USAID/Morocco

Privatization Sector Assistance Project

Economic Impact Analysis

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TABLE OF CONTENTS

EXECUTIVE SUMMARY

A. PURPOSE

The Government of Morocco (GOM) is committed to significantly expanding and strengthening its private sector and has made the privatization of state-owned entities (SOEs) a national priority, with 112 designated by the Government for immediate privatization. Given the substantial cost involved in pursuing such an ambitious privatization program, the US Agency for International Development proposes to establish a Privatization Sector Assistance Project to help finance the privatization of SOEs and encourage the government's nascent privatization efforts.

The purpose of this study is to evaluate the current economic situation in Morocco and the role played in the economy by state-owned enterprises, and to predict some of the likely effects of privatization on Morocco's economy. The study adopts a sectoral approach, discussing the effects of privatization on various sectors of the economy, and does not attempt to assess the impact of privatization on specific entities.

B. BACKGROUND

After years of pursuing a highly interventionist economic policy, in which the "Moroccanization" of economic assets figured prominently, the Government of Morocco has now firmly committed itself to economic liberalization and a marked diminution of the state sector. In a Speech from the Throne at the opening of Parliament in 1988, King Hassan II articulated the need for privatization by expressing concern over the "excessive and unjustified growth of the public sector and the proliferation of unnecessary and useless state-owned enterprises and SOE-subsidiaries[1]." This was followed by the appointment of a Minister for Privatization and enactment of Law 39-89 on December 11, 1989, authorizing the divestiture of state-owned enterprises. In October, 1990, the Council of Ministers promulgated regulations governing the privatization process[2] and the reconstituted Ministry of Economic Affairs and Privatization has since worked closely with USAID, the World Bank and other international organizations on privatization-related activities.

C. FINDINGS AND CONCLUSIONS

1. Importance of Privatization to Macroeconomic and Sectoral Performance

- **Privatization will result in a substantial reduction in the size of the public sector and will foster the continued liberalization of the Moroccan economy.**

  The government's privatization program complements existing efforts to restructure Morocco's public finances and reduce its burgeoning public sector. Privatization will expose enterprises to market forces, causing them to become more competitive and efficient. As a result, the market and not the government will determine investment and the optimal allocation of resources.

  As a number of SOEs currently receive subsidies and financial assistance from the government, their privatization will reduce claims on scarce budgetary resources, enabling these to be put to better use. At the macro-economic level, privatization will result in over 35,000 jobs being transferred from the public to the private sector, with the state ceasing to play a major role in the banking and tourism sectors of the economy. Petroleum processing will also be de-nationalized in the first wave of privatizations. As measured by contribution to Gross Domestic Product (GDP), the state-owned sector of the economy will shrink by almost one-third.

- **Privatization will enable enterprises to invest as they see fit, eliminating excessive regulation and oligopolistic practices.**

  Privatization will free enterprises of the requirement that their investment plans be approved by the government, and management and owners will assume responsibility for all investment decisions. This will improve accountability and the efficient utilization of resources, with notable benefits accruing to consumers and the macro-economy. Privatized entities will also no longer be required to invest in Treasury notes or maintain fixed price schedules, but instead will be able to respond to market conditions, resulting in major resource gains throughout the economy.

- **Privatization will create conditions conducive to foreign and domestic investment, greatly benefitting key sectors of the economy.**

  Increased investment in the industrial, tourism and commercial sectors of the economy will facilitate the modernization and expansion of facilities. Privatization of the hotel stock will attract much-needed foreign investment in this important sector of the economy, and investment in the industrial sector will increase its efficiency and international competitiveness. Similarly, de-nationalization of the energy sector could lead to further development of new energy sources, with growth in the financial and banking sector helping finance further growth in the economy.

- **The concentration of state-owned enterprises in certain sectors of the economy will accentuate the impact of privatization on the economy.**

  This phenomenon is particularly evident in the energy sector, where the de-nationalization of Mobil, Shell, Petrom-Gaz and Dragon-Gaz will result in the privatization of essentially the entire sector. Similarly, the anticipated privatization of the Societe Centrale de Reassurance will have far greater impact than is at first apparent since all reassurance must currently be channeled through the company, resulting in notable cost inefficiencies and anti-competitive pressures. Elimination of these practices via privatization should reinvigorate what has been a relatively moribund industry. In the case of the banking and financial sector, privatization of the ten financial institutions proposed by the government will result in the virtual privatization of the entire sector, leading to the increased availability of credit and enhanced growth prospects for the economy.

2. <u>Costs and Benefits of Privatization</u>

- **Privatization will be accomplished with only nominal labor displacement, with economy-wide job losses in the range of 4-7%.**

  In most instances, labor dislocations arising from the privatization of SOEs will be transitory, with most displaced workers being absorbed by other enterprises. Unemployment of a more permanent nature is only expected in the sugar-processing subsector, where industry consolidation is expected to produce job losses in the range of 7%. In the medium- to long-term, an expanding private sector and generally improved macroeconomic conditions is expected to generate an increased need for labor, with positive net employment effects.

- **Structural changes arising from privatization will require renewed emphasis on re-training programs and skills development.**

  While the net employment effects of privatization will be small and quite manageable, many workers will nonetheless need to be re-trained. To become and remain competitive, privatized state-owned entities will need better trained and productive labor forces. Employees lacking the requisite skills will need to be re-trained, and those in obsolete industries will need to be assisted in finding new employment. By emphasizing skills re-training, it will be possible to substantially reduce labor displacement and respond to what is certain to be a growing need for well-trained employees.

- **Asset sales will produce substantial government revenues that can be used to retire debt and improve government services.**

  While no estimates currently exist as to the magnitude of these receipts, the proceeds from privatization transactions will enable the government to reduce its external debt and help clear accumulated arrearages. This will eventually translate to lowered domestic interest rates and increased availability of credit to private and productive enterprises. As the government's financial situation improves, it will also be possible to reduce marginal and effective rates of taxation, further stimulating economic growth. It will also be possible to improve government services as funds used to subsidize inefficient state-owned entities are put to better use.

3. <u>Importance of Project to Privatization Process and Morocco's Reform Program</u>

- **Without the Privatization Sector Assistance Project, privatization may come to a halt, with serious long-term implications for the Moroccan economy.**

  USAID support at this time is vital if opposition to economic reform is to be overcome and if the government's adjustment policies are to succeed. The government has been unequivocal in stating that this is but the first phase of privatization. Other state-owned enterprises not on the initial list of 112 are currently being restructured as a prelude to privatization, and others are being merged or liquidated. However, the government has also been clear in stating that whether future privatizations occur depends on the results of the current privatization program, and to the availability of foreign technical and financial assistance. As the largest such project in Morocco, the Privatization Sector Assistance Project is uniquely well-placed to address identified needs and assist the government in fundamentally re-structuring the economy.

- **The proposed Privatization Sector Assistance Project will play a key role in promoting privatization by financing over one-third of the cost of the government's privatization program and by demonstrating the Agency's unequivocal support for privatization.**

Provisional estimates by the Ministry of Economic Affairs and Privatization and the World Bank suggest that privatizing all 112 SOEs will cost between $70-90 million, depending on the degree of pre-privatization restructuring required. Of this amount, the proposed USAID project will cover roughly one-third. It will thus be instrumental in alleviating funding and staffing problems that have delayed the privatization process, and will enable the Ministry of Economic Affairs and Privatization to complete upwards of 50 privatizations by year-end 1995.

