Morocco’s Request for Country of Operations Status

Technical Assessment*

10 November 2011

*** This document is provided as background reference material exclusively for participants to the EBRD SEMED Partnership Assembly on 28 November 2011. It was produced by EBRD Management for discussion with the Bank's Board of Directors at an earlier date, and may contain information that is out of date.**

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1. Introduction and Overview

Morocco, a founding Member of the EBRD, has requested to become a recipient country of the Bank. As set out in the Report of the Board of Directors to the Board of Governors of 28 July 2011 (BDS11-187) and consistent with the respective resolutions and amendments to the Agreement Establishing the Bank (AEB), it is expected that the Bank would follow a three-phase process in becoming active in Morocco:

- In the first phase, the Board of Directors would consider the use of cooperation funds;
- in the second phase, once the amendment of Article 18 AEB has been accepted by members, the Board of Governors would consider the use of Special Fund resources for special operations;
- in the third phase, once the amendment of Article 1 has been accepted by members, the Board of Governors would consider granting recipient country status to Morocco and therefore allowing the use of ordinary capital resources for ordinary operations.

This Technical Assessment has been prepared in order to allow the Board of Directors to make an informed decision at the first stage of the process. It will be further updated ahead of the second stage and replaced by a "regular" Country Strategy for Morocco in the third stage. Additional updates either orally or in writing, for instance on progress towards implementing the political aspects of the Bank's mandate, will be provided to the Board of Directors periodically whenever warranted. These would allow the Board to calibrate the Bank's activities in accordance with events.

The Technical Assessment builds on assessment missions to Morocco during which Bank staff consulted with the authorities, benefited from the views of numerous other parties and conducted an initial scoping of demand for the Bank's services. The Deauville Partnership process has offered the opportunity to build a strong basis for cooperation with other IFIs. The Technical Assessment thus serves not only to deepen the Bank's understanding of the situation in Morocco, but also to identify an initial set of priorities for action that could be financed with cooperation funds. While not a Country Strategy in the strict sense (since that would require recipient country status), it should therefore be seen to discharge some of the practical purposes of a Country Strategy.

The paper has four main sections. Section 2 provides an update of political developments and the current status of Morocco's progress towards pluralism and multi-party democracy. It is meant to inform the Bank's judgement on whether Morocco is on a trajectory that will allow it to meet the political aspects of Article 1 within the not-too-distant future. The assessment is based on the Bank's established methodology for country strategies, and in particular, presents an analysis "criteria by criteria" as envisaged in the 1991 policy on Implementing the Political Aspects of the Bank's Mandate (BDS91-16). In addition, the section takes into account some of the specificities of the political environment in Morocco with which the Bank has been less familiar in its existing region of operations. A methodological note on how to apply the Bank's approach to political assessments in the potential new region of operations has been circulated to the Board (Political Criteria and Methodology for Carrying Out Political Assessments of Countries in SEMed (SGS11-272 (Add 1))).

Section 3 sets out an assessment of Morocco's progress in economic transition. Given that the Bank has had little prior knowledge about Morocco, and absent the background usually contained in the Bank's Transition Reports, the section also presents some of the history of reforms in the country and is supplemented by considerable sectoral detail in Annex 1. Overall, Morocco has significant transition gaps in many sectors but also a good basis for progressing further toward a well functioning market economy. But there are challenges. The government's objective to foster growth that draws fully on the potential of the labour force will require a vibrant and competitive private sector, supported by well-targeted public sector investments and policies that help create new businesses and employment opportunities, lower formal and informal barriers to labour market participation, particularly for women, and allow moving towards market-based pricing particularly in the energy area.

Section 4 describes progress made in ensuring that the Bank's potential engagement in Morocco is closely coordinated with other IFIs. The work done so far, including under the aegis of the Deauville Partnership, should provide comfort that the Bank will focus its activities on those areas in which it has skills and capabilities that are complementary to other IFIs. Steps have also been taken for the Bank to join, and in some cases lead, joint initiatives among the IFIs in Morocco and elsewhere in the new region, once it has the mandate to do so.

Finally, section 5 presents the results of a scoping mission that assessed opportunities for the Bank to promote Morocco's transition through operations. It identifies project areas that address transition gaps and where the Bank's specific business model, on its own or jointly with other IFIs, would add value. While the Bank will not be in a position to finance projects during the first stage of its engagement, this review helps to inform the selection of possible technical assistance and similar activities, which are also outlined in this section. Altogether, there would appear to be considerable demand that meets the criteria for a Bank engagement, and the section provides for a broad range of possible initial operations by the Bank.

2. Political Assessment

2.1 Introduction

Morocco has been progressing gradually towards a functioning constitutional democracy for the past 50 years, albeit with fits and starts. It was the first country in North Africa to adopt a written Constitution and the first to prohibit a one-party political system. However, a highly centralised system of governance and social and economic pressures led to demonstrations in the first half of 2011 that followed from the uprisings in Tunisia and Egypt in late 2010 and early 2011. These have been generally peaceful and organisers have mainly pressed for reforms as opposed to regime change. In response, King Mohammed VI announced in early March that he would launch constitutional reforms aimed at strengthening democracy and the rule of law, and followed through with a constitutional referendum in July.

2.2 History

Mohammed VI inherited the throne in 1999 at the age of 35 and has gradually put the country on a liberalising path. Parliamentary elections in 2002 were generally considered to be open and competitive, with more than a dozen parties participating. In 2003, following a series of suicide bombings by Islamist militants in Casablanca, the Government enacted a tough anti-terrorism law that critics claimed was used to prosecute opponents of the King. In 2004, the King established the Equity and Reconciliation Commission whose main task was to investigate human rights abuses from 1956-1999 and make reparations to the victims. The Commission was headed by a former political prisoner and victims were permitted to testify in open court. The process was lauded by advocacy groups, though few perpetrators were ultimately prosecuted and held accountable. The types of reforms needed to prevent future abuses have been incorporated in the recent Constitutional amendments.

In the 2007 parliamentary elections, 33 parties and 13 independent candidates competed for 325 assembly seats. The best performing party won 52 seats (11 per cent) and the leading opposition party, the Islamist Justice and Development Party, placed second with 46 seats. The elections were assessed by international and domestic monitors as generally free and fair. The process during the campaign and on Election Day was orderly and transparent, according to independent monitors, though some concerns were expressed regarding low voter turnout (37 per cent of eligible voters), suggesting voter apathy, and there were a few reports of irregularities on Election Day.

2.3 Recent political reforms

In response to wide-scale protests in Casablanca, Rabat, Tangier and other cities, King Mohammed VI formed a commission of constitutional lawyers and academics to prepare reforms aimed at strengthening democratic rights and freedoms. The commission had limited consultations with political parties, many of which endorsed its main aims and expressed satisfaction that it contains sufficient guarantees of democracy, as well as with

NGOs. The commission's recommendations were announced on 17 June in a public address.

Key changes to the Constitution announced by King Mohammed VI include:

- The new Constitution introduces a stronger separation of powers and somewhat reduces the political authority of the King.
- Under the new Constitution, the Government will be formed based on the results of parliamentary elections. The Prime Minister – elevated to Head of Government and the executive branch – will be chosen from amongst the leaders of the party with the most votes in the election, rather than by direct selection by the King. The Head of Government will have the power to propose and dismiss cabinet ministers, will have appointment powers for 'civilian positions' and will have the power to dissolve the lower House of Parliament.
- The Head of Government chairs the Governing Council. He presents the programme of government to parliament and is accountable to parliament for its implementation.
- The King chairs the Council of Ministers. He can delegate his role as chair to the Head of Government, which would in practice reinforce the separation of powers. The Council of Ministers sets the framework for matters of strategy, arbitration and general policy (including macroeconomic and fiscal policy), areas in which the Governing Council has only deliberative character.
- The King will retain direct responsibility for religious affairs, security issues and 'strategic policy choices'. He is also the supreme arbiter among political forces.
- The Parliament gains additional powers of assessing government policy, ratifying legislation, enacting laws and holding the Government to account.
- The new Constitution enshrines the concept of 'judicial independence', making it a crime to tamper with legal rulings.
- The new Constitution makes it clear that Morocco is an Islamic state, but one which guarantees religious freedom and freedom of conscience.
- The new Constitution recognises Amazigh, the language spoken by the Berber minority, as an official language alongside Arabic, despite objections by conservatives who felt this would dilute Morocco's Arab identity. The Constitution also guarantees the preservation of Hassani and the diversity of Morocco's cultural and linguistic expressions.
- The new Constitution enshrines fundamental human rights as they are universally recognised and provides for the supremacy of international covenants (those ratified by Morocco) over national legislation, including gender equality.
- The new Constitution highlights the strategic importance of regionalisation and decentralisation; an organic law will further define the powers of the central government and the regions, as well as the resources, organisation and mechanisms to achieve greater decentralisation.

A referendum on the new constitution was held on 1 July and passed with an overwhelming majority of 98.5 per cent of the vote. There were no independent monitors, but most reports suggest that the results were a fair representation of the sentiments of those who voted. Turnout for the referendum was officially reported to be 73 per cent of eligible voters, which suggests a high degree of buy-in for the reforms. Some opponents of the proposed reforms (or the process for putting them forward), including those belonging to the February 20th movement, boycotted the referendum.

The new features of the Constitution are a significant step forward towards introducing checks and balances in the political system and creating a credible participatory democracy. However, the sharper division of power amongst the executive, legislative and judicial branches now enshrined in the Constitution will need to be fully implemented both through organic laws and in practice in order to realise the potential for meaningful accountability.

2.4 Status of political transition

The transition to democratic rule under a system of Constitutional Monarchy in Morocco is ongoing. Several positive steps have been taken over the past 12 years under King Mohammed VI, culminating most recently in reforms to the Constitution and the call to hold early Parliamentary elections. Organic laws on the two chambers of Parliament and on elections to regional councils have already been adopted. Adoption of most other implementing legislation under the new Constitution is only expected to begin with the new Parliament and could take up to one year. In the meantime, the elected institutions – the Parliament and the local councils – remain relatively weak in relation to other power centres.

