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Moroccan transition strategies towards free trade with the EU in 2010

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**38th CONGRESS OF THE
EUROPEAN REGIONAL ASSOCIATION
28 August-1 September 1998 IN VIENNA**

**MOROCCAN TRANSITION STRATEGIES
TOWARDS FREE TRADE WITH THE EU IN 2010**

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The current structure of Moroccan trade is that two thirds of its exports and 1/2 of its imports are with the EU. The major importing country is France, 28% of imports, and second is Spain 10%/ The primary exports are agricultural products, fish, phosphates and textiles. Imports are primarily capital goods, machinery, chemical products, oil, derivatives and cereals. Major exporters to the country are France, Spain, Italy, and Germany in that order (Bank AlMaghreb, 97). The current structure of Moroccan business is similarly geared towards raw materials extraction, agriculture, primary production such as textiles and some fabrication. This is reflective of the relative poor technological base of the country where the majority of the labor force is illiterate and primarily engaged in subsistence agriculture. There is a generally free educational system through university but the majority of the population does not choose to take part in it. This usually because the family cannot afford the books, uniforms and other ancillary costs, and because it is more meaningful to their life style to train children on the farm to work and contribute to the family's welfare. Unemployment outside of the subsistence sector is also high usually in excess of 30%., which gives even less incentive to labor to upgrade its education and skills and to enter the industrial labor force. Capital is scarce and expensive. Business know how is also scarce. Labor costs are in consequence very low when compared to even the lowest rates in the European Union. Labor productivity is also relatively low. A few key plants, usually owned by multi nationals, have however, shown that low productivity need not necessarily be the case. Such MNCs as Fruit of the Loom, Coca Cola, Proctor and Gamble and Fagor/Mondragon have above average labor productivity based upon careful selection and training, higher incentives, and more efficient organizational structures and capital investment. (Bank El Maghreb, 97) These MNCs and others like them have shown that Moroccan labor is reasonably upgradable over a relatively short space of time.

Moroccan-EU trade has been conducted since the mid seventies through preferential agreements. The free trade association agreement signed in 1995 calls for.

- .Duty free access of Moroccan industrial products to the EU, to be phased in over 12 years, vice versa. . Quantitative restrictions on the imports of Moroccan agricultural products . A consideration of reference prices in EU markets for Moroccan exports
- . Financial, economic, and social cooperation. (Min. Commerce Exterior, 1996) Since most non agricultural products currently enter the EU duty free under preferential agreements most of the adjustment to bilateral free trade will have to be undertaken by the Moroccan economy

The overall impact upon the economy will be determined by steps and strategies undertaken by government and private firms over the next 11 years.

The obvious opportunity for Moroccan firms when the country enters into free trade with the EU is to move into higher value fabrication and to expand basic manufacturing in textiles and related items. It is also an opportunity for EU firms to establish plants in the country to take advantage of these factors. In order for these firms to move into higher value fabrication such as the assembly of motor vehicles and appliances they will have to adopt the strategies of firms such as Fagor, a Spanish firm, which have already developed plants in the country. The strategy is establish a plant now, aimed at supplying the EU, giving the firm ten years to develop the labor, equipment, and organization to be competitively viable, have a decided competitive advantage in the EU. Such a strategy is aimed at moving basic fabrication and assembly which now takes place in Spain or other lower wage countries in the EU south in 2010 to Morocco. The development of such basic fabrication and assembly labor skills is a demonstrated option in Morocco. With the larger scale development of the labor force and upgrading of skills, firms may be able to develop strategies to move further down the value chain towards more complete product production and value added components.

Other strategies have also begun to take shape. The primary soft drink bottler of Coca Cola Brasseries Maroc has acquired SIM a local soft drink maker with proprietary brands. Brasseries Maroc had its products generally under license which prevented it exporting to the EU, but with the acquisition of SIM with its proprietary brands it is now strategically positioned to export to the EU. (Brasseries Maroc, 1998)

