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REGIONAL ARAB PROGRAMME FOR
THE DEVELOPMENT OF SUB-CONTRACTING

DP/RAB/86/001

Technical Report : Integration-Compensation in Relation to Sub-contracting *

Prepared for the Governments of Algeria, Egypt,
Iraq, Jordan, Morocco and Tunisia
by the United Nations Industrial Development Organization,
acting as executing agency for the
United Nations Development Programme

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* This document has been translated from an unedited original.

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INTRODUCTION

Scope and object of the study

This study falls within the general scope of the Regional Arab Programme for the Development of Sub-contracting, DP/RAB/86/001, which covers the following six countries : MOROCCO, ALGERIA, TUNISIA, EGYPT, IRAQ and JORDAN.

The object of the report is :

- to study the existing legislations concerning national integration-compensation, regulating sub-contracting operations with foreign partners, in the Arab countries,
- to study the advantages and disadvantages of the integration-compensation system for the national economy (technological integration, the promoting of exports and the inflow of foreign currency but with the risk of discouraging foreign partners), and
- to study and recommend a common integration-compensation system to be adopted in the national legislations of each country.

With this in view the study was based in Tunisia with visits being paid to Egypt, Morocco and Algeria.

It was found that the legislation covering integration-compensation, if it existed at all in these countries, applied only to the automobile industry sector.

* * *

The development of industrial activities in developing countries arises at least in part from a questioning of their status as exporters of primary products and their claims on the valorization of their natural resources.

Such activities were initally based on the policy of import substitution which was adopted by ECLAC, the Economic Commission for Latin America and the Caribbean, at the end of the forties.

The ECLAC thesis, which placed the emphasis on deteriorations in trading terms for primary production countries, was used to formulate industrialisation policies directed towards the replacement of imports, with a view to increasing national production and of attenuating their balance of payments problems.

I - THE POLICY OF IMPORT SUBSTITUTION

The principal instruments of this policy are :

I.1 - Customs' protection

Customs' or tariff protection is often considered to be a necessary measure for the industrial development of developing countries. The creation and survival of newly established industries justified the existence of protectionist barriers, without which they would not be able to face up to external competition.

In effect the customs' barriers, by raising the price of a product which could be imported, made it possible for local manufacturers to produce at a higher cost than that of their foreign competitors without the risk of being eliminated from the market.

For example: Customs' duties on imports of vehicles into Argentina were raised to 400% - 500% when automobile production started up.

Tariffs varied from one country to another, but this measure limited the outflow of foreign currency and so constrained the foreign partner to establish production within the country in order to safeguard former markets.

I.2 - State shareholdings in company capital

Another form of State intervention involved taking shares in the capital of assembly companies. These were either companies created by the State, in which foreign firms and/or private investors had shareholdings, or they were private companies in which the State had a shareholding.

The proportion of public capital funding, together with the level of decision making retained by the State, was in part a function of the economic and industrial policy of each country.

The Governments of the developing countries hoped, by means of joint-ventures, firstly to limit the outflow of foreign currency (by the repatriation of profits, etc.) and secondly to transfer part of the profits to local shareholders.

II - THE SEARCH FOR NATIONAL INTEGRATION

This is the fundamental aspect which characterises the legislation of each country, and which is well illustrated in the automobile sector.

The need to achieve savings in foreign currency, the desire to accelerate the rate of growth of their industry and to create new jobs, encouraged the developing countries to favour the establishment of vehicle assembly lines on their own territory and to slow down the importing of 'built-up' vehicles.

It was under these conditions that countries became aware of the possibility of establishing local production. Each country, preoccupied by the place which this type of activity could fill within its industrialisation policy, sought to determine the path it needed to follow in order to develop a local automobile industry.

In order to achieve these objectives the developing countries sought to make the incorporation of locally manufactured parts compulsory.

Some countries had fixed, at the time local assembly of automobiles started up, the percentage of local integration which had to be achieved by a given date. Decrees were drawn up to oblige manufacturers to comply with the dates for the progressive raising of levels for the integration of local parts.

II.1 - Levels of integration

Since national integration consists of assembling vehicles from their components, and then of systematically replacing imported components with those manufactured locally, national integration may be expressed, at any given date, as a percentage. The way in which levels are defined varies from country to country.

It can be expressed in terms of weight, of volume or of value, the aim being always to give an idea of the contribution of local production to the total manufacture of the vehicle involved.

II.2 - Methods of calculating levels of integration

1 - The manufacturers' method

The definition put forward by the manufacturers is that based on the level of 'offsetting'.

In this case the numerator is the value of the parts manufactured locally and expressed at the FOB (free on board) prices shown in the manufacturers' CKD (completely knocked-down) collections, whilst the denominator is the FOB value of the complete collection :

$$\frac{\text{Offset value}}{\text{Price of the complete CKD collection}}$$

2 The Moroccan method

This method values the locally manufactured parts at the price at which they are sold by the foreign exporter, that is to say the CIF (cost, insurance and freight) value.

The level of integration is given by the ratio of the difference between the complete CKD costs and the CKD cost reduced by the locally produced parts to the total cost of the complete CKD collection, that is to say in CIF terms :

$$\frac{\text{Complete CKD} - \text{Reduced CKD}}{\text{Complete CKD}}$$

This ratio is also termed the level of technical integration since it ignores all local valorizations (labour, manufacturers' costs, etc.).

3 - Method taking assembly into account

This gives a figure for the level of economic integration, measuring the value added by the assembly company. It is equal to the ratio of the difference between the value of the BU (built-up) vehicle and that of the reduced CKD to the value of the BU vehicle, that is to say :

$$\frac{\text{BU} - \text{Reduced CKD}}{\text{BU}}$$

4 - The Mexican method

This is the direct costs method, taking into account expenditure in foreign currency on imports of materials, licence payments and re-exported profits as external elements. The level of integration is given by the ratio of these expenditures to the price of the vehicle in the country of origin.