Political accountability

Elections. Citizens directly elect representatives of municipal councils and the lower chamber of the bicameral legislature. Although the powers of the Parliament to date have been limited, elections have been generally open, fair and competitive. The next parliamentary elections for the lower house (House of Representatives) were due to be held in September 2012, but have been brought forward to 25 November 2011. This creates some pressure to organise the election, make the necessary adjustments to the electoral system and for political parties to organise themselves; on the other hand, it makes it possible to shorten the distance between the Constitutional changes and the process of adopting implementing legislation by a new Parliament. Independent observers are expected to participate in monitoring the upcoming elections. The body that organises monitoring missions is the National Council of Human Rights.

Representative government and an accountable executive. While the new Constitution does provide for representative government with a clearer separation of powers, it is still unknown how this will be implemented in practice. Much power continues to reside with the King, who is a hereditary monarch.

Separation between the state and political parties. Independent political parties exist – there are around 20 represented in the current Parliament – and they actively contest elections on a level playing field. No single party dominates the Parliament; the top ten control around 72 per cent of the seats. In the upcoming election, there is no single party that represents the interests of the King – i.e., there is no ‘party of power’ in Morocco.

The rule of law and corruption

Constitutional rule and means of redress. Constitutional rule has been in place since 1961 and recent changes to the Constitution provide for more extensive means of redress.

Independence of the judiciary, equal protection under the law and fair criminal procedure. The Constitution provides for an independent judiciary and guarantees conditions for a fair trial, though there have been concerns raised regarding the independence of the courts in practice, allegations of corruption in the judiciary and political influence in legal proceedings (amongst others, Transparency International, National Integrity System Morocco 2009). Under the revised Constitution the Judicial Branch gains new administrative and financial autonomy. The King heads the Higher Council of the Judiciary half of whose members are to be elected and half *ex oficio* members or appointed by the King. The Higher Council has the authority to hire, dismiss and promote judges and under the revised Constitution takes on the functions of inspection and oversight. The Constitution prohibits arbitrary arrest, but there is a need for implementing legislation and international rights monitors have in the past pointed to cases of violations by the police.

Separation between business and politics. Corruption continues to be a serious problem despite efforts to combat the issue. According to the 2010 Transparency International Corruption Perceptions Index, Morocco is ranked 85 out of 178 countries. This places it in the middle of the rankings for countries in the Middle East and North Africa. Several prominent families in the country with large business holdings are believed to use their political connections to attract favourable treatment. Corruption in the judiciary is considered a particularly acute problem. In a speech in August 2009, King Mohammed VI announced a multi-pronged strategy for judicial reform to combat the problem of corruption in the judiciary and lack of judicial independence. This included modernising the regulatory framework, overhauling institutional structures and staffing, increasing efficiency, and implementing measures to prevent corruption and abuse of office. The country has a law on financial disclosure that applies to judges, ministers and members of parliament.

Civic and human rights

Freedom of speech, media, association and assembly. Protections of civic rights and liberties in Morocco are generally broader than in other Arab countries in the Middle East and North Africa. NGOs participate actively in political and civic life, though they can be subject to harassment if they touch on sensitive subjects. During the recent protests, the right to association and assembly was generally respected so long as they remained peaceful. The state controls the broadcast media, but the independent media operates freely and citizens have access to satellite and internet based information services.

Freedom of conscience and religion. Freedom of religion is guaranteed in the Constitution and respected in practice. Around 98 per cent of the country is Muslim, with small minorities of Christians and Jews. The King is ‘Commander of the Faithful’ and ‘Defender of the Faith’ according to the Constitution and is responsible for preserving freedom of religious practice in the country.

Gender equality. Morocco has a low ranking according to several indicators of gender equality, such as the UNDP Gender Equality Index and the World Economic Forum Global Gender Gap Index. However, in recent years Moroccan women have achieved considerable progress in obtaining guarantees of legal equality, access to justice, freedom to work and be educated and freedom to own property. The 2004 family code granted women increased rights in the areas of marriage and child custody. In Parliament, 30 seats in the lower house and 12 per cent of seats in local elections have been reserved for women. A law adopted in August 2011 will increase the number of reserved seats in Parliament to 100, with 60 seats reserved for women and 40 for youth candidates. The new Constitution specifically provides guarantees for equality between men and women in all political, economic, social and cultural spheres and establishes a state body to promote gender equality.

Western Sahara issue. Morocco controls most of the disputed territory of Western Sahara, which remains the subject of UN resolution efforts that have yet to bear fruit. The Moroccan authorities made a proposal in 2007 to grant autonomy to this territory under Moroccan sovereignty, while the Polisario Front liberation movement requests the holding of a referendum on independence. There have been mutual accusations of human rights violations on both sides, in Western Sahara and in the camps of Tindouf in Algeria. In the context of the renewal of the mandate of the UN peace-keeping mission in Western Sahara early 2011, the United Nations Security Council in resolution S/RES/1979 (2011), underlined the importance of improving the human rights situation in the Western Sahara as well as in the camps of Tindouf and requested that the parties collaborate with the international community in order to implement independent and credible measures to guarantee the full respect of human rights. In this regard, the Security’s Council welcomed Morocco’s commitment to further strengthening the national arrangements for the protection of human rights, including for Western Sahara. An independent National Council on Human Rights was created in March 2011 and regional offices of this body in Western Sahara are currently being established.

2.5 Assessment

Morocco is moving in a direction of more democratic governance within the framework of a constitutional monarchy. This process has been ongoing for some time, but has been accelerated by the revolutions in Tunisia and Egypt and the uprisings this sparked in many Moroccan cities. People in Morocco desire political and social reforms, but a strong majority express a clear preference to see this occur within the current system while preserving stability. The constitutional reforms approved in a national referendum on 1 July 2011 make significant strides in creating a more independent representative government and parliament that are selected on the basis of open, competitive elections. On other Article 1 criteria, Morocco has relatively robust democratic institutions – such as a pluralistic party system, an active and engaged civil society, and a reasonably open media.

In recognition of the progress already made to develop democratic institutions, and the commitments undertaken to make further progress in this direction, Morocco has been invited into the G-8's Deauville Partnership and Morocco's Parliament has obtained 'Partner for Democracy' status with the Council of Europe. Morocco has had an Association Agreement with the European Union since 2000, and was the first country in the Southern Mediterranean to be granted EU 'advanced status' on deepening ties and cooperation, which it obtained in 2008 in recognition of progress in democratic and other reforms. These reference points support the conclusion that Morocco is engaged in a credible transition towards a free, democratic and tolerant society.

While Morocco has made good progress in democratic reform, there is more to be done to create a functioning participatory democracy within the context of a constitutional monarchy. Further development of democracy will require concrete and consistent implementation of recent reforms to strengthen the separation of powers from the top down and persistent demands from the bottom up for genuine change. The conduct of parliamentary elections on 25 November will be the first hard test of the new Constitution, in which it will be possible to observe the openness of the process and application of the revised electoral law, the depth of national debate, the level of participation and the process of forming a new Government. Other important milestones include the effective transfer of more executive powers to the Head of Government and the Government, strengthening judicial independence and reinforcement of the rule of law and the passage of additional implementing legislation that will enshrine in 'organic law' the institutional refinements contained in the constitutional reforms.

3. Transition Assessment

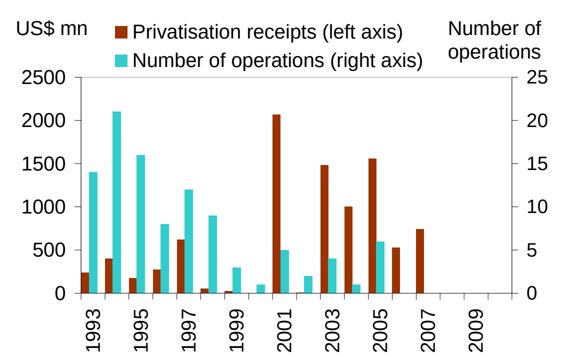
This section analyses the state of economic reforms and private sector development in the Moroccan economy. After a brief historic background on economic reforms it provides an overview of the current economic and sectoral reforms, drawing on Morocco's own priorities as described in "Plan Maroc" under the Deauville Partnership. It then outlines the key transition challenges in moving towards a well-functioning market economy. Annex 1 provides a more detailed sector-level assessment.

3.1 From state-led development to gradual reforms, 1956-2010

Morocco's post-independence economic history is of timid and gradual macroeconomic and structural reforms, with a major push in the 2000s. These finally started to pay off with macro economic stability and somewhat more inclusive growth through the last decade. As a result, Morocco entered the era of global crisis with fiscal and external current account surpluses, a low level of external debt, declining government debt, a comfortable international reserves position and improving – albeit still feeble - social indicators. These provided both a macroeconomic and, it appears, a 'social buffer' to manage the impact of the global crisis and recent popular demands in the context of the Arab Spring.

The following main periods can be distinguished:

Chart 1: Two stages of privatisation: moving from low hanging fruits to large ticket items (1993-2010)



Source: Ministry of Economy and Finance
Data on number of operations for 2006 and 2007 were not available; there were no privatisations in 2008-10.

- *Following independence in 1956, Morocco adopted a similar development path to that of other North African countries: state-led development and protectionism.* However, the direct role of the state and that of top-down planning was less pervasive than in some other countries. Throughout the 1980s reforms tended to be piecemeal and too timid to generate positive outcomes, while high levels of state spending and investments led to a build-up of domestic and external imbalances, necessitating macro adjustments that were supported by several IMF programmes in the 1980s and the early 1990s and two Paris Club debt reschedulings.