Similarly, given the emphasis the Mission has placed on privatization in its negotiations with the Government of Morocco, the project has great symbolic importance. Failure to proceed would be a severe blow to the Ministry, tantamount to a vote of no confidence. It would also severely prejudice the ability and willingness of the Ministry to implement its privatization program and could derail the entire process. While such factors cannot be quantified, the credibility of the government and the Mission are inextricably linked with the success of the project.

SECTION I

INTRODUCTION

A. OVERVIEW OF MOROCCO'S PRIVATIZATION PROGRAM AND THE PRIVATIZATION SECTOR ASSISTANCE PROJECT

The Government of Morocco (GOM) has recently enacted legislation mandating the privatization of state-owned entities (SOEs) and formally ending the period of "Moroccanization" of economic assets. After several decades of pursuing a highly interventionist economic and industrial policy, in which the creation of state-owned entities and the nationalization of foreign-held economic interests figured prominently, the Government has now committed itself to significantly expanding and strengthening the private sector. The creation of new public enterprises or subsidiaries is prohibited, and a Minister of Privatization has been appointed to oversee the privatization process.

Cognizant of the financial and technical constraints facing the Government of Morocco as it seeks to implement privatization, the US Agency for International Development (USAID) proposes to implement a Privatization Sector Assistance Project. This multi-year project will provide the Government with $20 million in non-project assistance and $5 million in technical assistance. To be disbursed in tranches, USAID funding will enable the government to design public information and awareness programs and secure much needed technical expertise.

B. PURPOSE OF THE STUDY

The purpose of this study is to evaluate the current economic situation in Morocco and the role played in the economy by state-owned enterprises, and to predict some of the likely effects of privatization on Morocco's economy. The study adopts a sectoral approach, discussing the effects of privatization on various sectors of the economy as well as the macro-economy, but does not attempt to assess the impact of privatization on specific entities nor evaluate the condition of these entities. The study acknowledges that privatization in Morocco is occurring in the context of structural adjustment and that the success of the later will have a major impact on privatization and its goal of achieving a fundamental re-balancing of Morocco's public and private sectors.

C. SCOPE, METHODOLOGY AND LIMITATIONS

In addition to analyzing the current economic situation in Morocco and the need for the Privatization Sector Assistance Project, this study reviews the country's state-owned sector and the importance of privatization to macroeconomic and sectoral adjustment. The scope of work for the project included:

- Establishment of a baseline privatization scenario
- Examination of the structure and performance of the state-owned sector
- Identification of the principal macroeconomic effects of privatization
- Discussion and, to the extent possible, quantification of possible secondary or tertiary effects
- Analysis of the costs and benefits of privatization to specific sectors and the macroeconomy
- Discussion and estimation of the overall cost of the government's privatization program.

Secondary sources of data were collected during the first week in Morocco. Reference was made to statistics and data gathered and compiled by the Ministry of Economic Affairs and Privatization (MAEP), the Ministry of Finance and Ministry of Statistics, as well as by the local USAID mission. Extensive reference was also made to data collected by the World Bank and IMF during its 1987 and 1990 appraisal missions. Wherever possible, the most recent data was used and, except where noted, all data is current through 1989.

After a thorough analysis of available economic, social and political data and a review of associated World Bank, USAID and IMF studies, interviews were conducted with USAID officers and representatives of the Ministry of Economic Affairs and Privatization and Ministry of Commerce. Personal interviews with USAID and Ministry officials were used to gain a better understanding of the context in which privatization is occurring and how the proposed Privatization Sector Assistance Project will complement this process. These interviews also yielded information on the various financial, technical and political constraints affecting the privatization process.

The major difficulty encountered during this study was the lack of any definitive listing of state-owned enterprises. No authoritative information exists on Morocco's state-owned sector and labor, investment and economic statistics must be treated with caution. In some instances, an entity in which the government holds but a minority share was found to be classified by the government as a state-owned enterprise, whereas others were classified as privately-held. Furthermore, some statistics classify employees of state-owned enterprises as government employees while others do not. Similar problems exist with World Bank and IMF data. As a result, comparative analysis of the privatizable and non-privatizable state-owned sectors is problematic.

D. ORGANIZATION OF THE REPORT

This report consists of four sections. Section II reviews Morocco's privatization program and establishes a baseline privatization scenario. Section III analyzes the impact of privatization on various sectors of the economy as well as on the macro-economy, and identifies its primary and secondary effects. Section IV discusses the efficacy of the proposed project in achieving program goals and objectives. The annexes provide detailed information on the Moroccan economy and the state-owned enterprises scheduled for privatization, as well as on pertinent macroeconomic indicators.

SECTION II

PRIVATIZATION AS AN ECONOMIC STRATEGY

A. MACROECONOMIC OVERVIEW

The Government of Morocco's privatization program is an integral component of its efforts to fundamentally re-balance its public and private sectors. Whereas prior to independence the government rarely intervened in the economy, after 1956 the state-owned sector increased dramatically, until by 1989 there were over 670 state-owned entities. So extensive has the network of state-owned and parastatal enterprises become that the government has been unable to calculate precisely the size of the public sector or the dollar-value of subsidies granted state-owned entities. This trend accelerated in the 1970s following adoption of a policy of "Moroccanization" wherein foreign-owned firms were transferred to Moroccan ownership and strict limits were placed on the foreign ownership of economic resources. Later, existing SOEs created subsidiaries, and it is this "subsidiarization" phenomenon that lead to explosive and, ultimately, unsustainable growth in the state sector. In the five-year period from 1973 to 1977, 92 percent of newly created public enterprises were subsidiaries of existing ones, with 52 new SOEs created in 1974 alone[3].

As in the case of most countries pursuing highly interventionist economic policies, the growth of the state sector has been accompanied by increasingly unfavorable conditions for private enterprise and the promulgation of credit and economic policies inimical to private sector growth and development. State-owned entities have been able to borrow and trade on favorable terms, and preference continues to be shown state sector firms in the awarding of contracts. While this has resulted in substantial investment incentives to state-owned industry, it has not been successful in increasing productivity or improving international competitiveness nor has it resulted in efficient upstream import substitution.

This legacy of statist economic policies has manifested itself in the neglect of sound management practices with SOEs viewed as serving an important social function in and of themselves, namely employment generation. The state-owned sector now accounts for almost 30% of the national wagebill, and 25% of Gross Fixed Capital Formation, with current expenditures of the Government rising from 14% of GDP in 1970 to over 30% by the mid-1980s (see Annex A). Similarly, government capital expenditures have risen from a historical norm of about 6% of GDP to over 19% of GDP[4]. This trend has been associated with the creation of an extensive array of ministries, agencies, directorates and state-owned holding companies responsible for managing and directing investment in SOEs. Inexorably, this has resulted in a diminution of market forces in the economy and profound structural imbalances, with the unabated growth in government consumption (expenditures) increasingly financed by deficit on the current account.

