price elasticity of manufactured exports, as well as the willingneas of Moroccan exporters to seek export markets if necessary to replace poor domestic returns. Manufactured exports have continued to record excellent growth rates under Morocco's structural adjustment program. As the GOM continues to implement economic reforms, the incentives for increased export production should improve. The experience of the early 1980's indicates that exporters in the manufactured sector will respond quickly and positively to changes in the incentive structure.

Fifth, the Moroccan business environment exhibits several positive characteristics favoring development of export-oriented industries. These include:

A Strong Labor Supply Base - Morocco offers a well qualified, highly trainable work force crucial to the development of export industry activities. Its high rate of unemployment and underemployment assures that there will not be any pressure on the relatively low cost of labor, one of Morocco's principal competitive advantages.

Proximity to New Export Markets - Moroccan exporters have traditionally been oriented toward France, but exporters have yet to take advantage of the opportunities in other European markets. Furthermore, many opportunities exist in the Middle East, Africa, and North America where Morocco's products currently have only modest footholds.

Well-Established Industrial Base - Morocco has a relatively well-established industrial base and a substantial group of efficiently managed private companies. If proper measures are taken to motivate Moroccan firms to export, such companies should exhibit a willingness to consider new market areas and a desire to turn business opportunities into profitable ventures.

Significant Natural Resource Base - Morocco offers a substantial natural resource base to support development of certain exports. It has considerable agricultural potential, and although this sector is far from achieving optimum productivity, long-term efforts are underway to improve agricultural performance.

Commitment to Development of an Export-Oriented Industry - Morocco is committed to long-term improvement of its balance of payments position through export industry led structural adjustment. The Government's actions to establish an outward-looking economic orientation through fiscal, monetary and institutional reforms is crucial to the development of the export sector.

C. Overview of Export-Oriented Manufacturing Industry

The majority of the private sector export-oriented firms in Morocco are involved in manufacturing. It is most likely these firms which USAID/Morocco's private sector strategy will impact upon. Morocco's manufacturing industry subsector is a critical element of Morocco's economy and is composed of both public and private firms. This subsector presently accounts for about 17 percent of total GDP, a proportion approximately equivalent to that of agriculture, forestry and fisheries in 1983. Manufacturing's share of GDP (current prices) has been nearly unchanged since 1972 (Table II).

1. Present Manufacturing Output

Manufacturing output amounted to nearly 16 billion DH in 1983. In real terms, the value of total manufacturing production increased 3.9 percent between 1982 and 1983, the first manufacturing industry growth since 1980. Domestic and international recession plus Morocco's successive stabilization efforts have been reasons for this stagnation. In volume terms, since the early 1980's only textiles, electronics and leather products, for which output surged in 1980/81 or 1981/82, have been exceptions to stagnant manufacturing performance. Growth in 1982/83 can be attributed in particular to the chemical industry, and more specifically to a substantial rise in the volume of fertilizer production.

2. Structure of Manufacturing

Morocco's manufacturing industry is composed of a modern and a traditional sector. Output of traditional manufacturing enterprises is estimated to account for about a third of total manufacturing production. Traditional production is particularly important in miscellaneous manufacturing (77 percent), clothing (53 percent), wood and wood products (50 percent), food industry (35 percent), and textiles (35 percent), the latter especially in carpet production.

Modern sector manufacturing in Morocco might be considered to include all firms with either 10 employees or more or 100,000 DH annual turnover. This modern sector comprised about 2800 firms in 1980, and represents the foundation for development of manufacturing exports. The analyses below are based on modern sector manufacturing industry.

Modern sector manufacturing is concentrated in particular in the Casablanca area, where over 60 percent of firms are located, although Government is encouraging dispersal of industry to other regions.

Manufacturing Activity by Industry. Consumer goods account for the major part of Morocco's manufacturing production. Capital goods are estimated to represent only about a tenth of total output. By industry group, agro-industry and textiles and clothing alone generate over 50 percent of production and more than one third of value-added. Other leading industries are chemicals and parachemicals -- represnting in particular processing of phosphate rock to phosphoric acid and fertilizers -- and electrical/metallurgical/mechanical industry:

TABLE II

Industry Group	Share (percent) Production	Value-Added
Agro-Industry	36.7	26.1
Textiles and Clothing	12.7	15.2
Leather and Shoes	2.1	2.5
Wood/Wood Products	2.8	3.2
Paper and Printing	4.6	5.0
Construction Materials, Ceramics and Glass	8.3	11.0
Electrical/Metallurgical/Mechanical	15.6	18.1
Chemical/Parachemical	17.2	18.0
Others	0.1	0.1
TOTAL	100.0	100.0

Source: MCIT, Les Industries de Transformation, 1980.

Size Distribution. The modern manufacturing sector is made up largely of small to medium-sized firms. Over a quarter of manufacturing firms have less than 10 employees, and 70 percent have less than 50 employees. Further, about one third of all modern manufacturing firms have annual turnover less than 500,000 DH. A few large firms account for the bulk of production and value-added: the 2 percent of firms with 500 or more employees generate about one third of total production and value-added. Small and medium size firms (less than 50 employees) are particularly prominent in food industries, clothing and textiles, leather and footwear, paper and printing, plastics and electrical/metallurgical/ mechanical industries.

Note that the largest firms account for the bulk of manufactured goods exports: firms with 500 employees or more, or with annual turnover of 10 million DH or more, generate 55 and 83 percent of total value of manufactured exports respectively.

Public Sector Participation. About 47 percent of total equity in Morocco's manufacturing firms was held by the public sector in 1978. Public participation was particularly important in the tobacco, petroleum, paper and printing, chemicals and the cement industries. Private sector participation is prominent in parts of agro-industry (processed fruits and vegetables and canned fish); in textiles clothing and leather goods; and in the electrical, metallurigical and mechanical industries.

3. Manufactured Exports

The vast bulk of manufactured output is directed at Morocco's domestic market rather than oriented to export sale. In 1981, exports accounted for only about 13 percent of the total value of manufactured production (Table III-6). Nevertheless, there are certain industries -- textiles, clothing, leather and footwear, chemical products -- where exports are an important segment of output. Further there are indications that manufacturing for export is increasing in importance. Between 1978 and 1981 total value of manufactured exports rose at an average of 9 percent per year. This increase took place despite the unfavorable world economy, and as a response due to Morocco's domestic recession, devaluation of the dirham and shrinking local markets. Major sources of increased manufactured exports were clothing and chemical/parachemical products.

During the first ten years of Morocco's independence, about 65 to 70 percent o fvalue of exports were generated by phosphates and agricultural products. During the 1970's, manufactured exports gradually increased from about one third to about 41 percent of total export value. Phosphate rock is still a major export item presently accounting for about a third of value, while other primary items, principally raw agricultural products, account for 27 percent. Manufactured export products have also become somewhat more diversified throughout the 1970's with the increasing importance of textiles, clothing, and chemical products among Morocco's manufactured export goods.

The major market for Morocco's textile, clothing and leather goods exports has been the EEC, largely in response to preferential trade arrangements. Modest exports of leather and shoes are directed to Africa. Chemical exports are more diversified, with volumes going to Europe, Latin America and South Asia.

4. Employment and Labor Productivity

Modern manufacturing industry employed about 190,000 workers in 1980. Total manufacturing employment in Morocco, both modern and traditional sectors, is estimated at about 500,000 persons. Textiles (22 percent) and food industry (16 percent) and clothing (9 percent) accounted for nearly 50 percent of total employment in modern sector manfuacturing. Average manufacturing wages are highest in chemicals, beverages and tobacco and transport equipment. This wage structure reflects inter-industry labor productivity differentials. Public sector participation in certain industries may also raise wage rates. Lowest wage rates tend to be in Morocco's more export oriented industries. Decreases in labor productivity between 1976 and 1980 reflect the decline in domestic demand for manufactured products.

5. Capital Stock and Capital Productivity

Agro-industry and textiles together account for about one-half of real assets of manufacturing industry. Processed quarry products (mainly cement) and paper and printing hold the next most important shares of real assets, about 8 percent each.

Average capital productivity, measured by capital-output ratios, is highest in clothing, leather and shoes, basic chemicals, metallurgy and metal-working, pharmaceuticals and cosmetics, electrical products and transport equipment. Gross profitability also tends to be highest in these industries . Note that several of these industries are among Morocco's relatively most export-oriented manufacturing activities (for example, clothing, leather and shoes).

6. Capacity Utilization and Factor Intensity

Utilization of Morocco's capital stock is quite low: in 1978 capacity utilization averaged an estimated 70 percent. Present utilization rates are still judged to be at approximately these levels due to domestic recession and some over-building of capacity in the 1970's. For various export oriented industries, low rates of capacity utilization indicate a margin for substantial expansion of production without additional investment.

Factory intensity by industry can be evaluated by relative capital-labor ratios, where high ratios indicate relative capital intensity and vice versa. Several of Morocco's least capital intensive industries -- clothing, leather and shoes, and others -- have tended to be among Morocco's most export-oriented manufacturing activities. By contrast, many of the most capital-intensive manufacturing activities were developed as part of Morocco's import substitution program.

7. Investment in Manufacturing

Investment in manufacturing industry between 1977 and 1983 reflects the general economic trends of the Moroccan economy. In the period of recession and successive stabilization attempts between 1978 and 1982, manufacturing investment declined to less than one-half to two-thirds of 1977 levels.

Table III

Manufacturing Investment Approved Under Morocco's Investment Code, by Major Industry Group, 1977-1983
(million DH)

	1977	1978	1979	1980	1981	1982	1983
Agro-industry	757	192	254	285	304	849	949
Textiles and leather	430	227	179	383	415	361	364
Chemical and parachemical	810	367	365	571	505	1,181	608
Mechanical and electrical	238	272	242	235	286	290	345
TOTAL	2,235	1,058	1,040	1,474	1,510	2,681	2,266

Source: BMCE, Monthly Review, May - June 1984.

Recent data on investment in manufacturing for 1982/1983 show that there has been a precipitous drop in public investment for 1983, but an increase in manufacturing investment from private sources, including a doubling of foreign private investment. The decline in public sector investment in manufacturing reflects Government's overall economic retrenchment between 1982 and 1983.

Table IV

Manufacturing Investment Approved Under the Investment Code, by Major Industry Group, and Source, 1982-1983
(million DH)

	1982				1983			
	Public	Private		Total	Public	Private		Total
Industry Group		Moroccan	Foreign			Moroccan	Foreign	
Agro-industry	464	351	34	849	27	727	194	949
Textiles and leather	24	305	32	362	7	309	48	364
Chemical and parachemical	426	653	102	1,181	24	466	118	607
Electrical/ mechanical/metallurgical	8	237	45	290	32	218	95	345
TOTAL	922	1,546	213	2,681	90	1,720	455	2,266

Source: BMCE, Monthly Review, May - June 1984.