- *A first series of more substantial though still cautious structural reforms came in the 1990s.* These included an early privatisation agenda (see Chart 1), some trade liberalisation in the context of free trade agreements (agreement with the EU was signed in 1996); current account liberalisation (Morocco obtained Article VIII status with the IMF in 1993); financial sector reforms with phasing out of direct credit controls, adoption of the Basel (1) regulatory framework in 1996, and allowing for more private sector and foreign-owned bank participation.

- *The last decade saw a more comprehensive and better sequenced series of reforms, targeting some key areas*: (i) large scale privatisation, particularly in telecommunications and service sectors; (ii) public finance reform, aiming to increase tax buoyancy while reducing tax rates, reduce distortions from various incentive schemes and modernize tax administration; and (iii) sectoral structural reforms, often in the context of major sector initiatives. Transport, energy and telecommunications were liberalized to varying degrees, and financial sector regulation, including for the non-bank sector was further strengthened. As measured by the WTO, average import tariffs in Morocco fell from 33.5% in 2002 to 18.1% in 2010, although non-tariff barriers are still considered to be high. The current and capital accounts have been liberalized for non-residents, although restrictions on residents remain in the form of partial – albeit gradually reducing - surrender requirements for export proceeds and limits on foreign investment by local institutional investors (pension funds, etc).

Mutually reinforcing fiscal and structural reforms finally started to pay off. During the 2000s, GDP growth averaged close to 5 percent, became less volatile and dependent on agricultural output, and importantly, somewhat more inclusive. Per capita income almost doubled, unemployment declined from 13.6% to 9% - although reflecting in part declining participation rates - and some social indicators started to improve (although in some areas of education and health they remain very unfavorable). Earlier persistent fiscal deficits turned into a surplus by 2007/8 which, together with significant external current account surpluses, helped reduce central government debt (to 47% of GDP) and the external debt (to below 25%) while building up a comfortable level of international reserves (covering 7.5 months of imports). Morocco first received an investment grade rating from Fitch Ratings and S&P in 2007 and 2010, respectively.

Although reforms went far enough to elicit a positive supply response, they were not sufficient to sustain or further increase the country's growth potential. Good progress was made in privatisation, which is almost complete outside the utilities and natural resource areas, trade liberalization, fiscal-structural reforms, and building up an effective framework for monetary policy and financial sector supervision.

At the same time, there remained a significant unfinished reform agenda. This included the broadly unreformed energy sector and infrastructure; poor capacity in particular at the municipal level, and serious shortcomings in the business environment, particularly investor protection and protection of minority interests and registration of property, according to the World Bank's Doing Business Indicators. How the remaining shortcomings affect different sectors of the economy is further discussed in Section 3.3 on sector transition gaps.

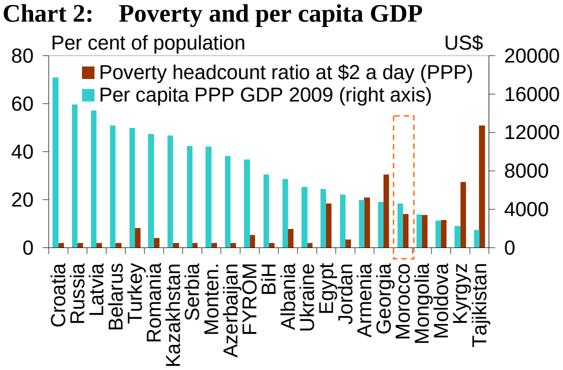
Moreover, notwithstanding some positive change, social inclusion has lagged and some of the health and education indicators, including gender-related ones, remained poor in light of Morocco's overall level of development. Unemployment among the young and educated remained painfully high and female labor market participation very low (see Box 1). These elements constrained equitable development and, ultimately, economic growth.

Box 3.1: Unemployment and social inclusion

Although growth and more consistent social policies helped improve social indicators over the past decade, some social indicators remain poor in light of Morocco's overall development and in comparison with its peers.

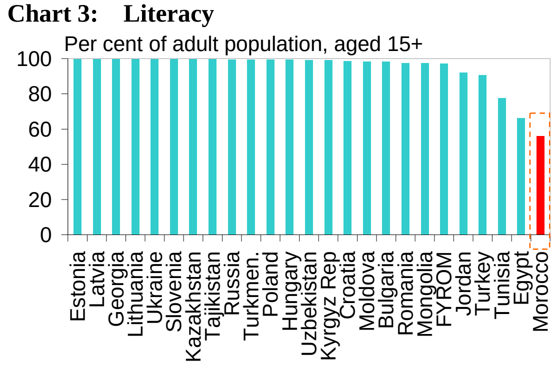
- **Poverty headcount** ratios at US$2 a day were cut by more than one third – from 24.4% in 1999 to 14% in 2007, using the Purchasing Power Parities (PPP) definition.[1] However, poverty continues to affect the vulnerable, in particular, the rural population and women.
- **Literacy and education:** The illiteracy rate stood at 50.8% for women and 28.1% for men, despite the implementation of a "Literacy and non-formal education strategy" initiated in 2004. Only 11% of the population have tertiary education, as opposed to 30% in Tunisia.
- **Unemployment remains very high though slowly declining:** more than 9% overall, almost 20% among the 15-24 year old, rising to above 40 % among graduates. It is especially high in urban areas (Chart 4). The gap between the male and female labour force participation is also considerable (Chart 5).

Chart 2: Poverty and per capita GDP



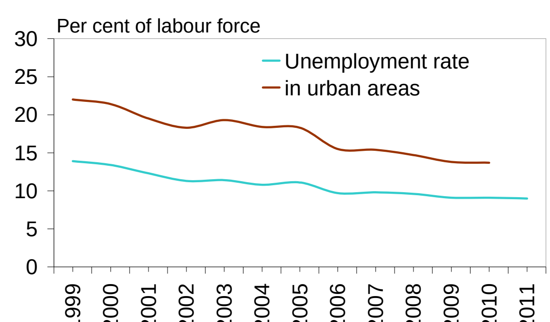
Source: World Bank WDI, IMF WEO

Chart 3: Literacy



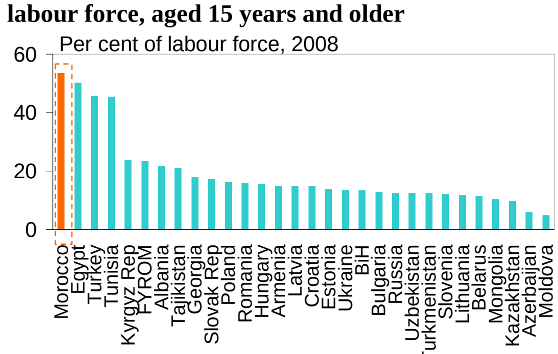
Source: World Bank WDI
Note: Data is earliest available, mostly 2009, except for Egypt, Jordan and Tunisia, where it is 2006, 2007, 2008 respectively.

Chart 4: Unemployment, national and urban



Source: Ministry of Economy and Finance

Chart 5: Labour participation
Gap between male and female participation in labour force, aged 15 years and older



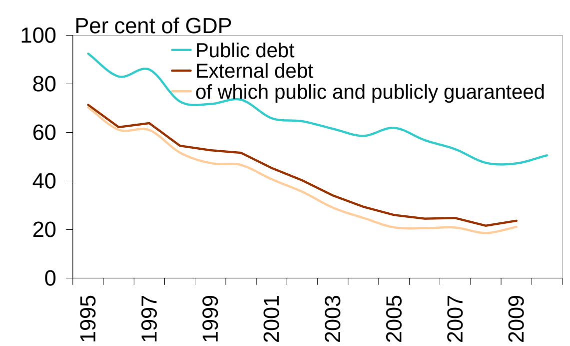
Source: World Bank WDI

[1] Poverty headcount ratios at national poverty line were reduced from 16.3% in 1999 to 9% in 2007.

3.2 Impact of the global financial crisis and the Arab Spring

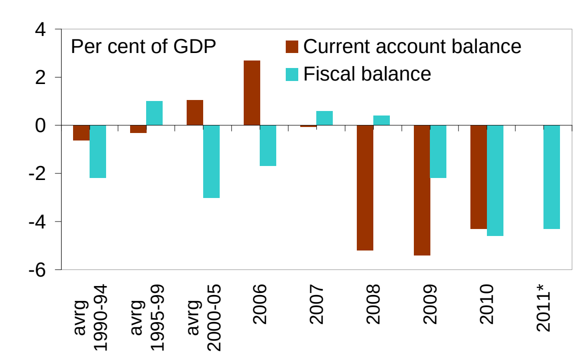
Morocco entered the global economic crisis with improved economic, and to some extent, social fundamentals, giving it room for policies to soften the crisis impact in 2009-10. The authorities used a social spending-driven fiscal stimulus to sustain growth. They increased wages and pensions and provided food and energy price subsidies as increases in imported fuel and food prices were not passed through to consumers.[2] Subsidies, most of them on fuel, now present an increasing burden on the budget (reaching about 5% of GDP), distort market signals, cause wasteful consumption and are socially unfair, disproportionately benefiting middle and higher income earners. At the same time the corporate income tax has been reduced to stimulate the supply response. Fiscal and external imbalances have re-emerged, approaching 4 and 4.3% of GDP by 2010, respectively. Overall growth slowed to 3.7% by 2010, though the slowdown was relatively moderate thanks to public spending and a rebound in tourism and remittances. At the same time, non-agricultural growth accelerated particularly in extractive industries and services (telecommunication and transport). In contrast, industrial production, specifically of manufactured goods that experienced slow growth before the crisis, has not rebounded with the global recovery, reflecting both Morocco's dependence on low-growth EU countries as its main trading partners and possible problems of competitiveness.

Chart 6: Public and External debt



Source: World Bank WDI

Chart 7: Current account and Fiscal balance



Source: IMF WEO
*estimate

The government has responded quickly to the unfolding Arab Spring since early 2011, focussing on three main areas:

- Embarking on constitutional reform (see Section 2);
- Increasing spending, including for subsidies, wages and pensions, broadly continuing the pattern of the crisis-response package, which was already socially focussed; and
- Restarting some of the structural reforms that were put on hold when the global financial crisis hit.