This ratio takes account of all the visible elements (imports) or invisible elements (profits) which influence the balance of payments.

In the following sections we give the results of this policy in some developing countries.

5 - Brazil

In 1956 Brazil decreed an integration of 95% by weight during the course of 1960. This date was met by all the manufacturers.

6 - Chile

In 1962 Chile imposed a level of integration of 50% for private cars and 25% for all small utility vehicles.

7 - Mexico

In 1962 this country imposed a level of integration of 60% on direct costs, to be met before 1966: this date was met by all the manufacturers.

8 - Philippines

The required level of integration was fixed at 82% before 1982. However this level has not been achieved, being 62.5% in 1978.

9 - Morocco

The first Moroccan Five-Year Plan for 1960-1964 fixed a level of integration of 40% for private cars and 70% for utility vehicles: these levels have never been achieved.

It should be pointed out that these different ratios have been obtained without taking into account the additional cost of the local parts as compared with imported parts delivered to the factory, since in the majority of cases purchases of raw materials, semi-products and items of equipment are made abroad.

III - THE LIMITS OF THE IMPORT SUBSTITUTION POLICY AND THE APPEARANCE OF COMPENSATION

As a development policy import substitution has not produced the results which were counted on by the developing countries.

This policy has given rise to the following three groups of countries :

* countries in which local integration is up to 100%, such as Brazil, Argentina, India, Spain and South Korea,
* countries where integration is at a moderate level, being voluntarily limited for reasons of production costs, as is the case in Mexico,
* countries where integration is limited by technical and economic reasons.

The principal factors which have contributed towards limiting the scope of this policy in most of the developing countries are :

1. the limited size of the market,
2. the problems of financing the imported production apparatus and techniques,
3. the excessive costs which may result from the manufacture of complex components (half-shafts, gearboxes, etc.).

III.1 - Compensation

In the face of the setback suffered by this model of development the developing countries adopted a new strategy from the seventies onwards, based on promoting exports. This was the origin of compensation.

III.2 - The definition of compensation

Compensation consists of the purchase, by the manufacturer involved in an assembly unit and in a given country, of goods produced in that country with a view to ensuring a source of foreign currency which would cover, totally or partially, the expenditure occasioned by the assembly operations.

III.3 - The compensation products

Compensation agreements involve the manufacturer accepting responsibility for selling manufactured products or raw materials on other markets.

To deal with this situation the manufacturers have set up companies specialising in this type of trading. Examples of these are Renault's SORIMEX, Opel's REINSENHAGEN, the SOGHO SOCHAS in Japan and many other companies which market Colombian coffee, bananas, olive oil, phosphates, etc.

Another form of compensation which is used is the establishment of the so-called 'compensation' projects, the production of these being reserved exclusively for export.

III.4 - Levels of integration-compensation

The pertinence of this strategy is measured by the level of integration-compensation. The method of calculating this level varies from one country to another: however it always takes account of the offset value of the exports from the manufacturer and the value of the CKD collections.

Laws regulating assembly activities and compensation have been drawn up in several developing countries, including MOROCCO.

Forms of compensation

1. The manufacturer purchases the components for his final product in the country concerned.

2. The manufacturer invests (in foreign currency) in a local company which manufactures (and exports) related products.

THE TUNISIAN EXPERIENCE

On the morrow of its independence in 1956 Tunisia found itself confronted with a multitude of social, economic and political problems linked with independence.

It was not until the beginning of the sixties that the political conditions were united with a planned and organised development.

- The first decade was directed essentially to the construction of the basic infrastructure and to socio-educative development, factors which were considered to be the prior requirements for any industrial development.

- During the second decade special emphasis was placed on the industrial sector, and a greater effort towards industrialisation was made by the country.

  The contribution of capital investments devoted to the manufacturing sector averaged about 22% of all investment.

- During the Seventh Development Plan (1987-1991) the manufacturing industries were called on to consolidate their contribution to the development of the country, both in regard to the creation of employment and regional development and also to the promotion of exports and to improving the balance of payments.

During the second decade and at the start of the third decade a series of legislative texts and measures were promulgated in favour of industrial development, including the following :

* Law 72/38 of 27 April 1972 (modified by the decree-law 85/14 of 11/10/1985) creating a special régime favouring the exporting industries;

* The creation of the Investment Promotion Agency (API) in 1973; this is a public body responsible for industrial development;

* Law 74-74 of 3 August 1974, rescinded by Law 81/56 of 23 June 1981, concerning those manufacturing industries with a production intended essentially for the local market.

* Law 87/51 of 2 August 1987 establishing a code for investments.

These measures made it possible to favour the creation of a not inconsiderable industrial fabric, as may be seen from the table on the following page.

PROJECTS, INVESTMENTS AND JOBS CREATED DURING THE PERIOD 1973-1986

Date	Number of projects	Investments in millions Tunisian Dinars	Number of jobs
4th Plan 1973-76	4,329	840.7	143,738
5th Plan 1977-81	7,818	1835.6	195,654
7th Plan 1982-86	8,534	2491.6	175,404

Source : A.P.I.

However these industries are based essentially on imported semi-products or raw materials, and the projects created are relatively more dependent for their supplies on inputs from outside than are the local production activities.

In effect the legislation which was promulgated did not make express provision for clauses relating to a minimum level of integration or for compensation.

In order to mitigate this inadequacy the administrative council of the Investment Promotion Agency(1), some of whose decisions have entered case law in regard to industrial development, when examining in 1981 a project from RENAULT for the assembly of private cars, required a net compensation level of 50% in the sector of industries related to the automobile sector for the foreign currency part of the project.

This policy has subsequently been applied to all the assembly units in the automobile industry, but it has never been made the subject of legislation as such. It remains a subject for negotiation, case by case and with each industrial manufacturer and enterprise.

....