The Government of Morocco has given new emphasis to encouraging investment, both foreign and domestic, particularly in agriculture and agro-industry. The

Industrial Investment Code of 1983 (Law No. 17-82, promulgated by Dahir No. 1-82-220, 17 January 1983), includes an extensive menu of tax exemptions and reductions. Additionally the Code now allows foreign companies to hold 100 percent of equity in locally registered companies, and guarantees repatriation of both capital and profits.

D. Institutions and Incentives for Export-Oriented Industry Development

1. Customs and Financial Systems for Exporting

A range of administrative and financial incentives have been created to promote exports. These include favorable tax provisions, special customs regimes and certain financing incentives.

Export and Investment Codes. A special Dahir No. 1-73-408 for industrial and artisanal exporters was published in August 1973. The objectives of this Code are to assist exporters by:

- exemption from taxes on export business profits for 10 years;
- provision of a foreign exchange allocation for the purpose of market development equal to 3 percent of a company's exports;
- guarantee of transfer of dividends and repatriation of capital for foreign investors.

Through the 1983 revisions to the Investment Code, certain additional benefits accrue to exporters who undertake new or expansion investment projects. These incentives include:

- reduction of business registration tax by 50 percent;
- refund of special import taxes on capital goods and equipment imported or purchased locally;
- exemptions from import duties and the TPS (sales) tax on capital goods and equipment imported or purchased locally;
- an interest rebate of 2 percentage points on loans to finance investment for industrial companies.

Special Customs Systems and Procedures. Exporters enjoy access to special customs regimes. Major among these are:

- Admission Temporaire (AT) which permits an exporter to import, free of duties and taxes for up to a year's duration, raw materials to be transformed in the manufacture of export goods.
- Drawback, which permits exporters to be reimbursed for average duties and taxes previously paid on imported materials purchased locally and later used in export.

- Importation Temporaire, which permits an exporter to import, free of duties and taxes, certain materials incorporated in a manufacturing process but later re-exported without changing form (e.g., packaging materials).

Recently, in February 1984 various procedures under these systems were revis ed to reduce administrative delays and frictions for export-oriented industries. Perhaps the most significant revisions have been modifications to the "AT" or Admission Temporaire system. Procedures have been simplified to include, first, allowing branch offices of the Customs Service (rather than the Director's Office alone) to grant AT status to items not mentioned on the basic list of permissible AT materials; and second, allowing firms to declare their own wastage rates in processing raw materials imported under AT. Other AT simiplifications now permit the rug industry to substitute a Departement de l'Artisanat bond for a bank bond in guaranteeing any eventual payment of Customs duties arising from a material's loss of AT status; and also allow, under certain conditions, the sale on the local market of items originally produced for export.

Additionally, the February 1984 revisions feature simplications to other customs regimes. These include easing regulations and procedures for use of Importation Temporaire; and a loosening of the drawback system to enable more rapid reimbursement of duty and customs payments. Finally, for firms with an annual turnover of at least 10 million DH and 75 percent export production, the revised procedures call for Customs clearance at an exporter's own factory.

Financing Incentives for Export. The Government of Morocco has also put in place a financing systems designed to favor exporters. The systems involve provision of both export pre-financing credits as well as other short and medium term export credits. Additionally, mechanisms for obtaining export insurance and forward foreign exchange coverage are available to exporters.

Export pre-financing credits ("credits de prefinancement") are short term (up to one year) working capital loans to cover the purchase of raw materials and other current production expenses associated with manufacturing for export. The credits are extended by commercial banks on the basis of documentation (e.g., three years of financial statements, a production plan) and real and personal guarantees of the borrower. They are discountable -- the commercial bank issuing them can turn around and "sell" to the Banque du Maroc the exporter's note to eventually repay his loan at a present value which reflects a favorable rate of discount. Short term export credits ("mobilisation des creances nees sur l'etranger") make loans available to exporters based on the trade bills they hold from clients to whom they have shipped goods. These credits are extended by commercial banks for a maximum period of 180 days and are also discountable with the Banque du Maroc. A similar mechanism of medium term (up to five years) export loans ("credit exportation a moyen terme reescomptable") are also available to finance overseas sales of equipment made by Moroccan exporters.

To promote export acitivity, these export credits have two special advantages. First, such credits are outside the formal credit expansion limits imposed on the commercial banking system by the Banque du Maroc ("encadrement") to control the growth of credit. Hence, any worthy exporter should theoretically be able to meet all his credit needs, even though credit for other activities is rationed. (The fact that commercial banks must obtain prior Banque du Maroc approval of these loans in order to discount them later diminshes this advantage somewhat; see Part III below. Second, these credits are provided at preferential rates of interest: 7 percent by commercial banks (8 percent for medium term credits) and a 5 percent rate of discount for commercial banks with the Banque du Maroc.

Export Insurance. An export insurance system was established by a dahir of April 1974. The insurance is funded by the Government, with the Banque Marocaine du Commerce Exterieur (BMCE) responsible for issuing policies. Government's budgetary allocation to export insurance was 80 billion DH in 1983. Areas covered include commercial and political risk of a client's non-payment. The system was recently revised to ease minimum and maximum limits somewhat and to permit exporters to insure only a portion, rather than all, their export shipments. Additional insurance is available to partially defray costs from an exporter's participation in trade fairs and market development, in the event commercial returns from these activities are unsatisfactory. A fifth category of insurance for manufacturing risk (risk of cancellation of export orders before goods have actually been shipped) is currently under discussion by policymakers.

Forward Foreign Exchange Coverage. Forward coverage against exchange risk is also available to exporters through the commerical banking system. This coverage enables an exporter to hedge his foreign exchange-denominated sales or purchases at a specified forward value in dirhams. The minimum term for such a contract is one month and the maximum, six months. The exporter pays a commission of 2 percent of the value in dirhams of the amounts guaranteed at the time of contract issue.

2. Government Institutions Promoting Export Development

The Moroccan government has established two organizations to be responsible for industry development and export promotion: the Office pour le Developpement Industriel, and the Centre Marocain de Promotion des Exportations (CMPE).

Office pour le Developpement Industriel (ODI). ODI was formed in 1973 with the objective of promoting industrial development, with particular emphasis on balancing industry growth by region, and on encouraging domestic and foreign investment in industry.

Its principal activities are:

- to conduct studies, both industry opportunity studies and specific project pre-feasibility studies, in all industry subsectors;

- to promote industry activity, both by providing technical and economic information to Moroccan and foreign investors, and by representing the Moroccan industry at overseas conferences, investment promotion events and trade fairs;

- to provide special assistance to small and medium business, including project development, project management, training and marketing development support;

- to participate financially in selected projects of strategic importance (special regional or national interest, demonstration of capital intensive methods or advanced technology), in cooperation with private investors.

The ODI reports to the Ministry of Commerce, Industry and Tourism. It is organised into four departments reflecting Morocco's key industrial groups and concerns; agro-industry, textiles and leather, chemicals and parachemicals, and electro- mechanical; plus a department of promotion and assistance, aimed at small and medium business; and a department of external relations, aimed at overseas promotion of Moroccan trade and industry.

In the last year (1983) ODI conducted studies for about 20 industrial projects, and took equity positions in four projects. It also promoted Moroccan industry by welcoming and escorting potential foreign investors, and by participating in missions and fairs overseas to identify investment, joint venture and subcontracting opportunities.

ODI maintains an office in New York to respond to the investment interests of U.S. firms, and to refer selected U.S. investors to ODI/Morocco for additional servicing. Currently ODI promotional activities in the U.S. are limited to handling investor inquiries and attending industrial promotion functions. ODI reports that as a result of its actions, three US projects were implemented in Morocco in 1982 and 1983:

1982	ROBINTEC - plastic pipe for irrigation
	UMAP-TREK - irrigation equipment
	American Ocean Resources Inc. - White fish canning
1983	MAPARCO - under license from Johnson & Johnson to manufacture sanitary napkins

<u>Centre Marocain de Promotion des Exportations (CMPE)</u>. The Moroccan Center for Export Promotion (CMPE) was set up in November 1980 with two objectives; to investigate new markets abroad, and to conduct promotion activities for Moroccan products. It is a public agency under the direction of the Minister of Commerce Industry and Tourism. CMPE is organized into a range of technical departments (leather, textiles, agro-industry, etc.) to conduct promotion and market research activities. CMPE's market research includes broad sectoral studies, as well as market studies of specific products and market outlets. For example, with EEC financing and assistance from the Irish Marketing Board, in 1982 CMPE sponsored a

major study of U.S. market opportunities for Moroccan products. It has also undertaken analyses of various questions of concern to exporters -- financing, transportation services and the like. CMPE's promotional activities have featured participation in trade fairs and industry shows, and the organization of trade promotion events, notably in Liberia, Senegal and Kuwait.

Besides CMPE's market research and formal promotion work, it acts as a source of information for Moroccan exporters. CMPE provides general data on trade flows for Morocco and overseas, as well as information on product requests from foreign buyers, and on commercial practices and customs requirements of foreign markets for Moroccan exporters. It has also produced some specialized documents to assist the exporters (e.g., "Le Guide de l'Exportateur") and has organized seminars and round tables to promote and encourage discussions of export- related problems and opportunities.

Office de Commercialisation et d'Exportation (OCE). Unitl recently a third public sector agency, OCE, was engaged in support for manufacturing industry export activity. Specifically, before October 1, 1984, OCE was charged with the overseas marketing and export of all Morocco's fresh fruits and vegetables, canned fruits and vegetable products, canned fish and wine. It was also responsible for the technical quality control of export production of these items. Since October 1, however, its marketing and export role has been terminated for all processed agricultural products, although it maintains its technical quality control function. Hence, agro-industry export producers now bear full responsibilities for their own market development and successful expansion of export production.

3. CGEM and Other Private Industry Associations

Certain private industry associations provide support to manufacturing export activities. Notable among these is the Confederation Generale Economique Marocaine (CGEM), a non-profit employers association which groups more than 40 individual professional and commercial associations, as well as individual firms. The CGEM is organized into four Federations (Industry, Business and Services, Construction and Engineering, Mining) designed to monitor and study issues of concern to their industry memberships. Additionally, CGEM has formed two technical committees -- Economics and Finance and Social Conditions -- charged respectively with considering economics/finance/tax questions, and wages, working conditions and training.

CGEM acts as a general forum for the business community's discussion of economic and social development questions in Morocco, and represents the business sector's points of view on matters of policy with the Government of Morocco. As the major employers' organization of Morocco, it also acts as a point of contact for the Moroccan private sector with overseas businessmen, and participates in Morocco's trade and investment promotion activities. CGEM publishes a weekly bulletin, Cedies-Informations, which contains timely economic information and provides a clearing-house for data on market and contract opportunities for foreign and Moroccan buyers and sellers.

In response to the marketing, technical and economic policy interests of exporters, an Association Marocaine des Exportateurs (ASMEX) was established in 1982 within the framework of CGEM. ASMEX has acted as an advocate for Moroccan export-oriented business, and in particular has produced studies on desirable export incentives and constraints to export activity. Its activities and influence are likely to increase with the expansion of export production.