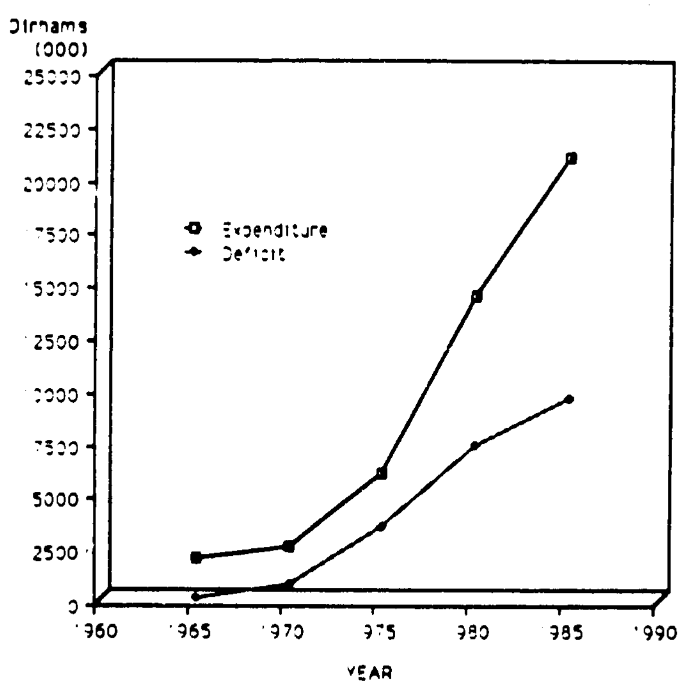
B. BASELINE PRIVATIZATION SCENARIO

1. Government Expenditures and Consumption

The end of the phosphate boom in 1975-76, and the concomitant increase in world oil prices in the later 1970s, reversed the gains in the country's terms of trade realized over the preceding 15 year period. However, despite the loss of a major source of revenue, the government until the beginning of the structural adjustment program continued to follow a policy of intensive public investment, substituting foreign borrowing for export earnings, with growth in the government's budget deficit mirroring increased government expenditures (Figure 1). By the mid-1980s, the Treasury deficit had grown to 12.6% of GDP, on a cash basis, and higher on a goods and services basis as arrears were accumulated. While implementation of a series of Bank- and Fund-mandated stabilization and adjustment programs have resulted in some improvement in these key economic indicators, as of 1990 interest obligations before debt relief still exceeded 5% of GDP with amortization before debt relief being closer to 9% of GDP[5]. Moreover, foreign debt obligations remain an important component of Government expenditures, which constitutes an additional dimension of the debt overhang problem.

Figure 1

GROWTH IN GOVERNMENT CONSUMPTION AND PUBLIC SECTOR BORROWING REQUIREMENT
(Current Durhams)



Source: The World Bank, 1989

2. The Impact of Structural Imbalances on Economic Performance

Morocco's accumulation of significant arrearages on its foreign debt, particularly to foreign commercial lenders, has resulted in its loss of international credit-worthiness and inability to borrow on the international markets. Ironically, however, it has been the government's efforts to restore its international credit position that has complicated and ultimately frustrated its efforts to implement privatization. The requirement set by the IMF that government expenditures be reduced by approximately 2% of GDP in the next year, and that the medium-term deficit be reduced to 3.3% of GDP from its current level of 5.4%, has meant that the government is unable to adequately staff the Ministry of Economic Affairs and Privatization or to undertake an aggressive program of divestment of public enterprises. While certain savings can be realized from further economies in other budget items, a lack of economic resources currently poses a formidable obstacle to public enterprise restructuring and privatization.

Two additional exogenous factors have seriously affected the government's economic growth prospects and structural adjustment efforts. The prolonged global recession has resulted in depressed prices for Morocco's primary export, phosphates. Reduced demand in the European Community for Morocco's agricultural exports, its other principal source of export revenue, has further eroded the government's ability to raise revenue. High unemployment in Europe has also dramatically impeded the ability of Moroccans to find employment in the EC, and a growing number of Moroccans resident in the Community have been rendered redundant. This has served to not only notably reduce foreign remittances but has left Morocco to contend with substantial inward migration, severely overtaxing social services and leading to increasingly volatile conditions in major urban centers. Recent enactment of stringent entry controls throughout the European Community and particularly in France promise to eliminate an important safety valve for the unemployed, requiring the government to devote scarce resources to social programs and further complicating efforts to reduce the national budget deficit and curtail public spending.

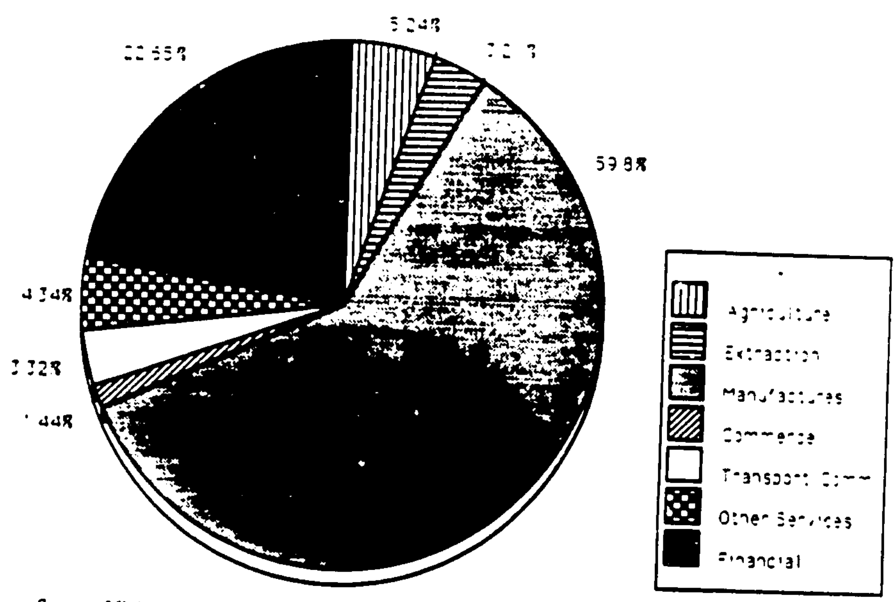
Finally, significantly aggravating the government's economic situation is the growing scarcity of foreign assistance. Several recent requests for multilateral assistance have been delayed due to a lack of resources on the part of the multilateral lenders, and the need to channel increased resources to Eastern Europe and the former USSR. While it is hoped that current plans to replenish the capital of the international lending organizations will ameliorate this situation, this will not occur in the short- or medium-term: precisely the period in which the government needs to carry-out major economic reforms and privatizations. Identification of other sources of financial and technical assistance has become of critical importance to the government, and its success in doing so will determine whether or not privatization and economic liberalization continues.

3. The Distribution of Labor Among State-Owned Entities

The initial list of 112 state-owned entities to be privatized spans the entire range of the government's economic activities, affecting over 35,000 employees in all regions of the country. The distribution of employment in state-owned enterprises to be privatized reflects the highly concentrated nature of Morocco's state-owned sector: roughly 60% is in the manufactured goods sector, and 22% is in the banking and financial sector (figure 2). Privatization will have its smallest impact of the country's agricultural sector, where only three entities are scheduled for privatization, employing just over 400 individuals and contributing less than one-tenth of one percent of value added in the sector.

FIGURE 2

IMPACT OF PRIVATIZATION ON LABOR: DISTRIBUTION OF EMPLOYMENT AMONG STATE-OWNED ENTERPRISES TO BE PRIVATIZED



Source: Ministry of Economic Affairs and Privatization (MAEP)

Of the 112 SOEs to be privatized, 37 are hotels. Of the remaining 75, 53 (or 71%) posted operating profits in the year ending December 31, 1989, with 22 (or 29%) posting losses (see Annex E). On a sectoral basis, the banking and financial sector has consistently out-performed every other sector of the economy, with the industrial sector, being the weakest. This pattern is reflected in the country's national accounts, with the financial sector being a net contributor to the Treasury, and the industrial sector a net beneficiary of Treasury subsidies.