(1) The administrative council of the I.P.A., which is formed from the various departments and bodies involved in industrial development, examines those projects submitted for approval where the total capital investment exceeds 500,000 Tunisian Dinars.

The Tunisian experience in the automobile industry

Tunisia entered the automobile industry in 1967 with the establishment of an automobile assembly unit, the SOCIETE TUNISIENNE DES INDUSTRIES AUTOMOBILES (STIA).

The idea arose from the economic policy adopted at that time which involved creating a pole of industrial development around which to develop a multitude of small and medium companies.

The objectives were :

- the creation of jobs,
- the development of the industrial fabric,
- the improvement of the currency position.

STIA, which assembles vehicles from imported CKD collections, has not succeeded in creating around itself the expected development of other industries.

In fact until the beginning of the eighties no automobile sub-contracting company had been created as a supplier to STIA.

Those companies manufacturing automobile components which were developed during this period worked essentially for the spares market.

The principal causes for this failure on the part of STIA were :

1) The reluctance, if not the open opposition, towards local integration activity which was shown by those partners who were in a monopoly situation
2) The absence of Tunisian legislation in regard to integration,
3) The absence of quality control operated by the Tunisian suppliers.

Disturbed by the balance of payments situation, and in the light of the experience of STIA, the authorities were led to revise their policy in this field.

The strategy adopted (the cooperation scheme chosen)

The principal objective of the policy followed in respect of the automobile industry was to draw the principal foreign firms with considerable shares in the local market into a true industrial cooperation which went beyond the purely commercial activities which these firms carried out in Tunisia with more or less efficient sales departments.

Within this framework discussions have been initiated on the basis of the following scheme :

To obtain a direct undertaking from the firms to establish a genuine partnership with a view to the industrialisation of the automobile sector. This direct undertaking from the firms is to include :

- Participation in the capital of the assembly units and of the compensation units,
- Shareholding in the technical and commercial management of the products. The aim of this shareholding is to ensure the competitiveness of the manufactured products by way of the motivation and involvement of the partners in the projects which are envisaged,
- Integration and compensation.

These criteria allow an industrial environment to be created around the assembly units by reinforcing the already existing sub-contracting units and by creating new units for the local and export markets. The ultimate objective is the acquisition of technology and compensation for the amounts of foreign currency paid to the partners when purchasing the CKD collections.

a - The assembly side

This scheme therefore has firstly an assembly side, in respect of which the Tunisian market has been divided into more or less homogeneous target areas for light vehicles :

. Private cars at the bottom and middle of the range,

. Utility vehicles.

To this end two or three manufacturers for each range or part of a range have, in general, been appointed so as to favour competition and to provide a fairly diversified choice for the consumer.

b - The integration-compensation side

Integration

The foreign partner involved in the assembly project undertakes to achieve integration within the project in the following way :

. By utilising components, already manufactured in Tunisia or other Maghreb countries, at a level varying from 10% to 30% (according to the foreign partner involved, and with an increasing level during the first five years),

. By seeking local partners able to establish sub-contracting companies which would become suppliers to the foreign assembly companies established in Tunisia.

Compensation

An undertaking is established in order to compensate for the expenditure of foreign currency on the assembly installations with a level rising up to 50% for the first five years of operation of the assembly units, to ether with an initial evaluation and, where necessary, a revision of the undertakings by each side in the light of the results achieved during the first five years.

This compensation should result in the following complementary actions :

- THE PURCHASE of products from the automobile sector or of related products from local producers (the percentage or quantity being fixed according to the foreign manufacturer - see the tables on the following pages) for the partner firm's own requirements or for those of any other companies linked with the partner firm.
- THE BUYING-BACK of part of the vehicles assembled in Tunisia (the percentage or quantity being fixed according to the foreign manufacturer).
- THE ESTABLISHMENT OF UNITS in Tunisia for the manufacture of components, these components being intended essentially for export (and not to supply the assembly plant).

  These units are to be initiated by the foreign partner, with whom firm export contracts must be concluded.

  Furthermore all these units are required to be established on a decentralised basis in such a way as to form poles for development in the less industrialised regions.

Agreements which have been signed

Five agreements have been signed after negotiation, and these have been duly approved.

The tables on the following pages summarise the agreements which have been signed with each manufacturer involved in an assembly project. These agreements cover both the assembly programme and also the undertakings in regard to integration-compensation.

UNDERTAKINGS AS SET OUT IN THE AGREEMENT PROTOCOLS

MANUFACTURER	PEUGEOT	CITROEN	RENAULT	GENERAL MOTORS	MERCEDES	VOLKSWAGEN	TOTALS
INSTALLED PRODUCTION (1) (units/year)	- 504 Pick-up : 10,000 - 504 Safari : 1,000 - 305 Saloons, Estates and Trucks : 2500	- Acadiane or equivalent : 1000 - LNA : 500 - VISA II : 3000	- R5 : 2000 - R9 : 2000	- Isuzu KBD Pick-up : 4000 - Opel Record : 2000	- Trucks : 770 - Combi/bus : 330 - Flat-bed vehicles : 1100	- Golf & Jetta : 3000 - LT and Transporter : 2000 (utilities)	35,200
JOBS	400		206	600	174	371	1751
TECHNICAL INTEGRATION	- 504 Pick-up : 1st year 13% 2nd year 20% 3rd year 24% 4th year 27% 5th year 30% - Private cars : 8% integration from the 1 . year	- 8% integration for all models from the 1st year	- 10% integration for the two models from the 1st year	- Integration for all models will rise from 12.9% in the 1st year to 30% at end of the 5th year	- Trucks: 25.79% - Combi-bus : 30.09% - Flat-bed vehicles : 42.02% (from the 1st year of production)	- Integration for all models will be : 6% in 1st year 12.5% in 2nd 15.5% in 3rd 20.5% in 4th 25% in 5th year	

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(1) Production intended for the local market, unless specifically indicated to the contrary.