Finally, in the wake of OCE's withdrawal from agro-industry export marketing, certain other private associations are beginning to develop. Various industries (fisheries, vegetable and fruit canning, etc.) are organizing member firms in order to undertake tasks of common concern -- pricing policies, export pomotion -- formerly handled by OCE. Most notable among these is the Union Marocaine de l'Industrie de la Conserve Animale (UMICA), which was found earlier in 1984 from two previously separate canning industry associations. UMICA's role will be to set minimum prices for its industry adjusted to international supply and demand conditions. It also intends to provide industry research and analysis, and represent the views of canners to Government policy-makers.

E. Possible Opportunities for the Development of Morocco's Export Oriented Private Sector Manufacturing Industry Sub-Sector

1. Product Opportunities:

A range of product opportunities exists for the development of manufactured goods exports. The following list of export opportunities by industry and product categories has been prepared through review of documents prepared, the World Bank, USAID, the U.S. Department of Commerce, the U.S. Trade and Development Program, Export Assistance International, CMPE/Irish Marketing Board and ODI. This list is indicative of the export potential which exists, but does not represent an exhaustive compilation of product opportunities.

Extensive preliminary studies of industry sectors have been performed by these organizations to identify products with export potential. Detailed market analyses are required, however, to determine the commercial viability of the various specific products for export to the U.S and other markets. Such analyses, based on cost-price studies for specific market outlets and importers, would determine the precise quality standards and competitive price requirements needed to bring about successful negotiations of sales contracts.

Agro-Industry

- processed vegetables: including tomatoes, olives and olive oil, capers, pickles, beans, asparagus, pepper and mushrooms.
- processed fruits: including orange concentrates and apricot preserves
- processed seafood products: including sardines, shrimp, mackerel and other fish
- frozen fruits and vegetables
- mineral water
- prepared specialty food products such as couscous
- cut flowers
- processed oil seeds

Electronics and Mechanical Products / Metal Working Industry

- electronics assembly products: motors, relays, switches, wire harnesses
- metal utensils
- decorative brassware and copperware
- metal furniture

Apparel and Leather Industries

-rugs
-light fabrics
-childrens' clothing
-men's suits and trousers
-knitted goods
-women's apparel
-high quality upholstery fabric
-men's and women's shoes
-leather goods: including clothing and furniture

Chemical and Parachemical Industry

-essential oils (i.e. perfume oils)
-fertilizer
-phosphoric acid

2. Market Opportunities

Moroccan firms have expressed a strong desire to expand and diversify their market coverage, and are particularly interested in entering the U.S. marketplace. However, their approach to export activities illustrates a perceived hierarchy of market development. The least demanding markets, with respect to the establishment of distribution channels and the achievement of product design and quality standards, are believed to be France and Belgium. Once firmly established in these markets, Moroccan enterprises aspire to entry into the German marketplace with its somewhat more demanding requirements. Finally, entry in to the U.S. is believed to be the last step of market development, given the significantly more demanding production and marketing discipline required of the Moroccan exporter to be competitive there.

The proximity of Middle Eastern markets also offers export potential for selected Moroccan products. In addition, there appears to be demand for Moroccan engineering and construction activities in this area of the world. Although long range potential may exist for the Moroccan exporter to serve the demands of African markets, the current income limitations of African economies restrict the immediate expansion of Moroccan exports.

Europe is of course the most important single geographic market for Moroccan products, and is likely to continue to be so. In some cases, there may even be significant potential for the expansion and diversification of current exports to Europe. For example, European demand for certain processed vegetables, such as green beans, olives and gerkins, has expanded sufficiently to justify greater market penetration by these Moroccan products. In the case of canned fruit, Morocco's export potential includes mandarin orange sections, and nectarines in syrup. European consumption of fruit juices has increased but Moroccan exports in this product area have not grown accordingly. The likely future entry of Spain and Portugal into the European Economic Community, however, threatens the long term competitiveness of Moroccan products in many European markets.

F. Key Constraints for Private Sector Oriented Industry

The single most important constraints to export development appear to be entrepreneurial attitudes, information availability, and enterprise "structure", namely the organization of enterprises for modern production and marketing activity. Certain financial systems for exporting may also be an important and possibly growing constraint. Although transportation is a significant constraint to exporting, its alleviation will require extensive sectoral analysis and planning, a long term effort outside USAID's immediate project focus.

1. Market Access

Successful penetration of new markets requires considerable market and technical information, and an organizational capacity to develop long term promotional efforts. A lack of information and organizational marketing capacity appear to be particular constraints for Moroccan enterprises in approaching the U.S. market.

(a) Information Availability

The positioning of a product in the U.S. market requires sound market research prior to active product promotion. Export planning for the Moroccan firm is hampered by a lack of sufficient market and procedural information. The following factors are representative of the specific informational gaps which must be filled at the enterprise level to bring about the expansion of exports to the U.S. market:

Marketing Statistics - Potential exporters require general economic and market trend analyses to determine the market growtb potential for targeted products. This is particularly important for the development of a long range promotional plan.

Distribution Channels - Appropriate importer, retailer and subcontracting contacts are difficult to establish for the Moroccan manufacturer who desires to initiate preliminary negotiations. For example, one Moroccan company used the New York telephone directory as a way of identifying potential contacts, a time-consuming and nontargeted approach to export marketing. In addition, information on the commercial reputation of an importer is needed to guide the Moroccan company in identifying the proper clients for potential sales development.

Style and Production Requirements of U.S. Importers and Retailers- Moroccan exporters require assistance in product development to meet U.S. consumer preferences and importer expectations. Such development includes an understanding of appropriate design and product presentation standards, as well as typical production scheduling requirements exacted by U.S. importers and retailers. For example, by law the Moroccan wine industry is required to produce wine of 12 percent alcohol content. Information is lacking, however, on whether this standard suits the taste preferences of the U.S. consumer, and if not what adjustments should be made as part of an export marketing plan to promote Moroccan wines in the United States. Often, however, when promising market contacts have been made, the potential U.S. client can help overcome information constraints. One experienced Moroccan exporter of high quality shoes for example, has entered into subcontracting discussions with a U.S. shoe company which has been willing to provide design expertise and to suggest alterations to production scheduling so as to better meet U.S. market demand.

U.S. Contractual Procedures - The U.S. definition of a binding commercial agreement, or the circumstances under which a foreign producer has a right to renegotiate to attain a suitable cost estimate with a U.S. importer typify the kinds of legal questions a Moroccan exporter must answer in achieving successful sales negotiations. Interviews with experienced Moroccan exporters indicate that some, though not all, need to retain legal representation in the U.S. so as to have proper guidance in establishing contractual relationships.

U.S. Customs Clearance Procedures - Information on product-specific U.S. import regulations and tariff restrictions needs to be made readily available to Moroccan exporters. This is particularly important if a Moroccan exporter deals directly with retailers who do not wish to be involved in the U.S. Customs procedure. For example, few Moroccan exporters interviewed were aware of the complexities of the Generalized System of Preferences which provides reduced import duties for selected articles entering the U.S. In addition, to bring about subcontracting arrangements with U.S. manufacturers, Moroccan firms need to be made aware of the advantages of U.S. Tariff Items 806.3 and 807. These provisions of the Customs Code allow for the assembly of manufactured articles offshore using U.S. parts, and subsequent import of the finished article into the U.S. with a customs duty liability only on the value-added offshore (i.e. Moroccan labor costs). Greater understanding of the opportunities of the 806.3 and 807 provisions could encourage subcontracting arrangements between U.S. and Moroccan firms, relationships which offer substantial manufacturing cost savings to U.S. manufacturers, while creating new production and employment opportunities in the Moroccan industrial sector.

U.S. Food and Drug Administration Regulations - Exporters expressed considerable dismay over the complexity of FDA regulations. The entry of agricultural products and processed goods from Morocco must meet FDA standards for labelling, packaging, and chemical processing. The time, effort, and cost involved in obtaining approval for the import of a product to the U.S. is feared by many potential exporters to be beyond the capability of Moroccan firms.

Federal Trade Commission - The shipment of manufactured goods, such as apparel, require specific labelling to include the country of origin, care, composition and manufacturer's name. Moroccan firms require counselling in the proper preparation of shipments to the United States so as to meet U.S. industrial import regulations.

(b) Organization of Marketing Activities

Several Moroccan exporters have developed short-term export expansion strategies, but many lack experience in effectively using certain modern marketing techniques required to launch long range market promotion programs.

Interviews with Moroccan companies indicate that only more experienced and exporters use various promotional methods to structure marketing efforts and to identify potential overseas trading partners. These methods include repeated participation in trade shows, fairs, industry directories, with follow-up development of personal contacts. Nearly all Moroccan exporters interviewed exhibited a lack of awareness of the use of the possibilities of employing a U.S. broker or agent service in developing U.S. markets. Only more experienced Moroccan exporters routinely prepare detailed sales literature and marketing development data to be used in discussions with potential overseas clients. Most typically, commercial relationships are developed as a result of ad hoc personal contacts. In the case of one metalworking company, for example, the director used a personal contact in New York to bring about preliminary negotiations with a U.S. department store chain.

2. Production and Technical Requirements

The diversification and expansion of Moroccan export-oriented industries will require strengthening the organization and operation of current production activities through improvements in production technology and management practices. At a production level, in certain enterprises, modifications to existing technology may be all that is needed to meet the production criteria of U.S. importers and distributors. In other cases, substantially new technologies may be required to undertake product development and expand output volumes for export.

At a management level, many Moroccan businessmen apparently are unfamiliar with how to properly compute cost of production of an article to determine appropriate competitive prices and margins for the U.S. market. Potential exporters, used to working with highly artificial pricing policies for their products as a result of a protected domestic market, often assume that an acceptable export price involves only the addition of transport costs and a commercial risk factor. Estimation of total landed cost for an article exported to the U.S. requires, however, an accurate and complete breakdown of the direct costs associated with labor and materials inputs, packaging and shipping costs and import duties, as well as some treatment of enterprise overheads and return on investment. Most Moroccan firms thus need help in dealing with the cost and pricing considerations which are prerequisites to successful market development.

In both production technology and enterprise management, substantial technical assistance will be required at the firm level to enable Moroccan manufacturers to establish the marketing and production capability to export competitively.

3. Financial Resources

In general, and contrary to initial expectations, financial resources do not appear to be a central critical constraint to development of export industry. This conclusion certainly holds true for local currency financing where manufacturers report that -- assuming well-prepared dossiers and existence of collateral -- ample financial resources are apparently available both for investment project funding (equity and debt) and for short term operations funding. Review of Banque du Maroc statistics for 1983 and early

1984, as well as conversations with manufacturing firms and bankers confirm that the banking system has had an excess of funds for dirham lending. This relative availability of local currency resources appears in particular to stem from a major effort on the part of Government to reduce its unpaid bills in 1983.