SECTION III

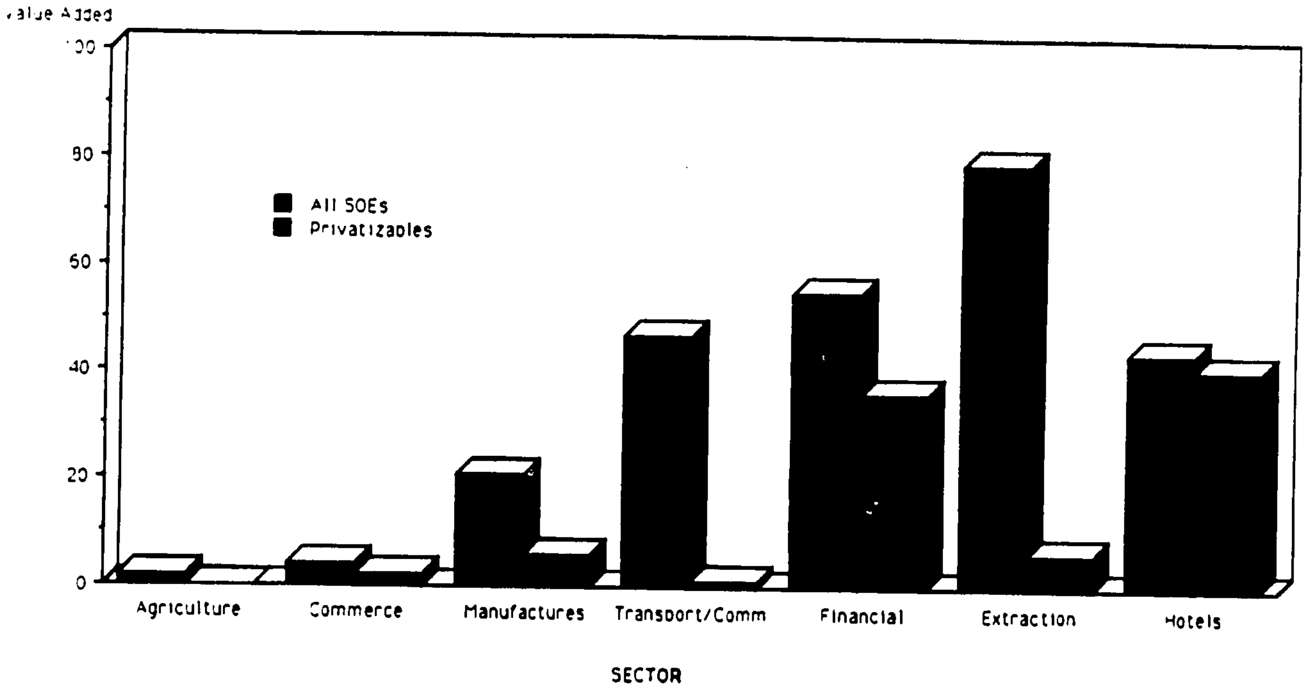
THE ECONOMIC IMPACT OF PRIVATIZATION

A. STRUCTURE AND PERFORMANCE OF STATE-OWNED SECTOR

On an aggregate basis, value-added by firms to be privatized exceeds 6% of Gross Domestic Product (GDP), with equity capital in excess of US $1.8 billion. In the case of financial institutions, privatizable state-owned enterprises account for 50% of total value-added in the state-owned sector (figure 3), and the privatization of the designated state-owned banks and financial institutions will reduce the state sector in these industries by almost two-thirds[6].

FIGURE 3

SHARE OF VALUE ADDED CONTRIBUTED BY PRIVATIZABLE STATE-OWNED ENTERPRISES



Source: Ministry of Economic Affairs and Privatization (MAEP)

Reductions of the state-owned sector of almost similar magnitude are anticipated in the hotels and commercial sectors of the economy. Even in those sectors where the aggregate numbers are not as impressive and where privatization will not result in a major reduction in the *number* of state-owned enterprises (mining, transport and communications), its effects will nonetheless be marked as the enterprises to be privatized often dominate the sector or are central to it.

Further suggesting that the actual amplitude of privatization on the state-owned sector and Moroccan economy will be far larger than implied in the number of enterprises on the privatization docket, is the fact that six of the country's eleven largest holding companies are included in the list of SOEs scheduled for immediate privatization (Table 1). Together, these holding companies own or operate over 100 downstream SOEs and parastatals, including over 50% of the equity of all state-owned enterprises. Privatization of these entities will thus have a major effect on the Moroccan economy, affecting almost half of the government's state-owned enterprise portfolio.

PRINCIPAL HOLDING COMPANIES & HOLDING COMPANY SUBSIDIARIES SUBJECT TO PRIVATIZATION
(Number of subsidiaries by share of equity)

Holding Company		Share of Equity (%) 100	50-99	25-49	<24	Unknown	Total	Privatizable
CDG		4	14	7	28	0	53	19
SNI		0	2	12	33	0	47	47
BNDE		0	0	2	15	27	44	44
ODI		0	11	14	10	1	36	24
BRPM		3	12	7	9	0	31	7
CMKD		0	16	6	7	0	29	6
OCP		13	4	3	7	0	27	3
CIH		3	2	3	19	0	27	3
ZELLIDJA		2	7	4	7	4	24	2
SOMED		0	3	3	16	0	22	6
SOFICOM		5	9	2	4	0	20	20
TOTAL	Number	30	80	63	155	32	360	181
	(%)	8.33%	22.22%	17.50%	43.06%	8.89%	100.00%	50.28%

Source: Ministry of Economic Affairs and Privatization (MAEP)

B. MACROECONOMIC EFFECTS OF PRIVATIZATION

According to the Ministry of Economic Affairs and Privatization, Morocco's state-owned enterprises received in excess of DH 11.3 billion in direct subsidies during the period 1983 to 1985. After subtracting payments to the Treasury from certain public enterprises (mainly OCP, the national phosphate producer), net transfers to public enterprises from the central government amounted to DH 5.7 billion for this period, or roughly 23.9% of the government's public sector borrowing requirement. Transfers of this magnitude have produced pronounced, structural, disequilibria in the national economy, confounding efforts to achieve long-term stabilization and adjustment. It follows that their elimination, even if incremental, will have a major impact of growth, investment and savings rates[7].

In the case of Morocco's state sector, the situation becomes even more convoluted as a result of SOEs enjoying preferential credit terms and concessionary financing. While no thorough or recent study has been conducted to determine the net macroeconomic effects of such practices, several studies have estimated these indirect subsidies to equal the amount of the annual Treasury subvention, for a total effective subsidy of DH 4.1 billion per annum[8]. Reducing these subsidies by only 20% would more than offset the entire projected cost of re-structuring the country's industrial sector and sugar-processing industry. Similarly, reducing the government's annual *domestic* credit requirement by just 10% would free over DH 400 million for productive investment elsewhere in the economy[9].

C. FISCAL AND BUDGETARY EFFECTS

One of the most direct effects of privatization will be augmented Treasury receipts from the sale of SOE assets. While it is impossible to forecast the amount of these proceeds without evaluating the individual entities, the good condition of Morocco's state-owned enterprise portfolio suggests that they will be substantial. Indeed, as of December 31, 1989, the net worth of privatizable SOEs stood at DH 14 billion, with 1989 profits (after tax) of DH 950 million[10]. As Morocco's agreements with the World Bank and IMF require the government to reduce government spending by 2% of GDP in the forthcoming budgetary cycle, and as the Privatization Act stipulates that all proceeds from asset sales will accrue to the Treasury, the sale of state-owned enterprises will directly translate into reduced borrowing and debt service requirements, with positive short- and long-term macroeconomic effects.