Indeed, reforms have picked up in important areas except for price controls for key staple foods and energy. On the positive side, a draft law has been put forward to give

[2] Subsidies pre-date the crisis, with certain staples and fuel prices having been fixed for a long time.

the Competition Agency real power to act and impose sanctions. The agency has also been asked to look into ways to tackle the subsidy problem. After many years of delay, regulatory agencies in several sectors, including energy, insurance, and securities, are moving to become more independent. Moreover, the Ministry of Energy has recently decided to move ahead with un-bundling of the vertically integrated energy utility ONE and corporatizing its units, with EU assistance. The Ministry of Finance is considering some form of a fiscal rule that would tie policymakers' hands in the context of a higher-level organic fiscal law. Moreover, the business environment has improved during the past year particularly in the area of protecting minority interests, dealing with construction permits and facilitating tax filings, advancing Morocco to the 94th rank on the World Bank's Doing Business Survey for 2012 ranking (to the neighbourhood of Serbia), up from the 115th rank a year earlier. On the negative side, subsidies and associated price controls remain. Policy consistency of subsidies has also become an issue as state support for some policy objectives can undermine others. For example, subsidies for bottled gas can slow down the penetration of subsidised solar water heaters in rural areas.

The government has identified the key challenges and priorities in its *Plan Maroc* prepared under the Deauville Partnership:

- *Diversification of growth sources: development of sectoral strategies.* The *Pacte National d'Emergence Industrielle (PNEI) 2009-2015* aims to develop specific manufacturing industries such as off-shoring, automotive, aerospace and electronics. There are well developed plans for all important sectors: *Plan MarocVert* (agriculture) which aims at both increasing higher value-added production and supporting small scale farming; *Plan Azur et Vision 2020* (tourism*); Strategie Energetique* and *Plan Maroc Solaire* (energy and renewables*); Casablanca Finance City* (regional financial centre), *Phosphates et Dérivé* (for phosphate extraction and transformation) *Plan Halieutis* (modernizing the fishing industry), etc.

- *Improvement of infrastructure, the business climate, competitiveness and connectivity.* This focuses on investments in renewable energy (42% share of renewable energy in electricity production by 2020), with significant public investments into a number of infrastructure projects for highways, rail, airports but also public sector logistics (including storage, distribution and trade logistics).

- *Human capital development and targeted support for the most vulnerable.* A national education plan focuses on a number of projects aiming at increasing educational quality; a special Initiative (INDH) is devoted to measures to reduce poverty, increase social inclusion in urban areas and improve the livelihoods of the rural poor.

- *Openness to the global economy and regional trade integration.* This requires completing liberalisation of trade policies and increasing regional integration including with the network of bilateral investment treaties. Morocco has already acquired "advanced status" with the EU, and has bilateral free trade agreements with the US, EU, Arab League and Turkey.

As with similar home-grown programmes under the Deauville partnership, the Plan Maroc focuses primarily on the major tasks facing the government and the public sector, drawing on a number of detailed sector strategies. The document is less specific on the role the private sector is expected to play and how the government intends to foster it, although there is a preference for public-private partnerships. Moreover, the subsidies and incentives envisaged in various sectoral plans should be examined carefully given their potential impact both on the budget and on market signals. Overall, the objectives and themes of the Plan Maroc are in line with the transition gaps identified below and the Bank's proposed operational priorities.

The short-term macroeconomic outlook is good - particularly in comparison with some of the regional peers - but there are risks**.** GDP growth is expected to reach 4½ % in 2011 and also in 2012 on the back of sustained fiscal stimulus and recovery in remittances and tourism. The government intends to reduce the fiscal deficit to 4% of GDP, as detailed in the budget law that is to be presented to Parliament on October 20, and seeks to cap subsidies at 3% of GDP. The current account deficit is expected to rise to over 5% of GDP and international reserves to decline further – a trend that is of concern. External debt, albeit rising, is expected to remain relatively low, with a favourably long maturity structure. Credit provision is likely to remain moderate. Despite the slowdown in credit growth since 2008, banking sector liquidity has declined due to a drop in deposit growth, which may have been caused by lower remittances. Inflation remains well contained at around 2%, although in part because of the lack of pass-through of high import prices of fuel and food. The monetary policy framework, pegging the exchange rate to a euro-dollar basket (with 80% and 20% weights, respectively), seems to have served the country well, also anchoring to some extent inflation expectations.

Risks to the outlook come from both the external and domestic fronts. Morocco's close integration with the EU – from where 75% of total receipts from exports, tourism, remittances and FDI originate and whose parent banks account for 25% of total banking sector assets – exposes it to ongoing stress in the eurozone. Being dependent on imports for most of its energy and much of its processed food needs, Morocco is also particularly vulnerable to commodity price volatility. Domestic risks come from halting or reversing reforms both in the traditional structural/sector areas and with regards to effective social inclusion.

3.3 Transition gaps

The sector review in Annex 1 documents sizeable transition gaps across the economy, with particularly large challenges in the energy and municipal infrastructure sectors. The structural policies and reform priorities outlined below have been discussed with both the government and private sector participants – and aligned with the authorities' Programme under the Deauville Partnership:

- **The energy sector has large transition gaps across-the-board**: Unbundling of the sector, the gradual liberalisation of energy prices, creation of a competitive wholesale market, independence of regulatory agencies and improving energy efficiency are the urgent priorities for reasons of both energy security and fiscal sustainability. Progress in this area is also critical for competitiveness. An ambitious "Green Energy" plan is under way, aiming at substantially increasing the use of renewables, but the overall transmission system needs significant upgrading and a competitively traded electricity market if renewable energy is to develop.

- **The infrastructure sector also suffers from a number of large gaps, especially in municipal services:** Strengthening the capacity of municipalities to better manage their increasing responsibilities for infrastructure (water and waste management) under the authorities' regionalisation plan is a clear policy and reform priority. Tariff reforms to improve cost recovery and regulatory independence are also among key reform challenges. Restructuring and fully corporatising the railway incumbent ONCF as well as strengthening the regulatory and institutional framework for the rail sector as a whole will address the largest transition gaps in the transport sector.

- **Agribusiness has medium yet pressing transition gaps**, as a vital sector for food security and employment. Challenges include developing a competitive processing industry and transforming the primary production into higher value-added products. Morocco exports mainly raw bulk products and imports finished goods.

- **Transition gaps are also significant in manufacturing and services.** Morocco's manufacturing industry is in decline, losing export market shares and preventing Morocco from benefiting fully from its various free trade agreements. Significant challenges exist in the area of **knowledge economy**.

- **The financial sector is relatively developed, but has important gaps in some areas, notably access to finance for SMEs and development of local capital markets**. Regulatory frameworks are reasonably advanced in both the banking and non-banking sectors, with further improvements in the pipeline, including independence of the regulatory agencies for the insurance and securities markets. However only 46% of the population has a bank account; SMEs lack the collateral, equity, and formalisation needed to borrow, despite an array of Government support and guarantee schemes. While the money and government bond markets are well developed, securities markets are small and lack liquidity, and the regulatory and tax frameworks for more advanced products (securitizations, derivatives) are yet to be developed. As such, the ability of financial institutions to raise long term local funds and for the private sector to manage interest and exchange risks is limited.

There are a number of themes that cut across sectors:

- **Institutional frameworks and regulatory institutions should help create a level playing field in each sector.** The ongoing move toward greater regulatory independence needs to be completed, and the business climate improved primarily through better protection of investors (particularly minority shareholders), legal contract enforcement and easier property registration.

- **The labour market is fraught with structural rigidities that ultimately affect competitiveness and job creation.** First, youth unemployment is high – even in comparison with other countries in the region – and culminates in jobless rates of around 40% for certain graduates (Box 3.1). Second, the gap between male and female participation in the labour force is higher than anywhere in the EBRD region. Third, the informal economy is significant, quantified at roughly 40% of employment, reflecting, at least in part, problems with the business environment, particularly for smaller-scale investors/SMEs.

- **Competitiveness is an issue.** Several studies point to problems with domestic competitiveness as evidenced by a deteriorating trade balance.[3] Barriers to entry, connected business in some sectors and low levels of corporate governance, a low absorption rate of new technologies, some anti-export bias of large investment programs in the non-tradables sector with high import content and labour market rigidities may all have played a role in weakening competitiveness.
- **More broadly, there appear to be limits to domestic-demand led growth for a relatively small economy such as Morocco's.** During the past two decades Morocco's growth was mainly domestic-demand driven, partly by design (with large public investment programs) and partly as a result of Morocco's inability to take full advantage of various bilateral free trade agreements. According to the World Bank, trade openness in Morocco (measured as the sum of exports and imports) stood at 78% of GDP on average in 2004-10, close to that of the much larger Egyptian economy (about 65%), and lagging behind Tunisia and Jordan (about 108% and 146%, respectively). The potential for export led-growth and further trade integration is significant.

3.4 Assessment and risks

Morocco's earlier timid reforms were accelerated in the 2000s and brought about clear results: real income almost doubled through the past decade or so, growth became less volatile and macro stabilisation was broadly achieved on the eve of the global financial crisis. In contrast to some peers, there has also been progress in the area of social inclusion. Overall Morocco entered the turbulence of the global financial crisis and then the Arab Spring with fiscal, external, and a degree of 'social' buffers in place.

Some structural reforms were halted as part of the crisis response, in particular as the decision was made not to pass through fuel and food import price increases to producers and consumers, putting an increasing burden on the budget and distorting consumer and investor behaviour. These policies were reinforced in the immediate wake of the Arab Spring, contributing to an increase in the fiscal deficit in 2011.

The authorities are aware of the fiscal sustainability and structural problems embedded in the high level of subsidisation. They are examining ways to modify subsidy policies, in particularly the high and untargeted energy subsidies that benefit primarily the better-off. Designing a socially accepted and well targeted social safety net would help ease reforms.