Moreover, the access of export industry to local currency credit should be further eased by the fact that both working capital financing ("credits de pre- financement") and short term export credits ("mobilisation des creances nees sur l'etranger") are theoretically in a priviledged position, outside the normal limits on credit expansion ("encadrement") exercised by the Banque du Maroc (BdM).

There do, however, appear to be certain problems in the export financing system. These problems may be largely procedural -- due simply to conservative banking practices and the BdM's fairly rigid control of the banking system. However, they may also stem from more fundamental causes, namely Morocco's scarce foreign exchange resources.

Bottlenecks in the pre-financing system ("credits de prefinancement") are visible at four points. First, nearly all exporters report that ceilings imposed by commercial banks on export pre-financing for importation of raw materials for the manufacturing process are considerably less than the roughly 25 percent of annual sales volume which is to be the rule of thumb under current structural adjustment policy. Second, it is also reported that an historical rather than a projected reference period is normally used for estimating pre-financing credit ceilings. This practice hinders growing export firms. Third, some exporters also suggest that pre-financing credits are generally deducted from the credit exposure limits established by the commercial banks for individual firms, so that in fact export pre-financing is subject to growth restrictions. Finally, it seems clear that collateral requirements for export pre-financing are quite stringent, and may be a particular constraint for small and medium enterprises.

All manufacturers and bankers interviewed who raised export financing as a constraint specified 1983 as the point at which the problems cited above became particularly noticeable. Available BdM data, though fragmentary, seem to bear out the fact that the pre-financing system has undergone some major shifts in 1983. For example, after ten-fold growth in the value of export pre-financing credits between 1978 and 1982, in 1983 the total value of these credits actually declined by 9 percent. This drop is reportedly attributable to institution of a new more strict policy of BdM export credit review beginning in 1983.

This policy, applied through the mechanism of a commercial bank's need to obtain prior BdM approval for rediscount of export pre-financing credit ("demande d'accord de reescompte du credit de pre-financement"), is reported to be motivated by BdM desire to prevent inflationary abuse of pre-financing credit's preferred status. BdM's fear is that export pre-financing credits will be used for financing domestic activities. However, the policy may also derive in some part from BdM's need to carefully manage scarce foreign exchange. In either case, the application of the policy to the export pre-financing system may be having adverse impacts on the rate of growth of exports. Further, as export production continues to expand, lack of flexible export pre-financing as well as lack of foreign exchange are likely to emerge as an increasingly serious constraints to export development.

Additionally, the export pre-financing credit system has problems of coverage. As presently established, the preferential access to credit enjoyed by exporters is limited to direct exporters alone. As export production begins to increase, indirect exporters -- those manufacturers who produce outputs to be incorporated by direct exporters in their production operations -- will have an increasing need for pre-financing credits. Unless the system can expand to include their legitimate export production related financing needs, additional constraints to export development may arise. In addition, it is evident that small and medium sized entrepreneurs, as well as entrepreneurs new to exporting, are discriminated against in the export pre-financing credit system. The cost of processing the applications of these exporters exceeds the benefits enjoyed by the credit institutions, and with limited pools of credit available, the larger and more influential exporters always have priority. These problems are discussed in greater detail in the project description which follows later in this Assessment.

Availability of financial resources in foreign exchange or otherwise does not seem to be a problem for medium to long term investment project financing of imported plant and equipment, for either new or expanding export enterprises, or indeed for other industrial enterprises. Some evidence of this is the fact that demand has been quite slack for a 1982 IBRD-funded line credit to the Banque Nationale pour le Developpement Economique (BNDE) for the foreign exchange components of industrial project financing.

Finally, there appears to be one clearly serious foreign exchange-related constraint on exporters. The Code des Exportations theoretically gives each exporter an allocation of foreign exchange equal to 3 percent of the firm's annual sales volume to be used for market development ("prospection"). In fact however, exporters apparently receive much less than one full Code-mandated allocation. As Moroccan exporters begin to execute serious long-term marketing strategies in the US market, the Code's market development allocations will have to be observed much more faithfully and most likely increased.

4. Commercial and Foreign Exchange Risk

The Moroccan export insurance system is guaranteed by the State and is operated by BMCE. Coverage is limited to risks associated with commercial, political and natural disasters and also provides insurance for non-viability which covers promotion and advertising at trade fairs. While insurance for manufacturing risk is not currently available to cover loss in the event of a contract broken by the client or as a result of a change in the import procedures of the country of destination, it is being considered by the Government. Exporters have consistently commented that the insurance system is too complex and too costly, and represents too many procedural aggravations. In most cases, firms do not use the system and prefer to work their insurance needs out on an exporter/client basis, dealing directly with the non-paying client. Additionally, although the system is now funded with an explicit government budget allocation, some exporters point out that in the past the insurance system had no reserves, and believe that it may still be unlikely to meet claims. The problems in the export insurance system are discussed at greater length in Section III., the Project Description.

No exporter encountered takes advantage of the forward foreign exchange coverage system. Excessive cost was cited as the reason for exporters' lack of interest.

5. Entrepreneurial Attitudes

Traditionally, Moroccan export activities have been determined on the basis of European trading practices and market demands. Moroccan firms have capitalized on geographic proximity and cultural ties to Europe, particularly France, and on development of appropriate marketing channels, purchase of European-made machinery and equipment and use of European technical expertise and personnel. As a result, Morocco's commercial orientation, marketing experience and production criteria are based on European consumer preferences, quality standards, supply schedules and market size.

Moroccan exporters exhibit a relatively passive marketing attitude as a result of Morocco's well-established European distribution channels and comfortable traditional commercial practices. Some of Morocco's success in exporting is reported to have arisen from European buyers seeking new sources of supply rather than Moroccan exporters actively developing new markets. This lack of a dynamic approach to export marketing has generally hampered the expansion and diversification of Moroccan export activities. Entry into new markets rarely appears to be based upon carefully planned detailed commercial strategies of the kind required to compete effectively in the international marketplace. Rather, development efforts normally focus on short forays into new markets, often without much prior analysis or preparation, which if not met with rapid success, lead to quick discouragement. Obviously however, there are exceptions to this rule. Some of these have been evident in C&L's discussions with certain Moroccan exporters who have undertaken a series of carefully prepared preliminary visits to develop new markets in the U.S. and elsewhere.

Perceptions of Moroccan exporters regarding the U.S. market are particularly revealing as to the shifts in attitudes which will be required for Moroccan manufacturing to become effective in developing new markets in worldwide commerce. The U.S. market is portrayed by Moroccan exporters as tremendously complex with respect to commercial procedures and consumer preferences. This attitude is a result of the interplay of specific marketing and production factors which include:

o <u>market size</u> - The U.S. market offers maximum sales volume potential through a minimum number of commercial contacts, but Moroccan exporters are intimidated by quantity requirements of U.S. importers and retailers as well as the diversity of consumer preferences. This is a major discouragement to new-to-export companies who are not accustomed to the market's complexity. As a result, the inexperienced Moroccan exporter interprets the U.S. market as broad and marketably unmanageable.

o <u>language barrier</u> - There is a general lack of English language skills among the Moroccan business community. Although the ecoles superieures, (e.g. ISCAE), offer language training as part of their curricula, there are few opportunities for business students to use their language training. The lack of adequate English skills has discouraged Moroccan companies from undertaking U.S. marketing trips. One striking exception arising in the C&L interviews was, however, an experienced Moroccan exporter who took the initiative to hire an interpreter to work with him during his sales calls and contract negotiations procedure in the U.S., though this solution is too expensive for most exporters to employ.

o <u>quality control standards</u> - The Moroccan exporter perceives the quality standards on the part of U.S. trading partners as requiring an extensive degree of production uniformity and quality consistency compared to more traditional markets. This creates a significant discouragement to Moroccan exporters seeking to expand to the U.S. Hence, once more Moroccan companies' familiarity with the production standards of European importers reinforces a passive attitude toward market development.

o <u>commercial practices of the U.S.</u> - Moroccan firms understandably know less about the legal system, tax and tariff regulations and contract negotiation requirements of the U.S. than they do about European practices. U.S. business representatives follow different procedures in negotiating a contract than do European firms. For example, the U.S. partner usually expects to be in frequent contact with a foreign producer once an agreement has been met, which is not the case with many European importers. This approach is not clearly understood by the inexperienced Moroccan exporter.

6. Transportation Services

The availability of adequate and competitively priced transportation from Morocco to the U.S. and other non-European markets is cited a severe constraint on the potential expansion of Moroccan exports. The frequency of scheduled vessels and planes, the availability of appropriate routes and the high-cost rate structure limit the ability and motivation of Moroccan companies to produce for new markets such as the U.S.

The Moroccan maritime and air transport sector has benefitted from significant investment to expand construction of facilities and equipment capabilities. Schedules for air and sea freight activities are structured to provide maximum service to and from the European markets. Direct service to North America is, however, significantly limited. In the case of perishable articles, such as cut flowers, the availability of frequent and efficient air service to North America has prohibited at least one Moroccan exporter from expanding to the U.S. market. Another company has indicated that current sea routes require that products be transshipped through a European port to the U.S. which increases the shipment time and expense. Small and medium size Moroccan firms which might aspire to exporting are particularly hindered by the commercial shipping services, given the small volumes of these firms' shipments and the limitations of their financial resources.

7. Administrative Requirements and Procedures

Manufacturers commend senior Moroccan government officials whom they say have unanimously exhibited an awareness and understanding of the need to improve administrative requirements associated with the customs and foreign exchange control procedures for exporting. It is clear moreover, that increased flexibility has been recently introduced into customs and administrative procedures to allow accelerated development of exports.

However, administrative procedures are still criticized for excessive paperwork requirements and particularly for a general lack of motivation on the part of lower level customs staff to respond effectively to the needs of Moroccan exporters. Nevertheless exporters seem to consider customs procedures more of an annoyance than a significant constraint to their exporting activities. In particular established and experienced Moroccan exporters are familiar with managing the procedures and documentation required to export, and have developed the informal contacts with senior officials necessary to expedite the administrative process.

Perhaps most important are exporters' assessments of the customs regime of the temporary admissions (l'admission temporaire) for duty free imports of raw materials to be transformed and reexported. Several areas of concern are underlined. First, the process of government authorization for use of and release from Admission Temporaire status, while simplified, continues to be regarded as overly complex in time and paper required. Second, exporters

stress that the expensive bank bond required to guaranty any eventual payment of customs duties liability substantially raises the cost of production and acts as a limit on access to credit: banks apparently routinely deduct the bonded amount from a firm's credit ceiling for future working capital requirements. Additionally, some firms apparently have difficulty in obtaining partial release ("mainlevee partielle") from Admission Temporaire as AT-imported goods are liquidated, thus also raising costs. Many exporters suggest that an answer to these admission temporaire bonding difficulties could be the moral guaranty ("caution morale") currently used on an experimental basis in the rug industry. In this approach the Departement de l'Artisanat morally rather than financially bonds carpet manufacturers to guaranty the payment of any customs duties arising from domestic market sale of materials
imported under admission temporaire. Third, indirect exporters do not benefit from l'admission temporaire, which limits the availability of domestically produced inputs for export-oriented industrial development. While it would prove useful to apply the system to intermediate producers, Government is concerned that AT would be abused and that it would be difficult to verify whether the imported goods were actually used to produce parts later incorporated in articles for export or rather released on the domestic market. Finally, although procedures permitting manufacturers to establish their own wastage allowances applicable under admission temporaire have recently been provided for in the revised customs procedure, exporters report that customs officials often continue to challenge and delay application of these new wastage standards.