D. SECONDARY AND TERTIARY EFFECTS OF PRIVATIZATION

Privatization of state-owned enterprises will produce a variety of direct and in-direct costs and benefits to the economy. Privatization will all but remove the state from banking, commerce and tourism, with the remaining state sector playing a markedly diminished role in the economy. While the *direct* impact of privatization on agriculture, transport and communications and mining will be less dramatic, this is somewhat misleading since the privatization of government holding companies will lead to major "secondary " privatizations, with as many as 300 SOE-subsidiaries being privatized as a result of the privatization of the parent company[11]. Here, it is important to note that depending on how downstream entities are classified and treated, the number of secondary privatizations could increase by as much as one-third, with some World Bank and ILO estimates suggesting that as many as 135 holding company affiliates could be affected.

While it is difficult to distinguish between the employment effects of privatization and those attributable to other factors, a number of studies by the World Bank, ILO and Ministry of Economic Affairs and Privatization suggest that direct and indirect labor displacement should be nominal in both the short- and long-term. The privatization of all 112 privatizable SOEs is expected to result in initial labor displacement of between 4-7%, with structural (i.e. long-term) displacement only expected in the sugar-processing industry. In large part this is because almost two-thirds of the enterprises to be privatized are in the manufactures sector, where value added is high, the rate of return on investment is healthy and state-owned enterprises are in generally good condition, with positive cash-flows and positive net worth. Over-employment in the sector is also negligible, as it is in the financial sector, the other sector of the economy most directly affected by privatization. The following is a brief summary of identifiable secondary and tertiary impacts by sector:

1. Industrial/Sugar-Processing Sector

Of all the sectors affected by privatization, the industrial sector, with its dominant sugar-processing subsector, will experience the largest dislocations. Moreover, in contrast to every other sector, these dislocations will be of a structural nature, and permanent job losses in excess of 5% are anticipated. Substantial restructuring prior to privatization will also be required, with mergers or liquidations (or both) in order. Nonetheless, the sugar subsector *as a whole* is viable and is expected to show a profit after restructuring. As a net beneficiary of Treasury subsidies, privatization of the sugar-processing sector will have a marked impact on the country's national accounts and eliminate one of the least efficient and productive components of the government's public enterprise portfolio.

2. Financial and Banking Sector

Privatization of the 10 SOEs contained in the financial and banking sector, coupled with reform of Morocco's financial and capital markets, is expected to result in significant medium- and long-term employment generation. Expansion of the Casablanca Stock Exchange is expected to result in a 5-fold increase in volume and 100-200% growth in employment in investment banking, placements and retail marketing operations. Indeed, the major challenge facing the government and the banking industry will be responding to the increased demand for trained banking and financial services professionals. As state-owned enterprises are privatized, their successor entities will want to realize a higher return on capital than at present. This will require that Moroccan financial institutions be able to provide the necessary investor guidance. Increased demand for credit, and the absence of government loan guarantees, will require that banks substantially increase their credit appraisal operations and augment their loan evaluation staff.

In the short-term, the privatization process itself will severely tax the expertise and capacity of Moroccan financial institutions. Divesting of hundreds of state-owned enterprises will be a monumental task, with just the enterprise valuation process expected to require thousands of person-hours. As a consequence, a major focus of the privatization program must be the training of skilled professionals. Ironically, privatization and growth in the industry may result in some temporary dislocations as banks shed unproductive workers or those lacking the requisite skills. This may be particularly true in the case of the Banque Nationale pour le Developpement Economique, BNDE. With its emphasis on *development* banking, it is not immediately apparent how this institution will fit into the country's banking system. As the BNDE seeks to become competitive, it may seek to eliminate its development banking operations (and related personnel) and restructure. These effects will net-out in the longer term as the Bank expands its credit operations and staff.

3. Manufactures Sector

In the manufactures sector, privatization is also expected to produce negligible labor displacement while leading to increased profits in the sector, primarily due to abolition of sole-source limitations and the ending of mandated prices. At present, state-owned enterprises are frequently required to buy solely from government contractors or other state-owned enterprises, in the classic statist economic configuration. In the case of the agricultural products market, state-owned enterprises are forced to sell to the government at controlled prices, often far below market rates. These anti-competitive practices have been identified by the World Bank and IMF as seriously compromising the financial integrity of state-owned enterprises and militating against their economic efficiency, and have directly resulted in the underdevelopment of what should be highly competitive sectors of the economy.

Medium- and long-term prospects for the manufactures sector are excellent. Wage rates are internationally competitive, and Morocco's geographical location make transshipping and distribution easy. The sector has also been a net contributor to the Treasury for a number of years, with Casablanca ranking among Africa's most powerful industrial centers. The sector is also predominantly privately-owned, which explains the relatively muted impact privatization will have. On the other hand, privatization in other sectors of the economy will lead to growth in the manufactures sector and expansion and liberalization of Morocco's financial and credit markets will do much to alleviate a serious shortage of investment capital and investment financing.

4. Agricultural Sector

Agriculture is a sector where complicated backward- and forward-linkage effects are likely to produce dislocations of a transitional nature, yet lead to significant positive employment and income-generation effects in the medium- to long-term. In the short-run, privatization and liberalization of agriculture is likely to reduce certain farm incomes as a result of subsidies and price controls being eliminated. Similarly, adoption of market-oriented economic policies will likely result in significant increases in food prices, at least in the short-term. The dislocative effects of the latter, however, will be compensated for by better-targeted compensatory feeding programs and other existing government services, at a lower cost than current agricultural subsidization programs and with far smaller macroeconomic effects. With the majority of the country's population still employed in agriculture and agriculture-related activities, this increase in their purchasing power will reverberate throughout the economy and obviate the need for the perpetuation of expensive rural assistance and food subsidy programs.

5. Hotels and Tourism Sector

In the case of the tourism and hotels industry, the secondary and tertiary effects of privatization will predominate, and no immediate macroeconomic and sector effects are anticipated. The sector does not receive any subsidies from the government, and government involvement in the sector is at a minimum. Consequently, the effects of privatization will take time to materialize but are nonetheless significant.

This is particularly true as concerns private investment in the sector. Despite the fact that the majority of international-quality hotels have been placed under management contracts, thereby becoming quasi-private entities, over-staffing and a lack of foreign investment continue to plague the sector. Furthermore, the fact that the government has remained reticent until recently to sell outright its interest in hotels, preferring to lease them to foreign or Moroccan investors, has retarded investment growth and resulted in comparably few high quality hotels for a country the size of Morocco and of such proximity to Europe.

This phenomena is evidenced by the preponderance of medium-grade hotels in the government portfolio. While to some extent this represents a conscious attempt to diversify the hotel stock base, it is more indicative of a dearth of investment in the hotel industry. This can be directly related to the fact that management contracts are subject to review and renewal of the government, and that in the past contracts have been canceled or not renewed for non-performance related reasons. Faced with uncertainty, investors have been understandably reluctant to undertake major capital improvements. Privatizing the hotel stock will eliminate this problem and reassure foreign and domestic investors. This consideration is made all the more relevant and urgent given Morocco's heavy dependence on tourism and the fact that tourism receipts from North Americans and Europeans have fallen precipitously in recent years[12].