Work on other important reform agendas is moving forward, including in the areas of regulatory agency independence and competition policy, and the government's support

[3] OECD "Competitivite et developpement du secteur prive – Maroc strategie de developpement du climat des affaires", 2011; World Economic Forum "Global Economic Competitiveness Report 2011-2012", 2011. World Bank "MENA Development Report – From Privilege to Competition", 2009.

for public-private partnerships can be a socially acceptable way of more actively involving the private sector in the economy, if appropriately designed.

The fact that Morocco has not been able to benefit sufficiently from trade liberalisation appears to be a sign of weakening competitiveness. Improvements in the business environment and sustained productivity gains from private and public sector investment as well as moving towards market-based pricing are needed. Energy efficiency is poor in the context of cheap and subsidized energy, and skill mismatches and structural rigidities in the labour market are widespread. Shifting to export led growth would enhance Morocco's growth potential and, as empirical evidence suggests, help the spread of innovation.

Overall, Morocco has a good basis for progressing further toward a well functioning market economy so that it can take full advantage of its unique geopolitical location as well as rich human skills and economic potential. But there are significant transition challenges in many sectors and in the area of social inclusion. The government's objective to foster growth that utilises the potential of the whole labour force will require a vibrant and competitive private sector, supported by well-targeted public sector investments and policies that help create new businesses and employment opportunities, lower formal and informal barriers to labour market participation, particularly for women, and allow moving towards market-based pricing particularly in the energy area.

Table 1. Morocco: Selected Economic Indicators

	2006	2007	2008	2009	2010	2011 *Projection*
Output and expenditure			*(Percentage change in real terms)*			
GDP	7.8	2.7	5.6	4.8	3.7	4.6
Private consumption	6.9	3.8	6.0	4.6	2.2	...
Public consumption	2.9	4.3	4.8	12.1	-0.9	...
Gross fixed capital formation	9.7	14.3	11.5	2.6	-0.7	...
Exports of goods and services	11.6	5.2	7.3	-14.8	16.3	...
Imports of goods and services	8.2	15.0	12.2	-6.0	3.3	...
Labour Market			*(Percentage change)*			
Gross average monthly earnings in economy	na	na	na	na	na	...
Real LCU wage growth	na	na	na	na	na	...
			(In per cent of labour force)			
Unemployment rate (end-year)	9.7	9.8	9.6	9.1	9.1	...
Prices			*(Percentage change)*			
Consumer prices (annual average)	3.3	2.5	3.7	1.0	0.9	1.5
Consumer prices (end-year)	3.3	3.8	4.0	-1.6	2.2	2.0
Fiscal Indicators			*(In per cent of GDP)*			
Fiscal balance	-1.7	0.6	0.4	-2.2	-4.6	-4.3
Central government revenues	25.5	27.9	29.7	25.8	25.4	25.3
Central government expenditure	27.2	27.3	29.3	28.0	30.0	29.6
Central government net debt	57.3	53.5	47.3	47.1	50.3	52.9
Monetary and financial sectors			*(Percentage change)*			
Broad money (M2, end-year)	16.0	17.5	7.4	7.7	4.9	...
Credit to the private sector (end-year)	15.3	28.1	21.1	8.8	10.9	...
			(In per cent of GDP)			
Broad money (M2, end-year)	78.5	86.4	83.0	84.1	84.2	...
Credit to the private sector (end-year)	47.1	56.5	61.3	62.8	67.0	...
Interest and exchange rates			*(In per cent per annum, end-year)*			
Local currency deposit rate	3.7	3.7	3.9	3.8	3.7	...
Local currency lending rate	na	na	na	na	na	...
			(Dirham per US dollar)			
Discount rate	3.3	3.3	3.3	3.3	3.3	...
Exchange rate (end-year)	8.5	7.7	8.1	7.9	8.4	...
Exchange rate (annual average)	8.8	8.2	7.8	8.1	8.4	...
External sector			*(In per cent of GDP)*			
Current account, incl. official transfers	2.7	-0.1	-5.2	-5.4	-4.3	-5.2
Trade balance	-17.1	-22.0	-24.7	-20.6	-19.5	...
Merchandise imports	36.5	42.4	47.3	36.0	38.9	...
Merchandise exports	19.4	20.4	22.6	15.4	19.4	...
Foreign direct investment, net	3.7	3.7	2.8	2.1	1.4	...
Gross reserves, excluding gold (end-year)	31.0	32.1	24.9	24.9	21.9	...
External debt stock	24.5	24.8	21.6	23.3	24.6	...
Public and publicly guaranteed external debt	20.6	20.8	18.6	21.0	na	...
Private external debt	3.9	4.0	3.0	2.6	na	...
			(In months of future imports of goods and services)			
Gross reserves, excluding gold (end-year)	7.0	6.2	7.5	6.9	6.7	...
Memorandum items			*(Denominations as indicated)*			
Population (end-year, million)	30.5	30.8	31.2	31.5	31.9	32.2
GDP (in billions of Moroccan Dirham)	577.3	616.3	688.8	732.4	767.1	814.6
GDP per capita (in US dollars)	2151.7	2439.1	2850.8	2884.7	2861.3	3161.7
Share of industry in GDP (in per cent)*	17.7	17.5	21.3	18.5	na	...
Share of agriculture in GDP (in per cent)	15.7	12.6	13.4	15.4	na	...
Net FDI (In million of US dollars)	2009.9	2193.8	2150.4	1491.3	660.6	...

*excludes refining

Sources: Moroccan authorities; IMF; Bank Al-Maghrib.

4. Cooperation with other International Financial Institutions

4.1 An unprecedented coordination effort under the aegis of the G8

Several international financial institutions (IFIs) and major regional and bilateral organisations are currently active in Morocco. As emphasised by EBRD Governors in Astana, it will be important to avoid duplication and competition and to ensure that any potential activity of the EBRD brings specific value-added based on the mandate and competencies of the EBRD. Field missions from Banking, OCE and the Political Counsellors offered numerous opportunities to meet our sister institutions in Rabat and Casablanca.

This natural coordination process has been strengthened under the aegis of the Deauville Partnership, announced in May by G8 leaders. A follow-up Ministerial meeting in Marseille on September 10 formalised the Partnership and involved actively the World Bank Group, the AfDB, the EIB, the IsDB, and the Arab regional Funds (Arab Fund for Social and Economic Development, Arab Monetary Fund, OPEC Fund), in addition to the EBRD.

The MDBs and regional financial institutions signed a Joint Statement in support of the Deauville Partnership, committing to strengthened cooperation in the four partner countries – including Morocco. For this purpose, they created a "Coordination Platform" dedicated to (i) facilitating information sharing and mutual understanding, (ii) coordinating monitoring and reporting on the implementation of the Deauville Partnership, and (iii) identifying opportunities for collaboration on financing, technical assistance, and policy and analytical work. The group will be led by one of the participating IFIs on a rotational basis (starting with the AfDB).

The World Bank also coordinated a MDB Action Plan, whereas the AfDB put forward a Private Sector Development Initiative, which is still being discussed by MDBs and would consist of various joint initiatives on which the interested MDBs would work together. The EBRD is a full participant in these endeavours, subject to confirmation by shareholders of its engagement in the region.

In addition to these broad-based efforts, the EBRD signed Memoranda of Understanding with the AfDB and IsDB, respectively. A MoU with the EIB is, of course, already under implementation and will be adjusted to take account of specificities in the new region. The MoUs with AfDB and IsDB provide a general framework of cooperation in common recipient countries. The types of cooperation envisaged include: information exchange, secondments, joint training, coordinated technical assistance and co-financing. The MoU with AfDB also includes an offer from AfDB to make available office space pending the establishment of EBRD offices. Overall the MoUs confirm the complementarity of EBRD and the other institutions and the shared intention to use their skills and experience to advance their respective mandates.

4.2 IFI and major bilateral financing activities in Morocco

IFI annual business volume reached a high of € 2.4 billion in 2010 for a total portfolio in the country estimated at € 16.3 billion. The AfDB, the EIB and the IBRD account for a large share of this volume. AFD and AFSED also have a strong presence.

Morocco has a long-standing experience in the field of donor coordination through a well-established process of "Official Aid Harmonization". Frameworks of cooperation with multilateral donors are embedded in multi-annual strategy documents. The EU also plays a strong coordination role among European IFIs via the Neighbourhood Investment Facility, which provided over recent years € 43 million of grants for 4 projects, all cofinanced by EIB and AFD.

As Morocco didn't experience a regime change, the activities of MDBs in the country have remained steady during the course of the Arab Spring. In particular, the flagship Ouarzazate Concentrated Solar Power project has been progressing, based on a successful coordination effort by the World Bank, AfDB, EIB, KfW, and AFD.

MDB support is expected to grow in volume and ambition in the context of the Deauville Partnership. The EIB and the World Bank have announced, respectively, financing targets of € 2.2 billion and $ 1.8 billion over the next 3 years.

In a recent country plan released ahead of the Marseille meeting of the Deauville Partnership, Morocco defined its assistance needs from international partners as threefold:

1. short-term support to maintain and consolidate the macro-economic framework (essentially budget support);
2. medium and long term support to bolster growth and further job creation, including concessional loans to finance public sector projects and the development of financing mechanisms and guarantees for SMEs;
3. a new and efficient approach to enhance the effectiveness of this external support, favouring a "programmatic" approach.

EBRD activities will evidently relate to component (2), while discussions with the authorities and the implementation of the Deauville Partnership IFI Coordination Platform should support progress on (3).