8. <u>Managerial and Technical Manpower</u>

Although Moroccan exporters have not underlined the availability of skilled labor as a problem for their current production activities, an expansion of the export economy will increase the demand for qualified manpower. Firms indicate that they now rely upon in-house training and apprenticeship activities to provide trained labor. Job creation as a result of an active export oriented industrial sector will call for enhanced productivity of Moroccan workers. Also, increased production for export will likely require development of vocational training and diversification of technical subjects in response to more varied export activities. However, the Government of Morocco has embarked on a major effort to strengthen the country's vocational training system. Moreover, a major IBRD funded education project due to be implemented shortly will include vocational education components to improve technical training and ease such shortages of skilled manpower that may emerge.

Some Moroccan firms have commented as to a lack of experienced management to fulfill various production and marketing requirements. The ecoles superieures, such as ISCAE, are currently undergoing a review of their curricula to improve and expand their education of management skills for new entrepreneurs. Language training is provided but there is a lack of opportunity to use their skills. Faculty from overseas universities -- especially from U.S. universities -- have not often been called upon to provide a U.S. perspective of production and marketing practices.

9. Energy Costs

Several entrepreneurs emphasized the high cost of energy as a key constraint to export development. Morocco's dependency upon expensive imported energy -- 80 percent of national energy needs are met through oil imports -- means that as energy costs rise, the cost of production for certain manufactured goods will thereby reduce their international competitiveness. For certain energy-intensive products export development is clearly impossible. While several exporters (e.g. ASMEX, the Association of Moroccan Exporters) has called for the subsidization of energy prices for industrial development, in view of Morocco's limited financial resources and present structural adjustments, this would not be a realistic or appropriate policy. Therefore, certain energy intensive products will simply remain outside the capacity of the industrial sector to produce for export.

10. Limitations of the ODI and CMPE Role in Export Development

ODI and CMPE provide an important source of general information and assistance for Moroccan firms interested in exporting. Nevertheless, these agencies can only function at a general support level rather than at an enterprise specific level. The implementation of aggressive marketing and production programs required to develop Morocco's exports to the U.S. can only be based on detailed and timely data tailored to a given firm's own production characteristics and activities. Further, a successful exporter requires continuous inter-action and information exchange with his existing and potential clients to develop and execute long term export marketing and production strategies. While ODI and CMPE can provide basic assistance to exporters, the critical enterprise- level marketing actions and technical information gathering can only be performed by Moroccan export businesses acting on their own behalf.

Through the Private Sector Export Promotion Project, USAID/Morocco will address some of the more important constraints to export development which are listed above. In order to reduce the perceived risk of expanding to new markets, USAID will help the Government of Morocco restructure and improve its export credit insurance program. The project will address the financing constraints of small and medium exporters through the establishment of a prefinancing facility. The project will address some of the technical and managerial weaknesses of Moroccan exporters through assistance in export production and marketing. The project is described in detail in the next section of this report.

III. PROJECT DESCRIPTION

A. Project Objectives

Goal:

The goal of the project is to improve Morocco's balance of trade and in so doing strengthen Morocco's debt-servicing capability.

Purpose:

The overall purpose of the project is to increase exports by Morocco's private sector. In addition, each of the project's three components has a specific sub-purpose. The sub-purpose of the export credit insurance component is to expand export credit insurance coverage so that at least 20% of insurable national exports are covered. Increased coverage should stimulate an increase in exports. The sub-purpose of the export prefinancing credit component is to expand export prefinancing credit to new users and hence facilitate their entry into the export sector resulting in increased exports. The sub-purpose of the production and marketing assistance component is to improve the export production and marketing of beneficiary firms, increasing their exports.

B. Project Components:

The project will have three components, each with a sub-purpose as indicated above: an export credit insurance component, an export prefinancing component, and a production and marketing assistance component. The insurance component consists of an \$8 million loan to assist Morocco establish an improved export credit insurance organization with significant private sector participation in ownership and management. A \$1 million grant for technical assistance will support the development and establishment of the new organization. Export credit insurance has the potential to be a powerful tool to support expansion of exports.

Export insurance alone is not sufficient, however, to cause rapid expansion of exports. Export finance resources must be available to complement the insurance program. Through the export prefinancing component, A.I.D. will lend \$8 million to meet the financing needs of small and medium exporters which arise in the export process before the exports are actually shipped. Enterprises new to the export sector will be in particular targeted.

The production and marketing assistance component will address Moroccan exporters' technical constraints through a a \$2 million grant. The results of USAID's private sector export promotion effort are expected to be significantly increased export production and sales in the medium term, and greater investment and employment in the export sector.

In the following section, each of the components is described in detail. Each component is analyzed in terms of the current weaknesses and constraints in the system, followed by a discussion of USAID's proposed interventions.

1. The Export Credit Insurance Program

No country has been able to mount a successful export drive without providing exporters with a reasonably inexpensive and flexible form of export credit insurance. The rationale behind export insurance programs is to mitigate the risks of selling abroad on credit terms, and thus encourage firms to expand their export sales to new buyers and new markets; export insurance also enables exporters to obtain non-recourse financing from commercial banks. In almost all countries where such credit insurance programs exist they have been government owned and operated.

A number of factors make selling abroad on credit terms riskier than selling domestically. Reliable information on foreign buyers from third parties is usually harder to obtain, and it is therefore more difficult to assess creditworthiness. General industry or sector trends may also be less well known, and a foreign seller does not benefit from the inside knowledge about his buyer which comes from the close daily contact on an informal basis which is available between domestic firms. In the event of default on credit, foreign sellers are further disadvantaged by their distance from the buyer and the lack of a local presence. It is usually more complicated and costly to enforce payment or bring suit, and foreign sellers may not be equitably treated in the courts of the buyer's country.

To address these and other problems involved in exporting, export credit insurance programs have been developed. These programs generally cover two major categories of risk: commercial risk and political risk. Commercial risk covers the buyer's failure to pay within a specified due date or the insolvency of the buyer. Political risk coverage insures the exporter against the possibility of war, riot, revolution, expropiation, a shortage of foreign exchange in the buyer's country, the default of a public buyer, or any action of a government which may preclude the buyer from paying. Political risk also includes catastrophic risk, e.g. cyclones, floods, earthquakes, and volcanic eruptions.

a) Morocco's current export credit insurance program

Morocco does have an export credit insurance program, but it is widely recognized among bankers, exporters and government officials that the program does not function well and must be improved substantially if it is to become a factor in stimulating exports.. The program is organized as a government service to exporters, backed by a national budget line item and managed by a department of the Banque Marocaine du Commerce Exterieur (BMCE). The BMCE is the second largest deposit bank in Morocco and is the primary provider of foreign trade financial services in the country. The Government of Morocco owns 56% of the BMCE, while the remaining shareholders are Moroccan investors and international banks.

The BMCE administers the export credit insurance program, yet holds a very limited role in decision-making and in formulating export credit insurance policy. The Ministry of Finance sets policy in accordance with the program's enabling legislation and holds decision-making authority on all political risk policies. An interministerial Commission reviews and approves commercial risk policies for individual exporters and handles the payment of all claims.

Although the export credit insurance program has been in operation for eight years, the program has yet to gain wide acceptance by exporters. Bankers agree that the current program has many weaknesses, hence they do not actively encourage their clients to take advantage of it. In sum, the program has had very limited success in encouraging firms to expand exports, in particular, to new buyers or to new markets.

Several factors account for these problems. First and foremost is a set of constraints relating to the program's location within BMCE. The success of the export credit insurance program depends on bankers' and exporters' knowledge and confidence in the program. However, given BMCE's significant role in the banking community, other commercial banks correctly view the BMCE as a competitor -- not a business partner. Bankers have been reluctant to develop relations with the BMCE's Export Insurance Department or to urge their client companies to do so, because of concern for their competitive position vis-a-vis the BMCE. Commercial banks fear that if they encourage their clients to obtain insurance, then competitive client information will be passed on the BMCE. Bankers currently encourage their clients to use the insurance program only when export financing cannot otherwise be done. In addition to the issue of competition, confining the program to the BMCE has excluded the participation of many interested actors in the business and financial communities in the insurance program; more general participation would increase knowledge and confidence in the program, as well as provide additional sources of capital.

A second set of constraints relates to the export credit insurance program's reserve fund. As currently constructed, the program has no real reserves. The insurance risks are covered by a 'technical reserve' of Dh 80 million (approximately $8 million) which appears as a line item in the GOM budget. The business and financial community are well aware of the fact that the program has no real reserves to cover risks, and this diminishes their confidence in the program's capacity to reimburse losses. The lack of real reserves also encourages the program's managers to be overly conservative in issuing policies. Furthermore, there is no regular mechanism for reinsuring risks with Moroccan or foreign reinsurers, obliging the program to assume 100% of any risk it covers in all but exceptional cases; this limits the program's potential coverage.

The administration and management of the insurance program highlight a third set of weaknesses. As noted above, a department within the BMCE administers the program. However, it lacks the independent authority to make significant decisions. Thus far, all decisions have been submitted for approval to the Interministerial Commission or the Ministry of Finance; this delays the time for processing insurance applications by several weeks, even for small or routine credit limits. The program's efficiency is also hampered by the lack of effective information management systems. The Export Insurance Department currently relies on extensive calculations by hand to administer the program and hence, professional staff are overwhelmed by administrative details. Little time can be spent on more effective management of the program.

The last set of weaknesses concerns public awareness of the program. Thus far, the BMCE's Export Insurance Department has been unable to undertake any systematic effort to develop close working relations with exporters and bankers; marketing has been completely passive. The lack of any serious marketing effort has curtailed the potential use of export credit insurance.

b) Restructuring Morocco's insurance program

USAID and the Government of Morocco have agreed to undertake a number of activities to restructure the export credit insurance program. While each of these activities is discussed in detail below, the core of the USAID-GOM effort consists of the following measures:

(a) Transfer the export credit insurance program from the BMCE to an independent entity whose ownership will be shared by the Government of Morocco and private commercial banks and insurance companies.

(b) Establish a real reserve fund for the export credit insurance program.

(c) Allow for reinsurance of commercial risk with Moroccan and foreign reinsurers.

(d) Streamline operating procedures and administrative procedures.

(e) Develop an aggressive public relations and marketing program targeted toward exporters, bankers and export promotion organizations.

(f) Provide technical assistance to implement and institutionalize these reforms.