	PEUGEOT	CITROEN	RENAULT	GEN. MOTORS	MERCEDES	VOLKWAGEN
COMPENSATION	- Buy-back of 3000 504 pick-ups - Creation of STUFOM to produce three parts of the XU engine and flywheel of the XD 3 engine (Export TO about US$4,000,000) - Purchase of car parts made in Tunisia by SOGEDAC (Export turnover about US$1,000,000) - Purchase by FRECOM, Peugeot subsidiary, of non-automobile products (Export TO US$522,000)	- Purchase of part of the production of STUFOM to a value of US$610,000 - Creation of LA TUNISIENNE DE L'OUTILLAGE producing tools with an export turnover of US$216,000 - Purchase of Tunisian car parts by SOGEDAC to a value of US$650,000 - Purchase of non-automobile products to a value of US$261,000	- BONDEN TUNISIE project for the manufacture of remote controls for cars, cycles and mopeds (Export TO US$1,120,000) - RIT project to produce hand-brake levers & safety wheel nuts (Export TO US$1,295,000) - SOTUPEA for the manufacture of oil-filled ignition coils (Export TO US$826,000) - STAC for the manufacture of fuel level detectors (Export TO US$518,000)	- Creation of a series of projects, the export TO of which to be US$12m at end of the 5th year 1. VALEO EMBRAYAGES TUNISIE (Export turnover is US$1,430,000) 2. COFAT INTER-NATIONAL (Export TO is US$3,150,000) 3. Spark plugs 4. Driving mirrors sun visors and locks 5. Rubber components 6. Stamped metal components - Purchase of Tunisian industrial products by Motors Trading Corp. (Export TO is US$8m)	- 50% of the production exported	- Compensation of 50% of the net imports of CKD by the end of the 5th year, including the buy-back of 500 LT

This policy has begun to bear fruit; as an example of this the following table shows the 1984 balance sheet for compensation by the manufacturers (as in operation at that date) :

in Tunisian Dinars

DESIGNATION \ MANUFACTURER	RENAULT	PEUGEOT	GENERAL MOTORS (*)
CKD imports	3,097,395	25,000,000	-
(A) Total compensation negotiated	1,548,700	12,500,000	-
(B) Compensation realised - as turnover as value added	 729,400 292,000	 10,230,000 10,230,000	 159,000 130,000
Coverage ratio (B/A) - as turnover as value added	 47% 19%	 82% 82%	 - -

Source : Manufacturers

(*) GENERAL MOTORS were involved in compensation operations even before the assembly unit came into production.

Reasons for the setback

1. However, the national and international crisis in 1985-87 (a fall in the purchasing power of the Tunisian Dinar), and
2. the reluctance of the manufacturers to apply the agreements made in respect of integration-compensation led the Tunisian authorities to revise their policy :

   As a result :

   - The VW project was completely abandonned.
   - The RENAULT MONTAGE TUNISIE plant was shut down.
   - The GENERAL MOTORS assembly plant never started up, although most of the equipment had been acquired.
   - The activity of STIA (with the PEUGEOT and CITROEN group) was reduced in January 1988 to just the assembly of industrial vehicles.

These decisions to shut down plants, coming essentially from the Tunisian Government, were primarily based on the negative effects of this industry on the currency situation.

3. <u>The levels of integration and compensation</u> were not clearly defined in the contracts signed with the foreign partners :

- The required levels were not the same for each manufacturer;
- These percentages were not linked with penalties in the event of non-compliance, so as to avoid promises which would be difficult to honour.

4. <u>Negotiations</u> :

The industrial projects promised by the partners within the framework of integration-compensation took a long while to be implemented, if they started up at all, and this was very often with higher costs and altered objectives.

Realising the compensation operations was also mainly held back by problems of the time taken, voluntarily or involuntarity, by the manufacturers to approve the products, together with price discussions and the failure of the manufacturers to accept the slight excess costs which operated to the disadvantage of the local producers as compared with foreign industries.

THE MOROCCAN EXPERIENCE IN REGARD TO INTEGRATION-COMPENSATION

Since independence Morocco has made continuing efforts towards industrialisation through the combined effects of a strategy for encouraging import substitution and a policy for promoting exports.

At the present time the manufacturing sector occupies an important place in the national economy. It contributes about 13% to the overall domestic value added formation and thus becomes one of the essential factors in the economic and social development of the country. Industry directly absorbs 5% of the active population or 7.5% if indirect employment is included.

In addition to this, and despite an unfavourable international economic context, industrial exports have increased at an average annual rate of some 26% during the period from 1980 to 1985.

This relatively positive balance sheet is the consequence of a series of measures taken by the Moroccan Government, including :

- the creation of the Office pour le Développement Industriel (ODI), a public body responsible for industrial promotion and participation,
- the promulgation in 1983 of the industrial investments code, replacing the 1973 code,
- the promulgation in 1982 of the integration-compensation law applied to the automobile industry sector.

The Moroccan automobile industry

Within the framework of its industrial policy Morocco decided, towards the close of the fifties, to create an automobile assembly industry on an import substitution model.

The establishment of the first assembly enterprises was intended to constitute the basic element in a process of integrating local manufacture.

The assembly enterprises

In Morocco the automobile industry is characterised by an activity of assembling private and utility vehicles and an activity of manufacturing spares.

This industry accounts for 32% of the production, 22% of the value added and 19% of the employment in the metallurgical and mechanical, electrical and electronic engineering industries (IMME).

The automobile companies active in Morocco are Moroccan enterprises in which the manufacturers have shareholdings. The table on the following page lists the companies involved in assembling automobiles.