6. Energy Sector

Privatization in the energy sector will most likely take the form of the denationalization of the various petroleum-distilling companies, and is not expected to result in any notable changes in employment or backward- and forward-linkage effects. Indirectly, however, de-nationalization may result in increased investor confidence and renewed interest on the part of international investors and multinational companies in oil exploration. Any such developments however will be conditional on a number of other factors, most notably settlement of the Western Sahara's political status and would only accrue in the long-term.

E. OVERALL COST OF PRIVATIZATION PROGRAM

A variety of estimates have been made as to the cost of privatizing Morocco's state-owned enterprise portfolio, with the most recent being an appraisal conducted by the World Bank as part of the Public Enterprise Restructuring Loan (PERL). This study indicated that privatizing all 112 entities referred to in the Privatization Act would cost between $70-90 million[13]. This estimate includes the cost of appraising and evaluating the 112 SOEs, retaining the necessary technical assistance and a minimal amount of enterprise restructuring. It also assumes that most restructuring (as in the case of the sugar processing subsector) will occur *prior* to privatization and will be covered by the government's operating expense (OE) budget. Should, however, such restructuring be included as part of the overall privatization program, then the total cost of privatization is likely to be nearer $90-110 million.

Similarly, in calculating the cost of privatization it is assumed that a number of expenses will be absorbed by the government as part of its ordinary operating budget, or covered by existing foreign assistance programs. This includes re-training and vocational development, which presumably can be handled through existing programs offered by the Ministry of Education and other units of the government. As far as USAID is concerned, the challenge will be adapting existing programs to reflect the changing needs of the population. The Agency may also want to focus on identifying sectors likely to experience labor shortages (i.e. banking) and work to reconfigure existing training programs to help individuals qualify for these positions.

SECTION IV

THE PROJECT IN CONTEXT

After a number of false starts, the Government of Morocco has recently been making a serious and concerted effort to implement recommended structural changes to its economy. Anti-competitive and statist economic policies have been repealed, the "Moroccanization" program abrogated, and widespread liberalization undertaken.

Since 1989, privatization has become a key factor in the government's adjustment program, and in April, 1990, the government enacted a sweeping privatization law that provided for the eventual privatization of the vast majority of the government's public sector portfolio. No sector or state-owned enterprise was exempted from privatization; rather, the government designated 112 state-owned enterprises for immediate privatization, legislating into law that they be privatized, or fundamentally restructured along market-lines, within five years. To ensure that issues not be under-subscribed, and to attract foreign investment, the government stipulated that there be no restriction on foreign investment or foreign assumption of ownership. The only exception is in the case of the *agro-processing industry*, where Moroccans will be given the first opportunity to buy state-owned enterprises. In this case, the "reservation period" is for only 30 days, after which the transaction is opened to all interested parties. Save for employees who can realize special savings through Employee Stock Ownership Programs (ESOPs) and certain special regional preferences, the law requires that Moroccan and non-Moroccan investors be treated equally.

Going into the privatization project, several key sectors of the economy remain dominated by state-owned enterprises. This is particularly true in the case of financial institutions, where roughly 60% of all banks are state-owned or controlled. Similarly, state-holding companies play a dominant role in certain areas of the agricultural and commercial (commerce) sectors. This has lead to unproductive and inefficient investment, pronounced resource gaps, uncompetitive practices, and a loss of international competitiveness. Extensive state-ownership has also contributed to burgeoning budget deficits and unsustainable levels of foreign indebtedness.

The proposed Privatization Sector Assistance Project seeks to assist the government in privatizing the state sector and in creating conditions conducive to private enterprise and private investment. By funding a significant portion of the privatizations legislated by the Dahir in 1990, the project will contribute to a major reduction in the state sector and a fundamental reorientation of Moroccan government economic policy. The use of project funds to design and implement public information and public awareness programs will also help strengthen support for Morocco's entrepreneurial classes and complement on-going efforts to promote private investment and small and medium-size enterprise (SME) development.

USAID support at this time is also vital if opposition to economic reform is to be overcome and if the government's other adjustment policies are to succeed. The government has been unequivocal that this is just the first phase of privatization. Other state-owned enterprises not on the first list of 112 are currently being re-structured as a prelude to privatization, and others are being merged or liquidated. However, the government has also been clear in stating that whether future privatizations will occur depends to a large extent on the results of the current privatization program, and on the availability of foreign technical and financial assistance.

Though unquantifiable, these *demonstration effects* are of key importance. In the face of considerable opposition the government has publicly embraced the sale of state-owned enterprises and economic liberalization and made private sector development the cornerstone of its economic and social policy. USAID is intimately associated with these policies, and the Mission and US Government are well-known throughout the country as major proponents of the Privatization Law and privatization process. If the privatization program succeeds, and it can with adequate support, economic reforms will continue and further privatizations will occur. If it doesn't, or if USAID support for privatization is seen as lacking or hesitant, the credibility of the Government *and* USAID will be severely damaged. As the largest privatization project in Morocco, the Privatization Sector Assistance Project is uniquely well placed to assist the government in its efforts and to demonstrate not only the importance of privatization but the fact that it can work and make a major difference.

SOURCES

1. HM King Hassan II, Speech from the Throne, as quoted in "Privatization: Morocco," Alfred H. Saulniers, ed. (Rabat: Ministry of Economic Affairs and Privatization, 1990).

2. Decrees Implementing Law No. 39-89 Authorizing the Transfer of Public Enterprises to the Private Sector, 16 October 1990.

3. Saulniers, Alfred H. "Morocco: Setting for and Lessons from Privatization." (Rabat: Ministry of Economic Affairs and Privatization, 1992).

4. Ibid. (Cf. International Financial Statistics, 1991).

5. The World Bank. Country Economic Memorandum (Morocco), January 30, 1987. The World Bank. "Kingdom of Morocco: Sustained Investment and Growth in the Nineties".

6. "Privatizable state-owned entities" are those SOEs enumerated in the Privatization Act as candidates for privatization. "Non-privatizable state-owned entities" are those SOEs not so designated. The fact that an entity is classified as "non-privatizable" does not mean that it cannot be privatized; all it means is that it was not included in the legislation as is not a candidate for *immediate* privatization.

7. Saulniers, Alfred H. Morocco: Setting for and Lessons from Privatization. (Rabat: Ministry of Economic Affairs and Privatization, 1992); The World Bank: Issues for a Medium-Term Structural Adjustment Program, 1990.

8. The World Bank. *Public Enterprise Restructuring Loan*, Staff Working Papers, 1990.

9. Bank Al-Mahgrib; International Monetary Fund; International Bank for Reconstruction and Development, Public Enterprise Restructuring Loan, Working Papers.