An independent privatized export credit insurance organization The project will assist the GOM to establish a new export credit insurance organization; the key feature of this new organization will be the active involvement of the private sector in ownership, as well as management. The structure of the new organization will enable it to respond quickly and effectively to the needs of Morocco's export community; under the new organization, both the quality and availability of export credit insurance services will be improved to meet exporters' requirements.

A.I.D. will lend $8 million to the GOM to fund the reserves of the new organization. The GOM will on-lend these funds to the new organization at a rate 1% above the rate paid to USAID; this additional 1% will compensate the GOM for administrative costs of writing the loan agreement and of collecting the loan repayment. The new organization will borrow these funds from the GOM in dirhams and will repay the GOM in dirhams. The immediate effect of the real reserve fund will be to create confidence in the solvency of the insurance program, thereby encouraging increased use. Reserves will be invested in short-term Government securities at the highest available rates and investment income returned to reserves for loan repayment and claims payment.

The new organization will be jointly owned by the GOM and by commercial banks and insurance companies. Commercial banks and insurance companies will own at least 50% of the capital. The GOM, banks, and insurance companies will contribute a total of US $2 million as start-up capital, the individual portions depending on percentage of ownership.

Risk sharing will be governed by an agreement between the GOM and the new company, based on the following principles:

-- The GOM will assume all political risk and receive 50% of political/commercial risk insurance premiums for assuming this risk.

-- The independent company will assume all commercial risk up to the amount of invested capital and accumulated profits.

-- The GOM will assume all commercial risk in excess of available reserves. The GOM will receive 10% of commercial premiums for providing this reinsurance for commercial risk.

-- In addition to the reinsurance provided in the risk-sharing arrangement described above, the company will reinsure commercial risk, to the extent financially feasible, with Moroccan and foreign reinsurers.

Responsibility for the management and administration of the credit insurance program will be divided between the General Manager of the Export Credit Insurance (ECI) program and the Board of Directors. The General Manager will carry out the policies of the program as established by the Board of Directors. His staff will be trained specialists in one of the following areas: (a) finance and administration, (b) marketing, (c) underwriting, and (d) information services.

As a statutory corporation, the new entity will have a Board of Directors elected by the shareholders. The Board of Directors will be composed of representatives of the GOM, shareholder banks and insurance companies. The primary function of the Board of Directors will be to set overall policy for the organization. The Board will also establish a credit committee from among its members to make major credit decisions. This sub-committee structure for major credit decisions will allow for more frequent and regular meetings than the current Commission structure and expedite the decision making process.

Only the largest credit decisions will be submitted to the GOM for review and approval. These decision will be made by a separate committee of GOM representatives from interested Ministries and Departments; the composition of the committee will parallel that of the present Commission. The committee will also set general guidelines with respect to country exposure and will also have final decision-making authority on setting premium rates.

It is estimated that the General Manager and his staff alone will be able to make decisions on at least 50% of the applications, specifically, those involving relatively low credit limits. The Board of Directors will have to review approximately 40% of applications, those that involve higher credit limits. The GOM will set overall country limits and make decisions on the applications with the highest limits (approximately 10%). This credit decision-making formula will assure prompt decision-making and still allow the GOM to decide on the transactions and countries where it assumes the greatest risk.

Streamlining operational and administrative procedures In order to improve the efficiency of operational procedures, the following measures will be taken:

-- All operations will be mechanized using a micro computer. This will speed procedures, eliminate measurable amounts of paperwork, free up staff time, and provide accurate information for management planning purposes.

-- With external assistance, a management information system will be designed which will generate monthly financial statements and exposure information by country and industry. The system will also give accurate, up-to-date information on the processing of all inquiries, applications, claims and collections. Cost accounting and policy analysis systems will be implemented which will enable managers to pinpoint administrative problems and uneconomic policy holders and take appropriate actions.

-- All operating forms and procedures will be reviewed in order to streamline and simplify operating procedures. An internal operations manual will be prepared covering all functions of the export credit insurance program (marketing, credit information, underwriting, claims and collections, and accounting reserve management. All personnel will be instructed in the new forms and procedures.

-- A new application system will be developed to allow experienced exporters to calculate their own premiums. The export insurance staff will need to check calculations, but nonetheless, this will eliminate some of the more time-consuming paper work.

In order to streamline administrative procedures, the emphasis of underwriting will be changed from the foreign buyer to the exporter to the maximum extent possible. In underwriting insurance policies, the new organization will consider the following changes:

--Emphasize exporter's experience with the foreign buyer instead of solely considering foreign credit reports. Also, use bank reports. Exporter's and banks' actual experience with a buyer is the best predictor of future payment performance and is ignored in the current export credit insurance program.

-- Offer premium discounts for exporters who have a favorable track record with the insurance program. This will encourage the best exporters with good buyers to maintain insurance.

-- Offer reasonable discretionary authority to exporters who have solid track records with the export credit insurance program. This will increase exporter's flexibility in responding to new business opportunities and eliminate paperwork for the export credit insurance program.

-- Offer a premium discount for short credit terms (i.e. 60 or 90 days) instead of having a single rate for 1 - 180 days. This will make the program more attractive to many exporters who now sell on shorter terms, and will facilitate participation by more exporters.

-- Change claims payment procedures to allow for immediate payment on establishment of the fact that a buyer is bankrupt. Consideration will be given to reducing the waiting period for claim payment on protracted default from 6 months to 4 months. These actions will make insurance coverage more attractive to exporters and not increase risk to the export insurance program.

An aggressive marketing program The new insurance program will develop and implement an active marketing program to encourage greater use of export insurance. Given current staff levels at the BMCE, this marketing program will probably require an additional professional staff member. This individual will have full time responsibility for marketing. He/she will organize and attend export-related seminars and meet regularly with bankers, exporters and other government agencies to explain and encourage the use of export credit insurance.

Public relations materials will be necessary to familiarize banks and exporters with the program and to facilitate increased use of the program. Handbooks for exporters and instructions for banks will be prepared. Marketing materials will be developed for the program including a logo, brochures and pamphlets. An advertising campaign will be targeted toward the business and financial communities.

Technical assistance In order to implement and institutionalize the recommended reforms, a thorough program of external technical assistance will be required. The technical assistance effort will be designed to bring the latest and most effective techniques in export credit insurance to the

Moroccan program. The assistance program will seek to enhance the skills of existing staff, to train new officers and the commercial banks with which they will work, to introduce new disciplines and policy forms, to revise policies and procedures to the "state of the art," to change and expand the focus of management, and to introduce automated data processing and information procedures which will streamline the operation and improve the quality of decision making, organizational timeliness, flexibility and profitability.

The detailed elements of the recommended technical assistance program are as follows:

Advisory assistance for specialized management skills Work under this heading will consist of two categories: design and implementation. The design work will be done by a team of specialists in guarantees and insurance management, credit underwriting, claims and collections policy, and premium and reserve policy. The work of the team will include:

-- helping to insure a smooth transition from the current to the new organization, assisting with the drafting of any necessary legislation, regulations, registrations, etc. and preparing a plan for the organization and management of the new entity, including the recruitment of additional qualified personnel.

-- carrying out a detailed, comprehensive survey of the exporters and banks to determine their unfilled needs in export credit insurance and finance and their abilities to utilize new policies and procedures, in order to better tailor the export credit insurance program.

-- determining, in consultation with the Board and other responsible sources, the type and extent of the specific assistance to be provided the export community, including pre-shipment guarantees, and establishing the policy objectives, programs, instruments and procedures required to provide this assistance.

-- formulating new regulations, insurance forms, and improvements to the premium system, reserving policy, accounting, credit underwriting, and claims and collection procedures.

-- establishing for the first time a basis for reinsurance of the program's accounts, by working with the government and reinsurance companies within and outside Morocco to formulate satisfactory reinsurance agreement.

Following on the design effort, an advisor in guarantees and insurance management will assist in the implementation of new policies and procedures. The guarantees and insurance management advisor will help implement all systems, advise managers and operational personnel in how to discharge their duties most effectively, provide assistance in establishing improved relations with other export credit insurers worldwide, and help to assure that the policy objectives and requirements of the USAID program are being met.

Electronic data processing A comprehensive system of electronic data processing will be installed as an integral part of improving credit decision-making, accounting, forecasting, and effective insurance management. Grant funds will be utilized to purchase computer hardware, pre-packaged software and peripherals, and to develop new programs to facilitate data management.

Marketing program design and implementation Technical assistance will be provided to develop a marketing program. The program's aim will be to promote awareness of the existence and benefits of the export credit insurance program to Morocco's exporters and banks. Experts will develop a marketing plan to select target groups, to evolve a strategy for working with trade associations, government agencies and other interested parties, and to develop a format and schedule for marketing seminars and meetings. Two vehicles will be purchased by the project to facilitate the marketing program and will become the property of the organization upon the completion of the project.

Management training In addition to the on-the-job training provided by external advisors to the new organization, technical assistance funds will be used to cover the costs of specialized skill training outside the work place. This could include seminars at other export credit organizations such as the U.S. Eximbank or the FCIA, as well as specialized university or technical school courses in subjects as financial and credit analysis, computer science, and management.

2. Export Prefinancing Credit

The availability of credit at a reasonable price and on reasonable payment terms is an important element in the success of exporting firms. Export prefinancing credit is credit which is required during the pre-shipment preparation of export products, credit which enables the exporter to meet his working capital needs. Prefinancing is not tied to any specific expenditures and thus is available to cover virtually any expense related to the production of export goods from the purchase of inputs to the production and packing of the final product. Export prefinancing credit also helps meet administrative expenses and overhead requirements in the pre-shipment phase. In some cases, prefinancing may be extended to cover the cost of export development, such as market studies, international travel, and attendance at trade fairs. The export prefinancing credit facilities currently operating in Morocco work fairly well. However, there is a distinct bias in the system against the small and medium sized enterprises. This bias is caused by several constraints which are analyzed below. In order to facilitate the contribution of the small and medium sized enterprises to the export sector of Morocco, the project will provide an additional source of targeted financing and help eliminate these constraints.

a. Current Prefinancing Credit Facilities

Morocco's export finance program is managed by the central bank, the Banque du Maroc. In order to increase the availability and reduce the cost of export finance, the Banque of Maroc has established special facilities for export credit. The facility for prefinancing credit offers the following advantages:

(i) Lines of credit under the export finance program are held in a privileged position; theoretically, they do not come under the normal limits on credit expansion exercised by the Banque du Maroc.

(ii) Export credits are fully rediscountable with the Banque du Maroc bank given prior review and approval of the bank; they are not subject to the normal rediscount ceiling fixed for each commercial bank.

(iii) The Banque du Maroc refinances export credits at fixed rates of interest. As of September 1985, the central bank was "lending" funds to commercial banks for prefinancing credit at 6%; commercial banks passed these funds on to exporters at 8%. Hence, the refinancing facility enables commercial banks to support export-oriented transactions at a reasonable rate without having to commit their own resources.