Table 2: Summary of the activities of IFIs in Morocco

	Portfolio	ABV	Forecasts	Main sectors of activity	Private sector operations
World Bank (IBRD)	$1.5bn	Around $700m a year; $870m in 2010 (for 7 projects)	$700-800m in 2012; including $600m per year as DPLs over the next 3 years	Health, overcoming poverty, climate change and solar energy,	N/A
IFC	$172m in 13 companies	$ 18.5m in 2011 – cross-border transactions with leading banking group	Total investments over the next two years estimated at $250m.	Financial markets (SMEs, MFIs, and Funds). Also exploring activities in agribusiness, IT, and high value-added industries.	Private sector only
AfDB	USD 2.24bn for 21 operations (including 9 studies for USD 9.3m)	USD 550m expected in 2011 of which USD 250m is already approved	Volume is expected to remain high and continue growing	Financial sector reform, education sector support, private sector dev (chemicals), energy, irrigation and water & sanitation	No private sector projects until the recent OCP SA Investment Program (USD 250m) approved in June 2011
EIB	€4.5bn	€420m in 2010 (for 2 projects)	€500-800m for 2011; € 2.2 bn over the period 2011-2013	Transport (50%), energy, water, environment	28% of volume on average over the last 3 years
IsDB	$1.8bn (excluding trade financing)	€150m on average; €153m in 2010	Similar volumes in the years ahead	Energy, transportation, education, MSME, trade, agriculture, water and health	8% on average of volume
Arab Fund for Economic and Social Development	$3.6bn in loans since 1974	$493m in 2010		Agriculture, energy, transport, water & sewerage and social services	No recent project
OPEC Fund (OFID)	$227m	No operation in 2010		Energy, transportation, education	None in Morocco

	Portfolio	ABV	Forecasts	Main sectors of activity	Private sector operations
Arab Monetary Fund (AMF)	$220m in loans	N/A		Provide financial assistance to correct balance of payments disequilibria and implement structural reforms towards the modernization of financial systems	N/A
KfW/DEG	€1.7bn of loans over 40 years; €600m of current commitments	Small		Water and environment	
AFD	€2.2bn	€357m in 2010		SMEs, energy efficiency, urban transport, water & sanitation; environment; financial sector; education	Proparco did not sign new loans in 2010; previously, €32.5M of bank loans were refinanced for 23 SMEs in Morocco

4.3 Scope for cooperation on projects

While IFI financing in Morocco is well established and coordinated by the authorities, IFI business volume at its peak represented only 1.5 % of the country's GDP, thus leaving considerable room for additional activities. Private sector lending from IFIs is very limited. Credit lines to SMEs or lending to municipalities are almost inexistent. The development of those fields will constitute a major challenge for the EBRD.

Cooperation will build on each institution's specific competencies and business model. The EBRD's business model was described in detail in "Fighting the crisis, promoting recovery and deepening transition" (BDS09-54) providing the basis for the formulation of the medium term operational priorities of the Bank endorsed by Governors in May 2009. These include institutional, mandate and operational attributes such as, *inter alia*, its transition focus, respect for additionality, capacity to evaluate, structure, mitigate and take debt and equity risks, experience in supporting local (less experienced) and smaller businesses, ability to support different ownership models, and ability to intervene directly at company level to promote high quality standards in areas such as governance.

In preparing this technical assessment, the Bank has consulted closely, both on an institutional level and on the ground, with the MDBs active in Morocco. Based on the response, there would appear to be a broad range of opportunities for cooperation, some of which are set out in Section 5 below.

Regionally, in the context of the Deauville Partnership Action Plan, the EBRD has been flagged as a potential partner for the AfDB-World Bank SME Facility; the Arab Financing Facility for Infrastructure (AFFI); the Arab World Initiative for food security (driven by the World Bank); and the World Bank-led MENA Concentrated Solar Power Program.

There would appear to be room for cofinancing solutions in particular in the power sector, where MDBs have financed much needed infrastructure focusing on generation and to a lesser extent transmission. Distribution seems to be lagging behind, with pressing needs in terms of loss reduction, demand side management and quality of supply. That would require a particular effort in terms of regulatory reforms, including but not limited to renewable energy. MDBs are also present in the municipal sub-sectors. However, at present they provide almost exclusively sovereign lending, leaving room to explore possible sub-sovereign operations. AfDB and AFD have expressed willingness to join the EBRD in that endeavor. There appear to be similar opportunities for providing complementary financing solutions in the transport sector.

In terms of policy dialogue, cooperation would be particularly fruitful in tackling regulatory hurdles, with regards in particular to PPPs, commercialisation of utilities, and local currency financing. Under the AfDB-led Private Sector Initiative, the EBRD has been asked to take the lead in exploring the scope for joint initiatives on “Local currency and capital markets” and is expected to participate in exploring others, including joint guarantee facilities, liquidity support for banks, PPPs and work on the investment climate.

5. Opportunities for EBRD operations in support of Morocco's transition

5.1 Operational themes and technical cooperation framework

Operational themes

The Bank has developed an initial set of operational "themes" to guide its engagement in Morocco, based on consultations with government ministries, public organisations and a range of private companies in the corporate and financial sectors. The themes also take into account the directions set in the document '**Plan Maroc dans le cadre du Partenariat de Deauville**' prepared by the Moroccan authorities ahead of the Marseille G8 Summit (see Section 3.2).

The themes are consistent with the Bank's assessment of transition challenges, which are summarised in this section and described in more detail in Annex 1. They take account of the activities and experience of other IFIs active in Morocco and build on the specificities of the Bank's mandate, business model and comparative expertise. Coordination among IFIs will be further supported by the coordination platform established in the context of the Deauville Partnership as well as bilateral cooperation between the Bank and other IFIs.

It is proposed that the Bank's initial engagement in Morocco focus on the following:

- **financing private enterprise** to support competitiveness and employment with a specific emphasis on SMEs;
- **modernising the agribusiness value chain** to improve food security and develop a more open, competitive agricultural sector;
- **further strengthening the financial sector**, in order to promote risk-taking and a more diverse range of techniques and financial products;
- **supporting Morocco's sustainable energy strategy** to improve energy security and enhance economic competitiveness;
- **promoting infrastructure reform and the decentralisation of municipal services** with a particular focus on non-sovereign financing and the mobilisation of private sector investment.

In the build-up phase, there will be a particular focus on private sector / SME support and on the sustainable energy strategy. Furthermore, in each case the "horizontal" focus will be on project structures and instruments that draw on the Bank's specific attributes and strengths.

These themes are consistent with the medium term strategy of the Moroccan authorities which is based on four themes including the diversification of the vectors of growth by promoting the competitive advantages of Morocco, the implementation of infrastructure programmes, the development of skills and the targeting of vulnerable populations and global and regional integration (see Section 3.2). Under this umbrella Morocco has also developed a number of specific and detailed sectoral strategies with which the Bank can integrate its activities.

As noted in Section 4, the Bank is committed to participating in joint initiatives with other IFIs active in its potential new region of operations. These include local currency and capital market development and the possible design of joint guarantee schemes, on both of which the EBRD is expected to take a leading role, as well as regional cooperation on SME investment vehicles, liquidity facilities for banks, PPP development, capacity building programmes, work on the business climate and possibly further initiatives. These are not specifically taken up in the following but should be seen to complement the Bank's plans in Morocco.

The Bank's operations in Morocco, at both the initial and later stages, will seek to address issues of gender equality and women's entrepreneurship, within its mandate and in keeping with the Bank's Gender Action Plan. This could include studies that complement what is already known about the role of women in the economy and society and ways to enhance their participation in the labour force, technical assistance to encourage MSMEs in the informal sector to become officially registered, as well as tailored projects that would accompany future investments – e.g., with intermediary banks on lending to women-owned businesses, with corporate clients on improving their human resources policies, and in municipal projects ensuring benefits are equally shared between men and women.

The directions and priorities defined in this section provide an initial basis for the start of operational activities in Morocco. As they have been formulated on the basis of the knowledge available to date and without the benefit of a local presence, these directions and priorities are likely to be adjusted reflecting the build up of the Bank's operational experience in Morocco.

Annex 2 presents a tabular summary of challenges, investment priorities and related TC.

Technical cooperation framework

The operational themes guide the initial definition of Technical Cooperation (TC) assignments which could be launched as soon as the Board authorises the use of cooperation funds in Morocco. Based on its operational experience, the Bank has developed a range of TC mechanisms which generally fall into the following broad categories:

- **Regional or sector studies:** overarching reviews of particular areas or sectors, intended to inform the Bank and its interlocutors and to facilitate the identification of specific opportunities. This might include for example a market survey of energy efficiency investment opportunities or a survey of women's entrepreneurship and access to finance.
- **Capacity building and environment enabling:** targeted assistance to create an environment more conducive to transition or to facilitate particular reforms. This might include for example reform of securities law or support for PPP development. This category can also be viewed as covering TAM/BAS activities which are essentially stand-alone.

- **Project preparation and implementation:** assistance to support a particular project, during both preparation and implementation. An example of the former might be a feasibility study for a wastewater treatment plant investment and of the latter, technical assistance to a small bank following an equity investment by the Bank.

These categories can be thought of as following a natural sequence in the order in which they are presented above: the first step for the Bank is to understand the general area in which it is operating, to identify opportunities and to share its experience with its interlocutors. The next step is to focus on specific sub-sectors where a need is identified and the Bank's involvement is appropriate and lay the groundwork for successful interventions. Often, particularly in the infrastructure sector, significant policy dialogue is required, long in advance of any project commitments, in order to create an environment in which projects can proceed. Finally TC is deployed to ensure the success of specific projects or enhance their transition impact.

In practice of course there is considerable overlap so that one assignment may fall into more than one category. Similarly in some cases certain steps in the sequence will be unnecessary or can be pursued concurrently. This EBRD TC "toolkit" provides a framework within which the TC assignments outlined below have been identified and prepared. The initial TC activities identified for each operational theme are presented in the sequence described above with the volume and nature of TC assignments varying for each operational theme. It should be understood that TC that belongs in the first two categories may not result in investment projects during the initial stages of the Bank's engagement, but is no less urgent given the significant lead times involved if the Bank is to respond appropriately to Morocco's medium-term challenges in the coming years.