LOCAL FIRM	TYPE OF ACTIVITY (1)	INTEGRATION	PRODUCTION CAPACITY	NUMBER OF JOBS
SOMACA : Capital - Fiat 20% Talbot France 20% State 46% Private Moroccan 14% Location : CASABLANCA	Assembly of PC and small UV: FIAT, TALBOT, RENAULT, PEUGEOT 504 Pick-up	Effective level : 12% (excluding assembly)	25,000 vehicles per year in 1 shift	1175
CITROEN-MAROC Company in which Citroën holds 34% of capital	Assembly of PC (CX)	Ceased its activity at end of 1983	300 vehicles per year	65
BERLIET MAROC Berliet 40% SNI 60%	Assembly of UV	Effective level : 18% (excluding assembly)	8000 vehicles per year	600
AUTO HALL	Assembly of FORD UV		1800 trucks/year 800 pumps/year	850
SAIDA	Assembly of 10.7t and 19t VOLVO and BEDFORD UV and VOLVO cars and road tractors		4000 units/year	650
SOMAMI - DAF	Assembly of DAF vehicles		180 to 250 per year	350
SODIA Moroccan capital	Assembly of AMERICAN MOTORS Jeeps		360 per year	30
AETCO LEVER Capital entirely Moroccan	Assembly of Rover Leyland Jeeps		500 per year	200
HINO MOTORS	Assembly of 5.5t trucks in the SAIDA plant	10%		

....

(1) PC = Private Cars ; UV = Utility Vehicles

The sub-contracting companies

There are about a hundred sub-contracting companies, mostly at the semi-industrial stage, characterised by high labour contents and very short production runs requiring constant changing of moulds and tools.

They specialise in the production of parts and accessories of low technicity and with a low value added content.

Their activities are mainly directed towards the spares market and, recently and to a very limited extent, to outside markets.

Since the creation of the first assembly lines the action of the State has been decisive in guiding the development of the automobile industry in Morocco: the major phases of the evolution of this industry have corresponded to the various stages of State intervention.

Three stages can be distinguished, more or less following the directives of successive plans :

- From 1958 to 1960 : this phase is characterised by the construction of the first assembly plants where the creation of the automobile industry formed part of a policy of export substitution, parallel to the establishment of other complementary industries (iron and steel, mechanical engineering, etc.) and with the aim of forming a "balanced industrial complex".
- From 1960 to 1970 : no clearly defined policy was followed. These years were more characterised by an anarchic development of the assembly lines than by any desire to develop an integrated automobile industry.
- It is since 1973 that a shift towards international sub-contracting has evolved as a solution to the crisis in the automobile assembly industry.

The 1973-1977 Plan makes the promotion of exports of manufactured products the dominant guideline.

In effect the Moroccan Government, finding that the import substitution model was failing, attempted to modify the existing legislation by imposing the so-called integration-compensation law which consists in finding a solution in the short and medium term by opening up to the outside world.

In June 1982 parliament voted in an integration-compensation law regulating the assembly industries in Morocco.

This law, published in June 1982, had been drafted during 1972, a period when the market was expanding.

The long delay in its application may be attributed, quite apart from the reluctance of the foreign manufacturers, to the hostility of the Moroccan merchants who saw this law as attacking their vital interests.

Under this law the importing of spare parts is subject to a very high tax, or is even prohibited.

<u>Moroccan legislation in regard to integration-compensation</u>

In Morocco Law 10-81, promulgated by DAHIR No. 1-81-306 dated 6 May 1982, controls the assembling of automobile vehicles.

This law stipulates that authorisation for assembling is granted to any enterprise which undertakes in writing to achieve the level of integration-compensation laid down by the legislation in force, to integrate parts recognised as being of local manufacture and to produce the number of vehicles fixed by the authorisation.

The assembly of a new model as replacement for another model is also subject to approval.

In the event of non-compliance with the undertakings (replacement of a model without prior authorisation, failure to be in production by the stipulated date, namely 24 months after authorisation, failure to achieve the level of integration-compensation, etc.) provision is made for various penalties (fines, withdrawal of the authorisation, etc).

<u>Required levels of integration-compensation</u>

It has been laid down that at the end of three years the level of integration compensation in the automobile sector should be :

- 50% in the private vehicle category,
- 50% in the light industrial or utility vehicle category, and
- 60% in the heavy industrial or utility vehicle category,

in the case of units where the production is in excess of 2000 units/year for each model of private vehicles or light industrial or utility vehicles and 600 units/year for each model of heavy industrial vehicles or agricultural tractors.

These levels are reduced by 10% for those units where the production of each approved model is lower than the above figures, and these constitute the minimum levels required by the Moroccan authorities.

<u>Calculation of the integration-compensation levels</u>

When determining the integration-compensation levels each category is taken as a whole.

Private or light industrial vehicles

The integration-compensation level is calculated on the basis of each financial year, and takes into account :

a = Value of the parts offset by the manufacturer and which are to be replaced by others of local manufacture.

b = Value (FOB) of parts produced locally and exported as compensation by the manufacturer.

c = Value (FOB) of vehicles assembled locally and which are exported, reduced by the value (C&F) of the corresponding CKD collections delivered by the manufacturer.

d = Value (C&F) of all the CKD collections delivered by the manufacturer, augmented by those offset as under (a).

The level is thus equal to :

$$\frac{a + b + c}{d}$$

Heavy industrial and utility vehicles

The law has laid down that, when calculating the level of integration-compensation in this category, the corresponding CKD collection is that for the "chassis only". Therefore coachwork, bodies, trailers or semi-trailers in particular are not taken into consideration.

A ministerial decree of 1986 cancelled this consideration because the assembly units had not been able to exceed the level of 15%.

The level of integration-compensation is therefore equal to :

$$\frac{a + b + c + e}{d + e}$$

where :

e = Value (FOB) of the equipment of heavy vehicles, such as the coachwork, bodies, trailers or semi-trailers.

A national technical committee fixes the average prices for such equipment on the basis of consultation with local sub-contractors.

It was thus hoped that the obligation placed on firms to incorporate a minimum level of local parts would, in the long term, have an encouraging effect by the multiplication of local sub-contracting enterprises.