10. Ministry of Economic Affairs and Privatization: "Privatization Morocco"; USAID/Morocco.

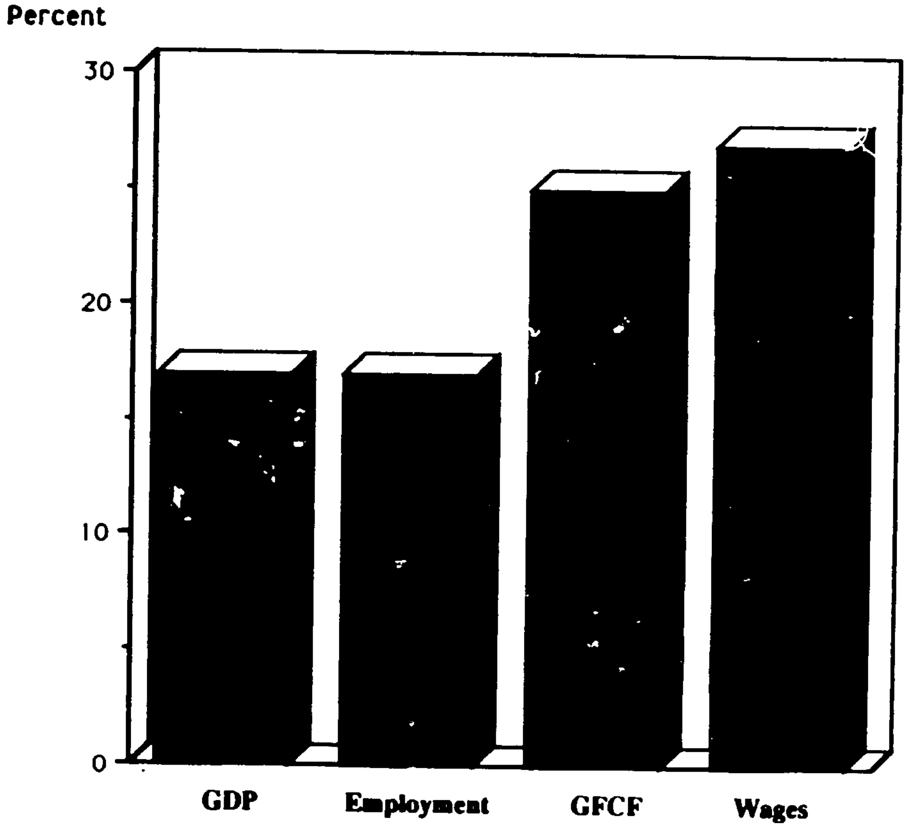
11. Ministry of Economic Affairs and Privatization: "Privatization Morocco".

12. IMF statistics indicate a decline in North American and European tourism of over 20% prior to the Gulf War. This translates to over $40 million in foregone receipts. While tourism as a whole has increased, the increase has come primarily from Algeria where per capita spending by tourists down approximately 50%.

13. The World Bank has developed a range of cost estimates for privatization, depending on the order in which entities are privatized and whether related expenses such as financial markets reform are included in the privatization budget. Similarly, all estimates are based on prevailing interest rates and conditions, are highly susceptible to changes in market conditions.

ANNEX A

CONTRIBUTION OF STATE-OWNED ENTERPRISES
TO THE MOROCCAN ECONOMY



Source: Ministry of Economics Affairs and Privatization (MAEP)

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ANNEX B

DISTRIBUTION AND CHARACTERISTICS OF SOEs DESIGNATED FOR PRIVATIZATION			
Sector	Number	Share of Sectoral Value Added	SOE Employment
Agriculture	3	0.06	411
Extraction (Mining)	5	6.25	1,543
Manufactures	41	6.12	19,837
Commerce	9	4.23	3,285
Transport/ Communications	2	0.93	820
Other Services	4	0.27	1,279
Financial Institutions	10	31.32	8,751
TOTAL	74	49.18	35,926

Source: Ministry of Economic Affairs and Privatization (MAEP)

25

ANNEX C

DISAGGREGATION OF GDP BY PRIMARY COMPONENT SECTOR
(Constant DH Millions)

Sector	1987	1988	1989	1990
Agriculture	24,075	31,347	32,650	32,661
Extraction (Mining)	3,992	5,243	4,875	5,318
Manufactures	28,587	31,891	33,378	37,880
Commerce	20,657	21,878	20,775	23,786
Transport/ Communications	10,510	12,030	12,700	13,428
Other Services	17,030	18,419	19,227	20,898
Financial Institutions	5,190	5,898	6,924	7,143
TOTAL VALUE ADDED	110,041	126,705	130,529	141,114

Source: Royaume, Comptes de la Nation 1990

ANNEX D

SECTORAL ANALYSIS OF SOEs DESIGNATED FOR PRIVATIZATION (As of December 31, 1989)				
SECTOR	NET PROFIT	As % of ALL SOEs	LABOR FORCE	As % of ALL SOEs
BANKING	413.3	40.04%	7,641	21.34%
FINANCIAL	46.8	4.53%	903	2.52%
COMMERCE	16.6	1.61%	486	1.36%
INSURANCE	(25.5)	-2.47%	562	1.57%
INDUSTRIAL	272.8	26.43%	14,281	39.89%
MINING	33.2	3.22%	1,084	3.03%
PETROL	118.8	11.51%	1,407	3.93%
AGRICULTURE	91.8	8.89%	1,767	4.94%
SUGAR	41.5	4.02%	5,798	16.20%
HOUSING	6.5	0.63%	97	0.27%
TOURISM	7.7	0.75%	654	1.83%
TELECOMMUNICATIONS	0.8	0.08%	300	0.84%
TRANSPORT	7.8	0.76%	820	2.29%
TOTAL--ALL SECTORS	1032.1	100.00%	35,800	100.00%

Source: Ministry of Economic Affairs and Privatization (MAEP)

ECONOMIC DATABASE FOR
SOEs DESIGNATED FOR PRIVATIZATION BY GOM
(1989 Data)