5.2 Financing private enterprise

Transition challenges

Morocco's industry has the potential to benefit, as a low cost manufacturing centre close to Europe, from recently concluded free trade agreements with the US, the EU, Turkey as well as Tunisia, Jordan and Egypt. Key sectors which may exploit this opportunity are off-shoring, electronics, automotive[4], aeronautics, agribusiness and textiles. At the same time these agreements create challenges for mid cap and smaller companies to modernise and become more efficient.

Ownership in the manufacturing and services (M&S) sector in Morocco is now largely private, but the Government owns the phosphate-chemical fertilizer industry and is also an important shareholder in the automobile assembly industry and in tyre manufacturing. The newly created holding company, SNI, in which the royal family is a large shareholder, also has significant stakes in the M&S sector, for example in construction materials, steel and metals refining. SNI's strategy is to reduce its controlling stakes in mature industries to a level of 20% and reinvest the proceeds in developing sectors. This

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[4] Renault Dacia is constructing a 400,000 vehicles plant in Tangier and Sumitomo's automotive parts business is the largest private employer in Morocco with 14,000 employees.

should lead to a diversification of ownership in the Moroccan economy but the process of divesting and reorganising will be challenging.

Tourism remains a key sector for the Moroccan economy with close to ten million visitors in 2010 (up from five million in 2005). The development of a number of large tourist resorts financed by international investors (US, Spanish, South African, Emirati/Qatari) has not been completed as those foreign investors have retreated with the crisis and only some of these ambitious and sizeable projects have been partially developed. The heavy involvement of the banking sector in tourism projects since 2005 has resulted in banks becoming reluctant to finance tourism real estate projects and more cautious on property generally.

Whilst larger corporates are generally well served by the banking sector, the widely held view is that SMEs, and particularly smaller firms, are not. This reflects both that SMEs often lack the transparency and modern management that banks require and that banks are ill equipped to work with SMEs, not least because they focus on asset based lending and SMEs often lack sufficient collateral.

The SME sector in Morocco represents over 93% of enterprises, which face a number of structural weaknesses including lack of competitiveness, poor productivity, and limited management skills. The ANPME (Agence Nationale pour la Promotion de la Petite et Moyenne Entreprise) coordinates several programmes supporting entrepreneurs and established SMEs, including technical assistance in areas such as certification, improving quality standards and computerised management systems. Companies are becoming more aware of the need not just to improve their standards but also to expand their activities, create more value and find new markets. The local consultancy market is relatively mature, especially in Casablanca and Rabat and particularly in the fields of IT, HR and production management. However, the culture of using consultancy services for management, organisation and strategic support is not developed among SMEs.

Bureaucracy and corruption are cited as major problems for businesses (particularly for smaller companies) in Morocco, which ranks 94th in the World Bank's "Doing Business" survey for 2012. Despite recent improvements, Morocco still has a low ranking for investor protection.

Against this background, the key transition challenges for the M&S sector are to:

- diversify the sector away from the dominant role of the phosphates industry;
- reduce the role of the government in favour of wider private ownership;
- increase the overall competitiveness, productivity and efficiency of the sector by promoting higher levels of research and development, modernising production facilities and improving the management and transparency of SMEs; and
- improve the business climate by strengthening competition policy, increasing investor protection and improving tax administration.

Potential investment areas

The main opportunities for direct Bank financing in M&S are expected to be in locally (typically family) owned mid sized companies, many of which require modernisation, particularly to meet the challenges of greater international competition arising from free trade agreements. Sectors where opportunities arise include construction materials (bricks, ceramic tiles, concrete products), textiles, offshoring (aerospace, automotive), renewable energy and handicrafts ("l'Artisanat"). There is also little new equity capital for smaller companies. However transparency is an issue in this sector and the Bank will need to draw on its experience of similar situations in other markets.

The opportunities for the Bank to work with larger companies are sector specific. For example the pharmaceutical sector seems to present few opportunities while on the other hand companies in the steel sector have urgent financing needs which cannot be met by local banks. Mezzanine debt and pre-IPO financing may also be of interest in selected cases.

The Bank could also play a role in supporting the expansion of the private sector by providing acquisition or expansion finance to purchasers of majority stakes from SNI.

Technical co-operation

TC activities in this sector will focus immediately on strengthening individual SMEs and subsequently on providing support for Bank facilities targeted at SMEs:

- The Bank plans to introduce the TAM and BAS programmes to Morocco at an early stage to address the current shortfall in management and strategic skills. Given the relatively undeveloped business consultancy sector TAM/BAS will focus on demonstrating the benefits of strategic consulting, in particular to support mid-cap family-owned enterprises that require longer term management advice on business strategy.
- Areas of focus for TAM include support to SMEs currently planning to expand their activities to sub-Saharan Africa and potentially to EBRD countries of operations. Sectors where it may be beneficial include agribusiness, construction materials, automotive, textiles, renewable energy and handicrafts. There is particular potential for TAM to start operating around the main port cities of Tangier and Agadir to support these areas in their efforts to boost exports.
- BAS will generally support enterprises at the smaller end of the SME spectrum. In collaboration with networks from professional associations and SME support agencies, BAS would focus on enterprises outside of Rabat and Casablanca, especially in the southern and eastern parts of the country. BAS would also work closely with SME financial institutions (credit lines and microfinance) to support SME access to finance. BAS may also initiate an accounting initiative to facilitate preparation of useful financial information by SMEs – this was shown in a recent study by Moroccan authorities to be a major determinant of successful access to financing.
- The Bank may also seek TC support for the deployment of its programmes to finance smaller companies directly such as the Local Enterprise facility (LEF).

5.3 Modernising the agribusiness value chain

Transition challenges

Agriculture accounts for 13% of Morocco's GDP but absorbs 41% of total employment. The main agricultural commodities produced are cereal crops (wheat, barley) which cover 75 per cent of arable land but account for only 10-15% of agricultural revenue. Primary agricultural production suffers from insufficient use of fertilizers, inefficient irrigation, outdated machinery, inefficient subsidies and fragmented small land holdings. Farm incomes are volatile and risk mitigation instruments are limited.

Rural credit is limited although the Government has started a warehouse receipts scheme. Average tariffs on agricultural products are high at 42% and there are untargeted consumer subsidies on basic foods but little direct support to farmers.

The livestock (poultry and beef) and dairy sectors offer considerable scope for investment. Yields in the dairy sector are low, even by North African standards, and the quality of milk is poor. The Government's priorities include promoting diversification away from water intensive arable crops and improving sugar production so as to reduce imports through the adoption of more efficient practices in irrigation, farming and processing.

Fish, canned olives, gherkins, canned apricots and citrus are important export products. Most agricultural products are however exported unprocessed. SNI has extensive holdings in the agribusiness sector but plans to sell majority stakes in the food companies they own, which would help to open up the market and encourage competition. In distribution, the presence of modern retail chains in Morocco is still quite limited and largely concentrated on the main cities.

Against this background, the agribusiness sector in Morocco faces the following key transition challenges:

- insufficient investment and use of production factors such as fertilisers; insufficient credit and poor infrastructure, particularly in distribution and processing;
- weak sector organisation with a near-absence of inter-professional interaction, management and supervision;
- limited water resources and inefficient use of water for irrigation, very small property sizes and dominance of cereal crops with low ratio of revenue per surface area of arable land; and
- dominance of SNI and its affiliates in sectors such as sugar, edible oil, dairy and retail.

Potential investment areas

The Bank has identified the following potential investment areas in the agribusiness sector in Morocco:

- investment to support the greater exploitation of the full value chain, such as funding for the creation of integrated poultry companies combining feed mills, livestock rearing and processing;
- finance for local private entities (for example in sugar refining and dairy) to increase capacity or provide needed working capital;
- investment in companies that compete with current monopolies and semi-monopolies to improve, or create, competition in respective markets, including support for enterprises divested by SNI to new private owners; and
- investment in areas that would lead to the transfer of skills and know how across the value chain leading to a more productive, competitive sector.

Technical cooperation

Reflecting these challenges, the Bank's initial TC activities in the agribusiness sector in Morocco would combine a sector-wide study with projects both to strengthen the overall environment and prepare specific projects. These would comprise:

- A sector study to identify weaknesses and shortfalls in detail, with a particular focus on the distribution and processing areas and their potential to contribute to greater food security and higher efficiency and profitability across the sector.
- Development and implementation of food chain quality standards through training provided to members of the FENAGRI food producers' association, including training on the requirements of EU export markets.
- Training, coordinated with traders and processors, for sugar farmers to modernise farming practices and improve yields and for dairy and crop farmers to improve quality of raw materials. Taken together these should promote better integration across the value chain.
- A technical, managerial and financial management improvement project focused on around 10 pilot agribusiness SMEs, including improvement of operational standards to increase access to export markets.

5.4 Deepening the financial sector

Transition challenges

Banking sector

The banking system has proved stable, adequately capitalised, profitable and resilient to shocks and is well developed compared to other countries in North Africa. While it withstood the financial crisis relatively well, it has in the past year been affected by regional instability. Many elements of the wider non-bank financial services sector are operational. Asset management, consumer finance leasing, factoring and mutual funds are relatively well developed. Insurance is growing strongly but still accounts for less than three percent of GDP. There is a state sponsored pension system for government workers with 3 state owned and one complementary private pension fund for top-up over the statutory level, as well as optional private sector pensions.

Similarly, most elements of local currency debt and equity markets are in evidence. The Casablanca Stock Exchange is the third largest equity market in Africa. There is a published government bond benchmark yield curve as well as an operationally efficient and relatively liquid secondary market in government debt and money market instruments. There is some corporate bond activity but no municipal securities markets. Derivatives such as FX forwards, swaps and short dated options are actively traded. The investor base is relatively diverse comprising banks, non bank financial institutions and some foreign investment.