In fact, and unlike other developing countries, Morocco requires that the products which are the subject of compensation must come from the mechanical engineering sector.

Therefore the manufacturers who deliver CKD collections have been led either to create subsidiaries for the production of automobile accessories (as in the case of RENAULT with its subsidiary RENAULT INDUSTRIE MAROC) or to purchase parts from local subcontractors (as in the case of PEUGEOT and TALBOT).

Contributions and limits

The advantages of the integration-compensation policy in regard to saving foreign currencies are obvious.

In the case of Morocco the table below makes it possible to evaluate the currency savings effected through compensation.

THE VALUE OF INTEGRATION-COMPENSATION

In millions Moroccan Dirhams

MANUFACTURERS	1980	1981	1982
PEUGEOT			
Integration	2.8	5.4	n.d.
Compensation	12.8	15.0	n.d.
RENAULT			
Integration	13.4	18.6	26.1
Compensation	26.7	29.6	38.7
TALBOT			
Integration	5.8	n.d.	n.d.
Compensation	14.3	12.94	n.d.
FIAT			
Integration	2.7	n.d.	n.d.
Compensation	17.8	n.d.	n.d.

Source : Maghreb Développement : "Voitures particulières et sous-traitance" No.58 - 1st Quarter 1983, p.27

Given that the level of integration still remains low it is therefore compensation which makes the largest contribution in relation to the law and hence to increasing the level of integration-compensation.

The table on the following page shows that manufacturers were obliged to take the draft law into account, and most of them very rapidly achieved appreciable levels of integration-compensation.

LEVELS OF INTEGRATION-COMPENSATION ACHIEVED
BY MANUFACTURERS ESTABLISHED IN MOROCCO

(as percentages)

MANUFACTURERS	1980	1981	1982
PEUGEOT	56.1	62.2	40.0
RENAULT	58.8	58.8	n.d.
TALBOT	32.0	30.5	n.d.
FIAT	17.3	20.0	n.d.

Source : Maghreb Dèveloppement No.58
1st Quarter 1983, p.27

Certainly this law has made it possible to develop certain units for automobile sub-contracting (engine parts, chassis and bodywork components, seats and interior fittings for vehicles and certain accessories) and to increase exports, but these are only labour-intensive units using the simplest of techniques.

In addition this law made no provision for delays in changing models (it only fixed the quantities, 2000 in the case of private vehicles and 600 in the case of industrial vehicles). In fact frequent changes in models penalise local sub-contracting (a short learning period and small production run to amortise tooling). As an example of this FIAT changed its model four times in a period of five years.

It should also be noted that this law has resulted in some reluctance on the part of the manufacturers. The number of private cars assembled in Morocco has in fact fallen from nearly 25,000 units in 1975 to 11,000 units in 1987, and this is essentially the result of the desire of the manufacturers to revise their undertakings downwards as well as to the effects of the national and international crises.

THE ALGERIAN EXPERIENCE

The industrial development strategy adopted by Algeria on the morrow of its independence was marked by :

- The nationalisation of the interests held by foreign companies, particularly the oil and mining resources,
- the development of industries for the valorization of raw materials,
- the establishment of major integrated industrial complexes.

Two essential phases may thus be distinguished :

Phase I : 1970 to 1979

This phase was devoted to the development of vertical integration and the creation of national enterprises specialising in the industrial infrastructure : forges, foundries, rolling mills, etc. and the production of consumer goods. This period was also marked by the high level of growth of the domestic demand and the growth of resources for financing, resulting from exports of oil.

The preferential choice of large-scale projects generated excessive economic and financial costs both in the construction and the operation of the units.

Phase II ; 1980 to 1989

This phase was marked by the carrying out of the First Five-Year Plan, 1980-1984, and the drafting of the Second Five-Year Plan, 1985-1989.

The objectives of the First 1980-84 Plan envisaged essentially a higher level of efficacy and a more intense utilisation of the potential of the existing industrial production apparatus.

The 1985-1989 Five-Year Plan envisaged in particular the development of the integration industries by meeting the needs of the priority branches and those activities which are of such a nature as to improve external trading.

From turnkey investments to mixed projects

Practically all the industrial enterprises created during the first phase were national companies without foreign participation, and their production was intended for the local market.

The investments made were of the turnkey or products-in-hand type, where an obligation regarding results was imposed on the supplier, since he was held not to have fulfilled his obligations, and so did not receive payment, until the forecast performance was achieved.

Furthermore, and with a view to developing local industry, the Algerian authorities required a fairly high level of internal integration: as an example of this the GUELMA cycle and motor-cycle plants achieved integration levels of 80% and 60% respectively.

However this policy did not produce the expected results, and this led the Algerian authorities to abrogate the 1966 Investments Code.

The latter in effect controlled at the same time, although under different régimes, national and foreign investments and made no provision for clauses relating to integration-compensation. This Investment Code was replaced by :

- Law 82-11 of 21 August 1982 covering private national economic investments, and
- Law 82-13 of 28 August 1982 covering the creation and operation of mixed economy companies.

The creation of mixed companies : The rôle of the agreement protocol.

The Law of 28 August 1982 lays down that one or more State enterprises are authorised to create mixed economy companies with one or more foreign enterprises.

These companies become share-issuing companies operating under Algerian commercial law, their own articles of association, the agreement protocol and the Law of 28 August 1982. According to Article 22 the shareholding of the State enterprise must never be less than 51%.

It is necessary to emphasize the procedure at the termination of which such a company may be constituted. The Law of 28 August 1982 establishes first of all "an agreement protocol" which is a form of prior contract concluded by the Algerian partner with the foreign partner.

According to Article 4

"this protocol must specifically define :

- the undertakings and obligations of each of the parties,
- the methods and means for ensuring a genuine transfer of knowledge and know-how, in particular for the promotion of exporting",

and is in this way to provide an outline of the integration-compensation policy.