The value chain indicates a longer term strategy for the Moroccan government and firms wishing to take full advantage of the Moroccan opportunity. Many countries, and related firms, of the EU which only several decades ago were classed as developing have moved, or are considering moving production of more basic manufacturing to Morocco, as they climb further up the technology ladder and the value chain. Many firms that have recently established in Morocco have come from Spain, Ireland, Italy, and Portugal. The Moroccan government has developed an assistance program to help MNCs establish in the country with favorable tax treatment and financial packages, as in the example of Fagor/Mondragon. The Moroccan government first assisted the firm by Fagor/Mondragon by finding it a domestic

partner, Madison, but when the joint venture did not work out the government assisted the firm in establishing its own wholly owned subsidiary, and with a financial package.(Fagor 1998) There is a policy under review of lowering or eliminating tariffs on imported materials for MNC joint ventures with Moroccan firms, which often proved difficult for the foreign firm, as was the case with Madison. The theory was that under the aegis of a joint venture there would be a transfer to the Moroccan firm and country of technology and know how.

Moroccan firms may well also look closely at the experience of Mexican firms when such firms were faced by the prospect of free trade with the US and Canada. The similarities are many. Mexico was and is a developing country with a low technology and manufacturing base, where most of its labor force is unskilled and engaged primarily in the agricultural sector. “ With its plentiful and inexpensive labor force and expanding middle class, Mexico presents an ample opportunity both as a manufacturing site and as a vast new market for competitors to exploit.” Most Mexican firms existed in closed, protected markets, which were primarily “sellers” markets, as one big supplier put it, “simply a matter of answering the phone.” Most of these firms entered a harsh awakening when faced with real competition in an open market for the first time. Many of them had to liquidate. Those that survived and prospered saw the change coming, the threats and the opportunity and adapted themselves accordingly, in advance of the change. One such company was Vitiro S.A., Mexico’s premier glass maker; It carefully assessed what the opportunities could be in the merged market and what the new competition would be like. It saw a niche opportunity in the returnable bottles market and in making bottles for the fast growing flavored water market. These were markets it could see it had both a comparative and a competitive advantage in compared to potential competitors. These were also markets that were small enough not to warrant the attention of the larger US glass makers. In assessing its new competition it could see it would have to pay closer attention to quality, customization and customer needs. It could see it was clearly leaving a sellers market and entering a buyers market. To adapt to these new market parameters it could see it would have to transform its organization and production processes, without losing its identity as a Mexican company. It could see that the key to success in NAFTA was not just gearing up to serve the North American market but also to become a global company where it could leverage a North American capability into a global capability. It accordingly adopted a longer term strategy to do so. It, also, foresaw the possibility of significant financial disruption with the country’s entry into NAFTA, and prepared for it.

They for example avoided external debt as much possible, and where necessary incurred in through subsidiaries, which were controlled but not majority owned by the firm. Borrowed funds were invested in new imported technology and equipment. As part of their competitive positioning and learning strategy they developed joint ventures with leading edge glass producers such as Corning and Owens-Illinois. Joint venture were also developed with major US glass users and customers such as Ford and Whirlpool. Vitro also focused on key leading edge international technologies, which if they did not have they licensed, such as float glass technology from Pilkington. They also sought out and acquired a key and complementary glass company in the US to which they could transfer management and technology and vice versa, Anchor glass, creating a substantive synergy effect. Importantly, Vitro did not plan on using initial factor advantages posed by NAFTA, such as low labor costs in its longer term strategy, because it understood that over time these would end. Instead it planned a strategy of utilizing superior competitive advantage in developing superior core competencies based upon improving technology, global capabilities and innovation..(Nichols, 1993)

Similarly Moroccan firms must seek to define what are the new opportunities and threats presented by entering into free trade with the European Union. What are the niches that can be exploited in the new merged market ? What is the new competition likely to like ? How best can they adapt to meet this new competition and fill possible new market niches ? What are the core, comparative and competitive competencies they can develop and or build upon ? How can they use the next ten years to position themselves, to transform themselves ? Can they develop a European capability which they can leverage into a global capability ? To do so they can usefully adapt many of Vitro's strategies.