(iv) The interest payable by the exporter is considerably lower under the official export finance program than from other credit sources. Interest rates for non-preferential credit are approximately 14%, while under the export finance programs, exporters obtain credit at an interest rate of approximately 8%.

Bottlenecks in the export prefinancing system are visible at four points: the level of available credit, the method of approving credit, access to credit for small and medium exporters, and inadequate coverage.

Credit availability: Problems in the availability of export prefinancing credit first arose in 1983. After a ten-fold growth in the value of export prefinancing credit between 1978 and 1982, the value actually declined by 9 percent in 1983. The number of approvals of prefinancing credit has not grown in the last four years.

The lack of growth in export prefinancing credit appears to be due to the central bank's adoption of strict export credit review policies in 1983. The Bank's principle fear is that firms will try to take advantage of prefinancing credit's preferred status and use the credit for financing domestic activities. The strict review policies may also be an attempt to carefully manage domestic credit and foreign exchange. In either case, the application of such policies to the export prefinancing system may have adverse impacts on the rate of growth of exports. As export production continues to expand, lack of flexible export prefinancing will emerge as an increasingly serious contraint to export development.

Furthermore, while export credits theoretically operate outside existing credit limits, some exporters suggest that prefinancing credits are in fact deducted from the credit exposure limits established by the commercial banks for individual firms. In practice therefore, export prefinancing may well be subject to growth restrictions.

Credit approval methods: Credit approval methods differ depending on the type of finance required by the exporter. In the case of post-shipment finance, the level of credit is strictly determined by export sales. In the case of export prefinancing credit, the methods of approving credit are considerably more complex and bottlenecks easily arise.

The decision to extend export prefinancing credit is initially made by the exporter's commercial bank. The bank then makes an application on behalf of its exporter client to the Banque du Maroc. The application requires the following information: (1) the use of the requested credit; (2) three years financial statements including details on accounts related to cash needs such as receivables, inventory, supplier credits and a number of standard banking ratios; (3) the volume of exports for each of the last three years by country; (4) export projections including firm orders; (5) projections of cash needs for the next 12 months; (6) a summary of authorizations and use of credit; (7) a commentary by the bank on the company and its export credit needs; and (8) a confirmation from the Office des Changes of the amount of export proceeds repatriated the previous year.

Based on the above considerations, the central bank determines an annual limit on prefinancing credit for each exporter. In general, the limit is equal to approximately 10% of the previous years' exports. The Banque du

Maroc does set more generous limits for exporters who sales are highly seasonal or for those who have received substantial firm orders from abroad. Pre-financing for up to 50% of exports may be granted in seasonal situations. However, in these cases fixed pay downs are required on a set maturity schedule.

Very few credit applications are turned down outright, although many are approved for amounts less than requested. The Banque du Maroc assumes that many banks generally ask for more credit than is needed. The Banque du Maroc's primary concern is <u>not</u> the exporter's financial situation since the commercial bank is at risk, but rather the potential abuse of the preferential status of export credit. The Banque wants to ensure that the beneficiary of the prefinancing credit actually exports and that funds are not used for domestic needs. Hence, the record of the the exporter in repatriating foreign exchange is critical in determining how much credit is approved.

The many steps required to approve prefinancing credit create bottlenecks in the system. One of the drawbacks of the current system seems to be the length of time the Banque du Maroc takes to approve prefinancing lines. Commercial bankers generally agree that the approval process has been faster in recent years. However, most approvals still take from 3 to 4 weeks to process and some approvals take considerably longer. Given that the export sector tends to be very time sensitive, this is an important issue for many exporters. In response to these criticisms, the Banque du Maroc notes that many applications received are incomplete, and particularly lack the confirmation from the Office des Changes of the amount of export proceeds repatriated in the previous year.

Secondly, some commercial banks and exporters believe that the amounts approved are insufficiently related to the actual needs of individual exporters. This problem is largely due to the bank's focus on <u>past</u> export proceeds, as opposed to <u>projected</u> export production. Since prefinancing credit supplements working capital, it is the current and projected production cycle which in fact determines an exporter's need for prefinancing credit. The central bank's 'historical' focus creates special difficulties for firms who are new to the export sector or for firms whose exports are growing very fast. This problem is compounded by the fact that credit ceilings are revised only once a year for each firm.

Lastly, the application process is clearly cumbersome. Given that the Banque du Maroc's principal concern is proof of production for the export market and not the domestic market, it is unclear why the Banque needs to review detailed applications. The application process is particularly difficult for small and newer companies. They frequently encounter problems in preparing the required adequate financial statements without substantial assistance.

<u>Access to credit for small and medium exporters</u>: All export goods are in theory eligible for the export financing programs. As currently constructed though, the scheme has a natural bias in favor of larger and more established exporters. The export finance program is mainly useful to a select number of

firms, representing about half of the number of firms exporting, many of which are publicly-owned or very large and well-off financially. There is little evidence that current participants in the program receive inadequate credit lines. However, the program is least successful in reaching smaller and newer firms.

The banking system in Morocco tends to be extremely conservative in its lending practices, particularly in the case of the export prefinancing program. The banks have stringent collateral requirements for export prefinancing, hence only large and experienced firms can gain access to preferential finance. Small and new firms often lack sufficient capital and collateral; furthermore, they frequently lack the export track record required by for the Banque du Maroc for obtaining prefinancing credit. Small and new enterprises are in effect blocked from participating in the official export finance programs.

Given these restrictions, small and new firms experience great difficulty in meeting their financing requirements. According to the World Bank, over 45% of a sample of small and medium enterprises used no bank credit at all and more than a third of the firms financed their operations from equity capital. This accounts for the tight cash position of many small and medium enterprises and their problems in maintaining adequate inventories or accepting large orders. Many small and medium enterprises have signficant export potential: in general, their ratios of employment and value added to invested capital are quite high and a number of them are already involved in production for export. Their potential for export-related activities should be encouraged, not hindered.

Inadequate coverage: As presently established, the export finance system provides preferential access to credit to direct exporters exclusively. As export production begins to increase, indirect exporters -- those manufacturers who produce the inputs required by direct exporters -- will have an increasing need for prefinancing credits. Expanding the export prefinancing system to include indirect exporters is critical to the growth of backward linkages in the export sector. Unless the system can expand to include their legitimate export-related financing needs, additional constraints to export development will arise.

b. USAID/GOM Interventions

In order to address the limitations of the existing finance program, the project will establish a new $8 million export prefinancing credit facility to be jointly managed by the Banque du Maroc and several commercial banks in Morocco. The new facility will be designed to address the export credit needs of small and medium enterprises and to stimulate increased export activity among such producers. These enterprises have considerable export potential, yet it appears that their activities are currently limited by lack of access to export pre-financing. As export production in Morocco continues to expand, the demands on the current system will be greater, thereby further limiting small entrepreneurs' access to export finance.

The new export prefinancing credit facility will be based in many respects on the existing facility. Exporters will continue to apply for prefinancing credits through commercial banks and export credits will continue to be refinanced through the Banque du Maroc at standard export prefinancing rediscount rates. However, as currently constructed, the export prefinancing facility meets only a portion of the credit needs of the export community. In order to address the needs of smaller exporters, the new credit facility must be more flexible than the existing system. Furthermore, significant changes must be made in the following areas: (i) the 'mechanics' of the prefinancing system; (ii) the eligibility criteria; (iii) the credit approval process; (iv) the criteria for determining credit ceilings; and (v) the extension of credit to indirect exporters.

The Mechanics of the Prefinancing System: AID will lend $8 million to the Banque du Maroc. The equivalent amount in local currency will be disbursed to commercial banks through the existing refinancing mechanism at the Banque du Maroc. The proceeds of the U.S. loan will be used to finance local dirham costs of export production. Exporters will borrow from the commercial banks at a rate of 10% and banks will obtain funds from the central bank at a rate of 8%. Although the spread to the commercial bank will be the same as under the current program, both banks and exporters will pay 2% more than they do presently.

The 10% interest rate to exporters is justifiable on a number of grounds. Although this rate is 2% higher than the current rate, it will still act as an incentive for small and medium firms because, up to now, these enterprises have had either no access to credit or have obtained limited amounts of credit at rates of 14% or higher. Most importantly though, increasing the interest rate will be an important step toward bringing export credit rates in line with market rates of interest and the rate of inflation. A 10% interest rate is above U.S. Treasury borrowing rates for similar maturities and approximates the opportunity cost of capital in the local market. Hence, the new prefinancing facility will have the added benefit of demonstrating to the Government that it can raise export credit rates while remaining competitive with the export credit rates offered by other countries. Eventually, this will help Morocco reduce its cost of providing export finance incentives.

Reflows, including principal and interest, from the new prefinancing facility will be rechannelled through this facility to make new loans to small and medium-sized enterprises on the same terms and conditions.

Eligibility criteria The new prefinancing credit facility will be targeted to small and medium exporters. The eligibility criteria for participating in the program will be as follows:

- The exporting firm is small or medium sized; i.e. the firm's total equity capital is less than US $765,000.
- The exporter does not have access to the existing pre-financing facility.
- The firm has specific orders for exports.
- The firm has the capacity to produce the goods to fulfill orders.
- The firm obtains pre-shipment insurance for export sales.

<u>Improved credit approval methods</u>: In an effort to streamline and expedite the credit approval process, new procedures will be instituted.

-- Delegate increased authority to commercial banks, taking minor decisions out of the hands of the Banque du Maroc. Responsibility for analyzing the financial position and needs of each exporter will be transferred from the central bank to commercial banks It is in the interest of the commercial banks to provide credit to only the most creditworthy customers, hence there is no need for central bank review in this step of the credit approval process.

-- Submit to the Banque du Maroc only those requests for the highest credit limits, as well as applications from rapidly-growing companies and companies with seasonal production cycles.

-- Require that exports have a minimum percentage of Moroccan value added, e.g. 50%, to qualify for pre-financing approval by the commercial banks. If less than the fixed percentage, the application would be submitted to the Banque du Maroc for consideration.

-- Revise approvals semi-annually based on increases in exports during the prior six months.

-- Require commercial banks to have proof of foreign exchange repatriation.

-- Assess penalties on banks if it is shown that loan approvals were given when the specific criteria were not met.

For the delegation of export prefinancing approval to the commercial banks, the Banque du Maroc will prepare a comprehensive statement of policies and rules to govern the approval of credit. A handbook for exporters will also be prepared and circulated to describe the procedures of the program to potential beneficiaries.

<u>Criteria for determining prefinancing ceilings</u>: Prefinancing ceilings for enterprises should be computed on the basis of projected annual sales, as opposed to historical data as at present. Exporters must provide satisfactory evidence that the export program is feasible and is likely to be carried out. This would favor exporters with rapidly growing sales.

<u>Extension of Credit to Indirect Exporters</u>: A study will be undertaken to determine the prefinancing credit needs of indirect exporters. Based on the results of this study, prefinancing credits may be provided through the new export prefinancing facility to indirect exporters who can clearly demonstrate the export orientation of their production. Adequate safeguards must be established in the program to ensure that financing actually contributes to exports.