Thus the Law of 28 August 1982 closely links the foreign enterprise, the supplier of the technology, with the capital needed to put it into effect.

To this end Algeria links the remuneration for the services of the foreign partner to the actual success of the investment and no longer to the execution of his services or supplies.

The foreign partner is thus held to an obligation concerning results, the law in effect providing that :

"The Mixed Economy Company is required to achieve the objectives which are assigned to it, in accordance with the agreement protocol and within the framework of the statutory provisions.

It is furthermore held to an obligation concerning results in accordance with the undertakings laid down within the framework of the agreement protocol and implemented within the framework of the statutory provisions." (Article 33)

The important rôle of the agreement protocol is thus evident, since it defines the obligations of each and specifically those of the foreign partner, in particular in regard to integration and the transfer of technology.

The contribution in regard to the transfer of technology is in particular calculated as a function of the "level of realisation of the objectives in terms of value added" and of the "level of replacement of foreign personnel and the mastery by the Algerian personnel of the know-how" as negotiated within the framework of the agreement protocol.

According to Application Decree No. 83-738 this negotiation includes the choice between various parameters specified by the decree and the application of a weighting coefficient to each of these, together with the method employed to calculate an index for the evaluation of the technological transfer.

An index of 0.3 or higher is regarded as signifying an effective transfer of technology.

The revision of the law on mixed economy companies and the appearance of compensation

Falling receipts of foreign currencies (caused by the fall in the price of hydrocarbons) and the rather unsatisfactory results of the law on mixed companies (which had discouraged foreign partners from becoming established in Algeria because of the conditions which it imposed) encouraged the Algerian authorities to introduce in recent years a new phenomenon in the industrial strategy: that of compensation.

In fact compensation in Algeria had always been a purely commercial practice in regard to payment, particularly with the countries of the East.

Thus directives were given to national enterprises to review the relative magnitude of the total amount of investment and the level of technological transfer within the enterprises, and also to take exports into account when calculating the balance sheets of new projects in terms of foreign currency.

These directives are also found in the chapter relating to industrial development in the New National Charter of Algeria which was adopted by referendum on 16 January 1986: this states in particular :

> "With a view to promoting industrialists who guarantee access to technological progress appropriate actions supported by national production and research structure should be under-taken, making use of formulæ for association with foreign partners who are in a position to guarantee the mastery of technologies for Algeria together with providing access to overseas markets for our products."

This, under another name, constitutes a policy of integration-compensation.

These directives were first applied to the contract with the Italian FIAT company for assembling private cars in Algeria.

The P.V.P.-FIAT contract(1)

This contract provides for the creation of a mixed economy company for the production of 30,000 private cars per year.

Apart from the conditions generally laid down for the creation of mixed companies this contract made specific provision for :

- the achievement, outside the actual assembly plant, of a level of technical integration of 25% for the first year which should rise to 40% at the end of the fifth year and to 70% after ten years,
- the construction of three units for the production of seats, alternator-starters and exhaust systems, with part of the production of these units being intended for export,
- the valorisation of the existing potential of the Algerian automobile components industry, with assistance given to the local sub-contractors by FIAT.

....

(1) P.V.P = Projet Véhicules Particuliers
(Pro.. .t for Private Cars)

THE EGYPTIAN EXPERIENCE

After the 1952 revolution Egyptian industry underwent two quite distinct phases :

- The first phase was that of the "Nasser era"(1) and the creation of the Republic of Egypt.

  This phase was marked in particular by nationalisations and State planning of industrial development.

  Another characteristic of the Nasser epoch was the development of vast industrial complexes and in particular the military and armaments industry.

- The second phase, after the 1973 war, corresponds to the new "opening-up policy".

  The object of this phase was to encourage foreign and Arab investors to establish projects in Egypt.

  This policy was evidenced in particular by :

  . the creation of the "General Authority for Investment and Free Zones" (G.O.F.I.)(2),

  . the promulgation of Law No.43 of 9 June 1974 (amended by Law No.32 of 25 April 1977) regulating Arab and foreign investors and those in the Free Zones.

This policy produced evident results, since the number of industrial projects approved by G.O.F.I. during the period 1975-1984 rose to 522, representing total investments of the order of £E1969.3m, 27.5% of this being foreign shareholdings (3).

Law No.43 of 9 June 1974 (amended by Law No.32 of 25 April 1977)

The aim of this law is to allow the inflow into Egypt of Arab and foreign capital, and with this in view two series of measures were instituted, covering :

- firstly the investment régime,
- secondly the status and organisation of the free zones.

Under the terms of this law four principal categories of goods could be the subject of an investment.

....

(1) The era of President Jamel ABDENNASSER.

(2) The administrative structure for encouraging investments.

(3) Source : Annual Report of the Federation of Egyptian Industries (1984-85).

It is concerned primarily with :

1) foreign convertible currencies for transfer into Egypt.

2) machines, equipment, raw materials and the means of transport necessary for realising an investment project.

3) trade marks and patents, and finally

4) the profits resulting from the investment, which are also considered as invested goods when they are utilised to increase the initial capital of a project or even when they are re-invested in another project.

In general the form of the Arab or foreign investment, as laid down in the law, is that of a joint-venture association of shareholdings. Legally these associations are required to adopt the form of public or private limited companies (1).

Their articles of association are drawn up in conformity with a model establishd by the Council of Ministers. They are subject to promulgation by decree.

The special feature of this law is that it does not only apply to the industrial sector but equally to other sectors such as agriculture, mining and oil prospecting, tourism, building and even the financial sector.

To this end no provision has been made in this law for conditions regarding integration or compensation where foreign shareholdings are involved.

However in regard to integration G.O.F.I. requires a "Domestic Local Component" of the order of 40% for any automobile project.

The automobile industry in Egypt

The automobile industry occupies an important place in Egyptian industry, both in the public and the private sectors.