CLASS	ACRONYM	BRIEF TITLE	SECTOR	PUBLIC SHARE (%)	LABOR FORCE	NET PROFIT	NET WORTH	VALUE ADDED (000DH)
1	BCP	Banque Centrale Populaire	BANKING	87.58	4,370	153.7	2,304.3	
1	SCR	Ste Centrale de Reassurance	INSURANCE	94.00	195	4.9	1,586.6	
1	CNIA	Cie nordafricaine intercont d'assurance	INSURANCE	59.99	367	(30.4)	1,158.0	
1	CIH	Credit Immobilier et Hoterier	BANKING	59.58	547	73.8	997.1	
1	BMCE	Banque Marocaine du commerce exterieur	BANKING	54.34	2,504	114.8	931.6	
1	SONASID	Ste nationale de siderurgie	INDUSTRIAL	100.00	588	95.3	910.7	611,504
1	BNDE	Banque nationale pour le developpement economique	BANKING	49.85	197	23.9	618.3	
1	SHELL	Ste Shell-Maroc + Texas Oil Co.	PETROL	50.00	674	45.7	562.7	
1	CELUMA	Cellulose du Maroc	INDUSTRIAL	37.34	580	106.3	407.0	241,143
1	FERTIMA	Ste marocaine de fertilisants	INDUSTRIAL	100.00	930	14.2	212.2	(57,073)
1	CIOR	Cimenterie de l'Oriental	INDUSTRIAL	86.22	609	(5.6)	205.3	282,780
2	SNI	Ste nationale d'investissement	BANKING	53.89	23	47.1	337.7	
2	CMH	Cie marocaine des hydrocarbures	INDUSTRIAL	50.00	186	12.7	287.1	
2	EQDOM	Ste d'equipement domestique et menager	FINANCIAL	41.16	122	18.5	253.2	
2	SNEP	Ste nationale d'electrolyse et de petrol	INDUSTRIAL	95.15	474	38.8	222.1	147,611
2	SOMIFER	Ste marocaine de Bou-gaffer	MINING	55.23	319	17.5	214.4	
2	SMI	Ste metallurgique d'imitere	INDUSTRIAL	69.60	459	3.9	198.3	
2	SOFAC	Ste de financement d'achats a credit	FINANCIAL	58.14	132	20.7	196.4	
2	ICOZ	Industrie cotonniere de Oued Zem	INDUSTRIAL	98.06	979	16.1	182.9	105,326
2	TOTAL	Societe Total-Maroc	PETROL	50.00	358	32.0	181.5	
2	COTEF	Complexe Textile de Fes	INDUSTRIAL	97.22	1,489	9.0	179.7	93,556
2	SUNABEL	Sucrerie nationale de betttraves du Loukkos	SUGAR	100.00	390	15.5	178.4	69,281
2	SURAC	Sucrerie raffinerie de cannes du Gharb	SUGAR	99.99	531	8.8	165.1	6,944
2	SUCRAL	Sucrerie raffinerie de cannes du Loukkos	SUGAR	91.67	520	2.5	154.6	6,160
2	SUNAG	Sucrerie nationales du Gharb	SUGAR	100.00	1,023	11.5	122.2	41,493
2	MOBIL	Societe Mobil Oil-Maroc	PETROL	50.00	198	23.4	120.7	
2	FPZ	Ste des fonderies de plomb de Zellidja	INDUSTRIAL	39.69	383	41.6	101.8	74,148
2	COMAPRA	Cie marocaine de commerce de produits agricoles	AG	99.94	1,344	20.3	99.7	
2	CTM-LN	Compagnie Transport Maroc/Ligne Nationale	TRANSPORT	96.06	820	7.8	95.7	
2	SOMACA	Ste marocaine de construction automobile	INDUSTRIAL	42.31	928	9.5	91.0	(4,056)
2	SUCRAFOR	Sucrerie raffinerie de l'Oriental	SUGAR	74.67	349	(12.1)	88.9	28,384
2	SUNAB	Sucrerie nationale de Beht	SUGAR	98.75	490	0.3	85.4	9,642
2	PETROM	Petroles du Maghreb	PETROL	62.36	170	17.6	84.2	
2	SUNAT	Sucrerie nationale du Tadla	SUGAR	100.00	528	1.7	83.0	40,750
2	SONACAS	Ste nationale de commerce de semences	FINANCIAL	99.99	146	5.0	72.7	
2	SUNACAS	Sucrerie nationale de canne du Sebou	SUGAR	100.00	531	8.8	69.0	29,573
2	GEN TIRE	General rubber and tire cie.	INDUSTRIAL	32.58	528	17.4	67.7	59,147
2	SOMAS	Ste marocaine de stockage	INDUSTRIAL	84.45	32	1.8	65.8	

ECONOMIC DATABASE FOR
SOEs DESIGNATED FOR PRIVATIZATION BY GOM
(1989 Data)

CLASS	ACRONYM	BRIEF TITLE	SECTOR	PUBLIC SHARE (%)	LABOR FORCE	NET PROFIT	NET WORTH	VALUE ADDED (000DH)
2	SUBM	Sucrerie de Beni Mellal	SUGAR	96.83	272	2.4	63.2	37,747
2	SUTA	Sucrerie raffinerie du Tadla	SUGAR	100.00	1,027	(0.6)	62.0	13,146
2	SICOME	Ste industrielle de confection de Meknes	INDUSTRIAL	11.93	935	(22.0)	55.3	19,294
2	CGI	Compagnie Generale Immobiliere	HOUSING	100.00	97	6.5	49.7	
2	SAMINE	S.A. d'enterprises minieres	MINING	56.66	390	5.2	48.4	
2	SOCOCHAR	Ste commerciale de charbon et de bois	COMMERCE	98.20	202	14.0	45.5	
2	SOCHE	Ste cherifienne de distribution et de presse	COMMERCE	35.00	284	2.6	19.2	
3	CTT	Compagnie de Tifnout Tiranimine	MINING	40.97	45	7.1	83.7	
3	SETAFIL	Settat Filature	INDUSTRIAL	35.00	214	(14.4)	75.0	7,674
3	SACEM	S.A. cherifienne d'etudes minieres	MINING	43.01	330	3.4	73.7	
3	CIFM	Cie immobiliere et fonciere marocaine	FINANCIAL	99.82	495	3.1	45.3	
3	SIMEF	Ste des industries mecaniques et electriques	INDUSTRIAL	99.98	485	(0.1)	41.4	33,581
3	SCIF	Ste cherifienne de materiel industriel et ferroviaire	INDUSTRIAL	43.61	619	1.9	36.6	43,103
3	SOFICOM	Ste de finance et de participation commerciale	FINANCIAL	100.00	8	(0.5)	32.3	
3	SODERS	Ste de derives du sucre	SUGAR	35.60	137	2.7	30.5	21,770
3	ADAROUCH	Ranche Adarouch	AG	50.00	130	1.6	17.9	
3	SNDE	Ste nationale de developpement de l'elevage	AG	99.99	24	(0.2)	15.9	
3	C3M	Cie arabe de machines outils a Metaux	INDUSTRIAL	52.54	62	(3.6)	15.3	3,674
3	SICOFES	Ste industrielle de confection de Fes	INDUSTRIAL	38.32	806	(9.2)	15.1	6,944
3	ESMAFOR	Estampage, matrissage et forgeage	INDUSTRIAL	41.92	13	(2.0)	14.6	0
3	CHELCO	Societe Chellah confection	INDUSTRIAL	32.00	680	3.7	13.5	15,573
3	MAROTOUR	Maroc Touriste	TOURISM	100.00	654	7.7	12.7	
3	SNT	Ste nationale de telecommunications	TELECOM	100.00	300	0.8	10.8	
3	VETNORD	Vetements du Nord	INDUSTRIAL	69.39	600	2.3	8.7	
3	COMAGRI	Cie marocaine de gestion des exploitations agricoles	AG	100.00	269	(2.3)	7.7	
3	SOTRAMEG	Ste de transformation de melasse du Gharb	INDUSTRIAL	73.70	67	1.3	6.7	
3	SONAFAP	Ste nationale de farine alimentaire de poisson	INDUSTRIAL	96.28	70	(5.0)	5.4	(624)
3	IBOVAL	Industrie bonneterie de la Vallee	INDUSTRIAL	35.00	290	(0.1)	4.7	4,125
3	DRAGON	Societe Dragon-Gaz	PETROL	50.00	7	0.1	4.5	
3	S3I	Ste internationale d'industrie et d'ingenierie	INDUSTRIAL	33.99	46	0.1	4.4	7,765
3	JADIVET	Jadida vetements	INDUSTRIAL	66.62	300	(4.4)	2.5	1,414
3	MAPROC	Manufacture arabe des produits en cuir	INDUSTRIAL	67.27	310	(28.5)	2.5	(12,061)
3	SICOCENT	Ste industrielle de confection du centre	INDUSTRIAL	30.00	414	(1.3)	1.9	6,159
3	SALAMCO	Salamca vetements confectionnes SA	INDUSTRIAL	51.00	330	(3.3)	0.3	2,703
3	SICOR	Ste industrielle des conserves de l'Oriental	INDUSTRIAL	46.05	320	(12.1)	(9.1)	3,014
3	MODULEC	Ste industrielle d'appareillage electromecanique	INDUSTRIAL	47.09	40	(1.0)	(12.6)	2,137

Source: Royaume, Ministere des Affaires Economiques (1991)