3. Export Production and Marketing Assistance

Establishing a more effective insurance program and a targeted financing facility will remove some of the key constraints to export expansion in Morocco. However, lack of sufficient knowledge and skills among many exporters prevents them from competing effectively in the demanding international marketplace. For instance, USAID's preliminary studies of the export sector indicate that Moroccan exporters frequently experience difficulties meeting the quality and quantity requirements of overseas buyers. These studies also indicate that while Moroccan exporters are eager to explore new markets, they frequently lack the knowledge and experience to successfully penetrate these markets. Hence, there is a significant need for technical assistance among exporters of all sizes and sectors.

To address these needs, the the third component will provide the following:

(i) A long-term advisor based in the Moroccan Center for Export Promotion (CMPE).

(ii) Expansion of the current assistance being performed by the International Executive Service Corps (IESC).

(iii) A USAID-managed Export Development Activities Fund to finance export promotion activities and studies proposed by the long-term advisor, the IESC, and the USAID Private Sector Office.

1. <u>A Long-term Advisor in CMPE</u> The primary function of the long-term advisor will be to act as USAID's resource for gaining knowledge and experience with Morocco's major export promotion organizations and with the export community in general. The advisor will be based in CMPE and will work closely with a high-level counterpart in that organization. From the CMPE base, the advisor will be in a good position to acquire in-depth knowledge of the export sector, and hence, to advise USAID as it moves toward greater involvement in export promotion activities. The candidate for this position will have had hands-on experience in producing and marketing for export, as well as experience in implementing export promotion programs in developing countries.

As Morocco's official export promotion institution, CMPE is the most appropriate base for USAID's long-term advisor. CMPE is characterized by dynamic leadership and has been very active in promoting Moroccan exports in a wide variety of foreign markets. However, because of its public nature and modest budget, CMPE is somewhat limited in the scope of the activities it can undertake. The advisor will therefore also develop close working relationships with institutions that provide services to the export community, including the Confederation Generale des Enterprises Marocaines (CGEM) -- the principal Moroccan employers' association -- as well as the Federated Chambers of Commerce and the International Executive Service Corps.

The advisor will be based in CMPE for a period of two years. During the first year, the advisor will focus on identifying exporters' needs and developing alternative strategies for meeting those needs, particularly those related to marketing. The advisor will work closely with CMPE staff and USAID's private sector office to define a strategy for increasing USAID involvement in export promotion. This will include examining to what extent and through what means USAID can provide assistance that will have long-term institutional benefits to these institutions. The advisor will also review and assess those exporters' needs that have been previously identified, arrange these needs in terms of priority and viability, and prepare a detailed program to address those needs. This program should be submitted to the Private Sector Office for review and approval within twelve months from the time the advisor's assignment begins. Some previously indentified activities will be implemented during these first twelve months. Finally, based on his experience and increasing knowledge of Morocco's private sector export community, the advisor will identify other needs or concerns that have not been previously or adequately identified, and will prepare a strategy for addressing these needs. This strategy will take into account and complement activities already planned.

Based on studies done to date, some of the activities which the project manager and his CMPE counterpart will initiate during the two-year period include:.

a. Export Education: With A.I.D. assistance, CPME will sponsor -- or co-sponsor with CGEM -- a series of lectures, seminars and workshops designed to meet specific needs of private export-oriented firms. Some topics such as the General System of Preference and the Uniform Product Coding System will be of broad interest to exporters. However, other important concerns tend to be product-specific or sector-specific. These issues will be dealt with in a more intensive workshop setting where an industry expert will be able to address the special concerns of Moroccan entrepreneurs within a particular sector. In cases of more highly specialized or technical interest, the advisor may work directly with one of the several industry federations that exist under the 'umbrella' of the CGEM. Possible topics for this component include textile labeling and flammability standards, pure food and drug regulations, consumer safety regulations, sector-specific overseas import regulations, issues relating to product design for export and to agribusiness and manufacturing.

AID assistance will finance experienced and knowledgeable specialists in the above areas. As a rule, CMPE or CGEM will organize and sponsor the seminars either jointly or separately. This will involve providing facilities, logistical support and publicity for the seminars. Other business organizations such as the Federated Chambers of Commerce will be invited to participate. Small and medium firms' participation in these activities will also be encouraged.

b. Short-term Advisory Assistance to CMPE The project advisor and his counterpart will develop a strategy for strengthening CMPE's capacity as an official export promotion institution. The advisor's knowledge of export promotion programs in other developing countries and the counterpart's knowledge of the Moroccan governmental and business environment will enable the team to identify institutional weaknesses and appropriate solutions. The project will provide short-term advisory assistance to CMPE in accordance with the team's recommendations.

c. Training The advisor will identify and finance training needs and opportunities for CMPE employees and selected Moroccan exporters. This will include conferences, seminars, and short-term training courses related to the production and marketing of exports.

d. Export Development Studies and Activities The project advisor and his counterpart will be responsible for identifying and designing special studies and promotional activities to benefit the export community at large. Proposals for studies and activities will be discussed and reviewed with USAID's private sector office and, if approved, financed by the USAID-managed Export Development Activities Fund.

e. Linkages with CGEM The project advisor will coordinate project activities with CGEM in an effort to create stronger linkages within the export community. CGEM represents four major industry federations and encompasses many private business associations and manufacturing firms. As the principal employers' association, it represents the Moroccan private sector vis-a-vis the government. Through close contact with CGEM's member firms and associations, the project manager will be better able to define exporters' needs and address those needs through collaborative programs with CMPE. For example, the product-specific and sector-specific seminars and workshops proposed above will be of particular interest to CGEM members. In addition to these educational benefits, the CMPE-CGEM linkage created under the project will also enable the two organizations to share information more effectively. This will in turn help CGEM improve its weekly newsletter Cedies Information.

f. Linkages with IESC The project advisor will also work toward creating stronger linkages between Morocco's export promotion institutions and the International Executive Service Corps (IESC). These ties will help the IESC publicize its activities to potential clients in the export community, and thus, enlarge its role in providing firm-specific technical assistance to Moroccan exporters. In projects that he has developed, the project advisor can work with the Country Director to assist in identifying and assessing a firm's technical needs. Through his ties to the export community, the advisor will be able to act as an information conduit between potential recepients of technical assistance and the IESC. The advisor may want to call upon IESC volunteers to assist in carrying out export seminars at CMPE or CGEM, and may explore possibilities for closer institutional linkages between IESC and CGEM, or other business associations.

Given that the project manager will be based in CMPE, the success of this project component depends in large part on CMPE's commitment and willingness to play an active role in project implementation. Thus far, CMPE's response to USAID's proposals has been enthusiastic. As part of its contribution to the project, CMPE will assign a full-time counterpart to the project and will provide office space and secretarial support for the project advisor. CMPE will also provide the facilities and logistical support for all project activities. Lastly, the organization will be actively involved in designing and implementing export development studies and activities funded by the project and in defining a strategy for future project development.

2. Firm-specific Consulting Services CMPE provides an important source of information and assistance for Moroccan firms interested in exporting. Nevertheless, this agency can only provide general support level to exporters, rather than technical expertise that is enterprise or industry specific, based on in-depth knowledge of and experience in a particular industry. Such expertise and knowledge is provided by the International Executive Service Corps (IESC).

As a non-profit organization, the IESC extends technical and managerial services to developing countries through its skills bank of 8000 retired executives. IESC initiated a program in Morocco in February 1985. Since that time, the organization has provided technical services to twenty-six firms in the private sector, many of which are currently exporting goods or have the potential to do so in the future.

In an effort to meet the technical and managerial needs of Moroccan firms, USAID will increase its support to IESC under the project. The aim of this support will be to improve Moroccan firms' capacity to produce and market for export.

The increased support will cover a 36 month program of activities, with an estimated cost of $1.246 million. Funds would be allocated and assistance provided using a three pronged approach.

The first and principal means of providing assistance will be an enlarged program of assistance to firms. The IESC will initiate approximately 36 projects per year, or an average of three per month. At least 90 percent of these projects will be with small and medium sized companies. Also, at least 90 percent of the projects will be with private sector firms who export or who have the potential to do so. Up to 10 percent can be with institutions that provide support to the export sector, either direct or indirect. The IESC will attempt to obtain an averge of 50 percent of the project costs from the client, but in any case the AID contribution will be limited to $6000 during the first year of the project. In the following two years of the grant, the client contribution is expected to increase as a proportion of the total project cost.

A second activity will involve technical assistance to groups of manufacturers facing similar export problems. An example would be providing an expert in quality standards for fruit and vegtable exports. The expert, working through or in conjunction with an association of firms, could establish testing standards that would satisfy quality or grading requirements in the principal markets to which products are currently shipped, as well as to markets in which exporters seek to establish a niche. It is estimated that approximately eight projects of this type will be carried out during the three year life of the project. Each project is estimated to cost $50,000, of which project funds would be used for no more than 50 percent of the total cost.

A third activity under the expanded IESC program will be a special program of assistance to manufacturers in the agro and agro-industry sector of the export community. Under this activity, experts with lengthy expertise in a particular agro-industry will work with several firms in an industry and will work with them in correcting problem areas. Whearas the second activity mentioned above will be aimed at at more general needs, affecting firms in similar industries, such as exporters of fresh fruits and vegtables, this third activity will be aimed at specific problems of a single industry, such as processing and marketing of fresh fish, or cut flowers. This would include, for instance, training and assistance aimed at preparing firms to package and market goods which will meet the tastes and standards of buyers in specific markets.

An additional portion will be alloted to direct support for IESC management and overhead in Morocco. This will represent approximately 8 percent of the total.

3. <u>Export Development Activities Fund</u> This discretionary fund will be managed by USAID's private sector office and will be used to finance activities and studies relating to export development in Morocco. It is envisioned that many or most of these activities and studies will be developed by the long-term advisor and, to a lesser extent, by the IESC, in conjunction with the officials in the private sector office. In addition, the fund will be used to finance activities it develops on its own, or in response to requests from the GOM that will benefit private sector exporters. USAID has already received several requests from the GOM to fund conferences and activities supporting exporters. One example is a conference on development of export market strategies. Given the newness of the private sector program and the partially exploratory nature of this project component, the private sector office needs a flexible source of funds to take advantage of such opportunities when they arise.

C. Summary of Project Outputs:

A new private sector oriented export insurance facility will be established to expand insurance coverage and insure a larger amount of Moroccan exports. It is expected that the facility will be at least 50% owned by commercial banks and insurance companies and will insure at least 20% of insurable national exports.

An export prefinancing credit facility established for small and medium and first time exporters. Given reflows from the initial $8 million used to fund it, this new credit facility can be expected to provide additional annual authorizations for short term prefinancing credit to small and medium sized firms which aggregate to at least $30 million over a five year period.

Management and technical skills improved in firms assisted by the IESC.

Improved export insurance information and services provided by Moroccan institutions.

Studies and activities supporting export promotion undertaken.