The creation of an automobile industry in Egypt goes back to the year 1960 which saw the founding of the NASR Company for the "NASCO" automobile industry and the concluding of four successive contracts for the manufacture of :

- trucks and buses with the German KLÖCKNER HUMBOLT DEUTZ company,
- trailers with the German BLOUMHARDT company,
- agricultural tractors with the Yugoslav I.M.R. company,
- and private cars with the Italian FIAT company.

....

(1) Original French text : "sociétés anonymes" or "sociétés à responsibilité limitée".

The policy adopted by NASCO in regard to the manufacturers involved the progressive integration of locally manufactured components with a view to reaching a minimum integration level of 40%.

In effect NASCO required each manufacturer to provide it with a list of the components and parts which it sub-contracted outside its own plants, accompanied by the drawings, standards, designs and tests to be carried out and their cost price.

Components manufactured locally to the manufacturers' standards are automatically integrated by NASCO.

This policy has allowed the development of several sub-contracting units and the achievement of a satisfactory level of integration :

- 70% for trucks, buses and trailers,
- 35% for agricultural tractors, and
- 20% for private cars, in particular after the integration of a 1500cc petrol engine made locally under a FIAT licence (this engine itself having a level of integration of 55%).

Up to the end of 1987 no compensation conditions had been required of the manufacturers, but a compensation policy was starting to appear. In fact during the concluding of a new contract in 1988 with the Yugoslav I.M.R. company for the creation of a mixed project for the manufacture of agricultural tractors the following points were agreed :

- the manufacture of 6000 65HP tractors per year, of which 1000 would be re-exported by the partner to the neighbouring countries,
- some tractor components would be re-exported to Yugoslavia.
- an integration level of 74.5% would be achieved, 42% of this being within the plant and 32.5% involving local sub-contracting.

In this way it may be seen that although the integration aspect was a requirement from the start of assembly activities the compensation aspect is still a new phenomenon in Egypt.

RECOMMENDATIONS

By means of the two actions of INTEGRATION and COMPENSATION it is possible to ensure a sustained development of the industrial fabric, the transferring into the country of part of the value added and the acquisition of an industrial technology, and also to guarantee resources in foreign currency to cover all or part of the expenditure occasioned by importing CKD kits or components or parts intended for assembly operations such as those in the automobile, electronics, domestic electrical appliances, cycle and motor-cycle and other sectors.

To this end we set out in the following pages a strategy, on the pattern of the Moroccan legislation, to be followed by the member countries of the project with a view to :

- firstly ensuring technological integration and the inflow of foreign currencies, and
- secondly of fixing in advance the rights and obligations of the foreign partners.

Within this framework the following provisions should be included in the scope of a law to be promulgated :

1 - Production :

Authorisation for production should be granted to any foreign partner who undertakes to integrate local parts and to compensate for 50% of the net imports relating to his manufacturing operations by the end of five years.

- Production must start up two years at the latest after the date of authorisation,
- every enterprise which has obtained authorisation must achieve the agreed capacities at the end of 3 to 5 years, according to a timetable,
- the integration of parts must begin at the time of start-up,
- changes in the types of products must be the subject of prior authorisation,
- the entry into production of the compensation projects must take place in the same year as the entry into production of the principal plant.

Penalties (fines, withdrawal of authorisation) must be linked to the undertakings of the partners in the event of non-compliance with their obligations.

These penalties are indispensable, since without integration and compensation the assembly projects would penalise development.

Local product :

A product will be recognised as being of local manufacture if it results from the converting of materials by appropriate techniques and machines and in which the local value added is greater than 50%.

Products resulting from simple assembly are not recognised as being of local manufacture. A list of local products will be established and updated by the competent authorities.

These products will be taxed or prohibited as imports.

2 - Integration :

Each foreign partner involved in a production unit must integrate, from the time of start-up, all parts recognised as being of local manufacture.

To this end every partner must approve and integrate the said parts in conformity with the drawings and specifications already submitted to the local sub-contractors, within the prescribed time limits and according to a rising level and a predetermined time-table.

Any arbitrary and unjustified refusal to integrate local components must be linked with penalties, up to the point of revocation of the contract.

3 - Compensation :

Each foreign partner is required to compensate for 50% of the total cost of his net imports of CKD kits, parts and components.

The following methods for compensation are, for this purpose, made available to the partner :

- The mounting of projects of which the production is intended exclusively for export,
- the purchase of components of local manufacture with a view to their export or their local integration,
- the buying back of part of the production of the production plant in which he is involved.

Thus the level of compensation is determined each year by the ratio A/B where A is the local value added of the exported products and B is the FOB value of the net imports intended for production.

This compensation level of 50% is to be attained at the end of 3 to 5 years of production on a rising scale with a minimum threshold of 15% to 25% in the first year.

4 - The institutional framework :

The success of such a strategy depends on the implementation of an adequate institutional framework or on the acceptance of responsibility for this policy by an existing national institution.

In addition to the systematic following-up of activities in which the foreign partners are involved this institutional framework will make it possible to :

- Check, within the prescribed time limits, that components of local manufacture are approved as complying with the drawings and specifications communicated by the partner.
- ensure that all the local components recognised as being suitable for integration are in fact integrated.

  To this end a list of local products will be drawn up and kept up to date. The importing of these products will be taxed or prohibited.
- follow-up the realisations of each partner in regard to compensation.
- lay down the importing programmes for CKD kits or components and parts to be granted to the partner as a function of his compliance with his obligations in regard to integration and compensation.
- ensure that new ideas for projects are duly identified, and to supervise their realisation with a view to reinforcing the industrial sub-contracting fabric.

In this regard it is suggested that this institutional responsibility could be accepted by :

- the Office de Développement Industriel in Morocco,
- the Ministère de l'Industrie Lourde in Algeria,
- the Agence de Promotion de l'Industrie in Tunisia, and
- the Industrial Design and Development Centre (I.D.D.C.) in Egypt.

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