The Moroccan government has made other structural efforts to attract FDI, including : a new financial and investment code designed to better serve the needs of foreign investors with such easements as a guarantee of funds transfers, no restrictions on currency exchange, lowered taxes etc, the establishment of offshore financial zones, foreign participation in privatization, guarantees and signed conventions against expropriation and double taxation, the establishment of commercial courts, etc. These measures have been part of the government's overall strategic plan to raise the competitiveness of Moroccan companies, called the "Mise a' Niveau" or the "raising to a new level" plan, which include the following, recognition of the private sector as the primary engine of growth, focusing public services and infrastructure

upon the private sector, reform of the educational system to better serve private sector needs, the raising of legal and judicial standards to international levels, the creation of industrial parks, the promotion of quality enhancement programs, export promotion, improving the technological infrastructure by creating a number of research centers on key technologies, improving professional associations,, new assistance programs (finance and advice) for entrepreneurs, and financial guarantees for investors. The government is also working with the European Commission to devise a joint program for Moroccan adaptation, which currently is budgeted at about 4.5 billion ECUs or about 5 billion US dollars.(Min. Finance 1998)

The Moroccan government after independence adopted a restricted currency exchange program whereby the currency was effectively overvalued so that capital goods could be imported into the industrial sector for a program of import substitution.. This policy hampered exports, particularly agricultural exports, To promote exports this policy has been gradually reversed and currency exchange has been liberalized and the Dirham's value decreased from 8.5 dh/US\$ to 9.6 dh/US\$ today. The government has also embarked upon a program in financial reform and innovation to encourage European firms to establish in the country, especially those aimed at exporting. These measures include the ECIP, the European Community Investment Partners program, and the BEI, Banque European d'Investissement, program. (Min. Finance 1998)

ECIP

Under this program a Moroccan enterprise may identify an investment opportunity and a European partner with the needed know-how, technology, and or financing. ECIP financing may be used for Feasibility studies of projects , Preliminary studies for forming partnerships, Capital financing, Management training, support and maintenance.

BEI

This program offers risk capital to investors with high commercial or technical risks. The amount, and terms of the financing are based upon the type of project and the availability of complementary credits and financing. It also offers its own feasibility studies and due diligence.

In addition, the Ministry of Finance and the Central Bank(Bank Al Maghreb) have developed various programs for financing and insuring exports. In relation the Societe Marocaine d'Assurance a la Exportation has been designated by the Ministry of finance as the provider of export insurance, which covers monetary, political, and "acts of god" risks.

In order to prepare the industrial goods to stand up to the EU competition, the government has exerted considerable efforts toward the privatization of publicly held enterprises. More than half of the firms under the privatization program are found in the industrial sector ,in addition to firms in different sectors, such as, CTM-LN(transport), SAMIR(steel).The program was authorized to transfer to the private sector 112 entities(75 companies and 37 hotels in the privatization law. Including indirect holdings, privatization will have an impact on 40% of the state portfolio.

To benefit from foreign style of management, and technology, 4 hotels, and 10 companies were sold in whole or in part to foreign buyers. Among the foreign industrial buyers figure Holderbank, the Swiss cement group; Dragofina, an Italian petroleum company (Ministry of Privatization and State Enterprises, 1996).

There is a recognition that current social and tax legislation is not conducive to enterprise, and export enterprise in particular, resulting in a growing informal or underground business sector which does not all or most of the taxes, required of the more formal sector. Efforts are currently underway as to how to adjust such legislation so that firms in the formal sector, as most EU firms would be, would not be at a competitive disadvantage. The Moroccan government should also clearly define where the country stands in terms of Porter's model of the competitive advantage of nations, (Porter 1990) and how it may evolve in relation over time. Porter's model states that factor conditions, firm structure and rivalry, demand conditions and related and supporting industries combine and interact to form an integrated "diamond" to determine the country's competitive position and advantage. In this diamond it is apparent that the only point on the diamond that would be the country's favor is factor conditions. The other points of the diamond clearly give the country a competitive disadvantage. It may be very difficult to develop a viable strategy in little more than ten years to put the country on a competitive footing with most European countries if the aim were upgrade all points of the diamond at the same time, but a serial strategy may be possible using the establishment and upgrading of firms initially based on factor advantages and then

climbing the ladder to develop a “cluster” (Porter 1990) of competitive firms, which would also stimulate related and supporting industries and in time increase demand conditions through increases in the standard of living. This is to some extent what is happening but for the country to successfully adapt to free trade with the EU a conscious planned strategy must be developed the government and private firms in cooperation and with all due priority.

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