Challenges in the financial institutions sector remain:

- The government debt market is one of the more active and well developed in MENA but this has not yet translated to a deep corporate or municipal securities market.
- Banks generally have developed the tools (in terms of risk management especially) to lend local currency in long maturities to private as well as public projects. However, this is achieved by taking maturity mismatch risk as most funding is short-term.
- Limited finance is available though the banking sector for MSMEs, particularly for smaller firms.
- Low penetration of non bank financial services as measured in proportion of GDP shows that there is room for increased development, especially in insurance.

Equity funds

The private equity industry started in early 2000 and expanded in 2005 with teams raising second-generation funds. International private equity funds started in 2008. The growth was fuelled by: (i) a new generation of funds and new fund managers (out of 12 active teams, eight began operations after 2005); (ii) growing investor demand; and (iii) a track record of successful exits, including a significant level of IPO listings in terms of value, as first-generation funds came to maturity.

However the industry remains fragmented, with few well-established local players and many small funds and an increasing regional focus of funds (i.e. North-African and pan-African). Although the number of independent fund managers is growing most major local managers are still backed by financial institutions which have historically established their own private equity funds.

Diversification of the private equity product offering remains very low. Investment strategies are mainly focused on capital expansion of primarily larger companies. The venture capital industry is at an early and formative stage. This relative immaturity contributes to a general shortage of equity capital which constraints the development of the wider economy. Against this background, the private equity industry faces three main transition challenges:

- continued deployment of funds in light of the crisis;
- strengthening of and increase in locally-based fund managers given lack of management and investment expertise; and
- further development of the institutional investor base.

Potential investment areas

Banking sector

EBRD activities will respond to the transition challenges faced by Morocco in the financial sector and aim to help the country progress towards a modern market economy:

- Lending long-term in local currency to local banks could be achieved by EBRD issuing long-term bonds on the local markets, where there is pent-up demand for high-quality paper, and on-lending to local banks. Alternatively, EBRD might act as an anchor investor in issues of the local banks as has been done in several markets in Eastern Europe.
- Supporting the issuance of capital markets products such as securitisation or covered bonds would be beneficial to the rebalancing of maturity mismatches and would support the further development of capital markets. In this area, EBRD would aim to work with the World Bank which is leading an effort to create the appropriate legal framework for these products.
- To foster competition in international trade finance, TFP should be offered, in particular to locally owned banks.
- EBRD funding and technical assistance could support the restructuring of the microfinance sector, help it resume growth on the basis of sound banking principles and facilitate access to finance, including in remote rural areas or poor urban areas. EBRD could also assist local banks to engage in downscaling programmes.
- EBRD’s willingness to share risk with local banks, under Medium-Sized Co-Financing Facilities (MCFF) would support the provision of financing to mid-size companies, while removing the need for syndication among local banks.

Equity funds

The Bank's investment priorities could address the transition challenges as follows:

- engaging in an active dialogue with locally-based funds or regional funds with a Moroccan focus that are currently raising capital, with the aim of promoting a stronger, more diversified domestic private equity industry which in turn will address an important gap in the availability of equity financing; and
- cooperating with other DFIs in developing a stable international, regional and local investor base, promoting greater investor interest in both this asset class and the underlying investee businesses.

Technical cooperation

The Bank's initial TC priorities for financial institutions are designed to help address these challenges. Morocco will benefit, alongside Egypt and Tunisia, from three planned regional TCs that will analyse the capacity of selected banks to benefit from various EBRD specialised credit lines (including the possible need for a first loss cushion and/or risk sharing); provide support for enhancing financial infrastructure such as credit bureaus; and prepare banks for the Trade Facilitation Programme. More specific TCs will focus on:

- Technical assistance to support the development of capital markets including a full needs assessment of non-bank financial institutions, banking system and local capital market development priorities will be undertaken by the local currency capital markets team.

- Technical assistance to support the deployment of the Bank's SME products calibrated specifically to provide "mini-finance" to smaller SMEs.

- A study to identify areas for EBRD involvement in the Insurance & Financial Services sector.

Policy dialogue will focus on the development of capital markets, especially local currency, as well as on establishing a market-based interbank interest rate.

5.5 Supporting Morocco's sustainable energy strategy

Transition challenges

Morocco is dependent on imported energy. Energy is consequently expensive and the government has made both energy efficiency and domestic production of renewable energy national priorities. In this context, the government has developed a comprehensive and ambitious sustainable energy strategy. This aims by 2020 to improve energy efficiency by 12% and produce 42% of domestic electricity consumption from renewable sources, represented by 2,000 MW each of wind and solar capacity. The key transition challenge in energy efficiency and climate change is to sustain and implement this strategy.

The need for improved energy efficiency is present throughout the municipal services sector but is particularly acute in buildings, whether public buildings or housing stock. There is also a strong demand for energy efficiency amongst private sector corporates with some large companies already well advanced in this respect. For example cement companies have reduced energy usage by one third over the last ten years. However smaller companies lack the expertise or appropriate finance to implement similar measures.

Morocco has established a specific institutional framework to drive the development and implementation of its sustainable energy strategy. The government has also engaged in a systematic effort to raise grant money through, for example, the Clean Technology Fund which recently committed USD 200 million for the Ouarzazate 1 solar power plant.

The success of the Government's efforts to develop renewable energy and meet increasing domestic demand for electricity depends heavily on the reform of the electricity sector. This requires the reorganisation of the State owned Office National d'Électricité (ONE), the establishment of a market for electricity and an independent regulator. ONE is a vertically integrated utility that acts as the single buyer of electricity and is also responsible for transmission and a large portion of distribution. There are Independent Power Producers (IPPs) implemented on the basis of sovereign guaranteed power purchase agreements and distribution in eleven urban areas, accounting for 45% of demand, has been transferred to separate utilities (Régies). ONE relies entirely on sovereign guarantees and budgetary support for its financing. It is effectively insolvent even though electricity is expensive in Morocco by regional standards.

Potential investment areas

The Bank intends to leverage its experience to create products for intermediated lending in Morocco. Preliminary discussions with a major local private bank confirm interest in developing such a financing instrument. In addition, the Bank will also build on its experience to promote private sector involvement in the construction and operation of new renewable capacity, principally wind, biomass and solar. Investments in renewable energy will be designed also to reduce direct reliance on ONE and state guarantees in order to make the electricity sector financially viable in the long run. Further Bank investments may include:

- energy efficiency investments by industrial and agricultural companies to reduce consumption and by distribution companies to reduce losses, including through introducing smart metering;
- independent and small-scale renewable energy projects, in the latter case possibly with a co-financing window; and
- “green mortgage” products.

Some of these products would rely on a mix of technical assistance and donor funded incentives.

In Morocco the sustainable energy and energy efficiency agenda is intimately linked with wider power sector reform, where the Bank's involvement would support sector liberalisation through strengthening of the regulatory framework, market opening, reorganisation, unbundling and corporatisation of ONE. Two types of investment would underpin the Bank's efforts:

- public (initially sovereign guaranteed) projects that support private sector development such as (i) connection to the grid of renewable plants; (ii) network adaptation to renewable production; (iii) SCADA for improvement of dispatch; (iv) support to regionalisation; and (v) HV lines including a trans-border line; and
- private sector PPPs, including construction of new thermal power plant, with the aim of reducing the reliance on ONE / sovereign finance.

Technical cooperation

The Bank's activities in this sector require a holistic approach and accordingly TC activities will begin with an overarching sector study complemented by assignments to strengthen the regulatory environment and develop specific projects.

- The initial TC activity will be a study to estimate the market size for energy efficiency and smaller scale renewable energy in Morocco and identify key opportunities and barriers to their implementation. This analysis will take into account both the set of recent measures adopted by Morocco in this area and the Bank's specific experience. This study would also include an assessment of the prevailing regulatory framework in support of sustainable energy and the effectiveness of any existing policy initiatives and funding programmes. The Moroccan authorities have expressed a strong interest in benefiting from the experience established by the Bank in these areas.
- The results of the market study will allow the Bank to identify priority areas of activity, including follow-up work on policy dialogue and structuring commercial financing arrangements for implementation of investments in sustainable / renewable energy. A typical market entry approach, particularly for smaller energy efficiency projects, is the Sustainable Energy Finance Facility, whereby financing is intermediated through local banks and the market study plays a key part in structuring and marketing this product.
- A framework providing for energy audits, which are critical in identifying energy efficiency opportunities, especially in industry.

Initial TC activities in the wider power sector would follow the basic pattern of scoping studies followed by targeted assignments but focussing specifically on the distribution sector, where the Bank has extensive expertise and which has had limited attention from other stakeholders to date:

- A study to establish a basis of regulation for evaluation of performance in the power distribution sector to be used for benchmarking, control and supervision, determining quality of service and, in the longer run, a tariff structure that effectively corresponds to costs incurred and capital required.
- An assessment of the technical needs for making the regionalisation of electricity distribution possible, e.g. an information system (SCADA), modification of electricity dispatch and centralised planning.
- A technical, financial and legal assessment of the public Régies including reviewing their short term investment needs.

5.6 Supporting infrastructure reform and the decentralisation of municipal services

Transition challenges

The dominant role of the state and high degree of financial and decision centralisation which is a recurrent feature in the infrastructure and municipal sectors across the region is also present in Morocco. Sub sovereign, non-sovereign and private financing solutions have played only a limited role to date.

There have been several attempts to introduce Public Private Partnerships (PPPs), with mixed results. PPP initiatives in the road sector have not been successful due to an absence of agreement on the risk-allocation profile between private and public sector. There are other deficiencies in the PPP framework including a lack of competitive tendering, inadequate tariffs requiring continued reliance on cross-subsidies (e.g. between electricity and wastewater which are provided by the same utility), poor payment record of municipalities, lack of a proper framework for developers to finance network extension, poor monitoring and inadequate dispute resolution mechanisms.

Against this background, a key transition challenge is to make the necessary structural changes and sector reforms to promote greater commercialisation of each sector as well as putting in place a proper regulatory framework that would allow PPPs to be used to finance future infrastructure development without the need for sovereign guarantees. Furthermore, it is important that the Government implements its reform agenda for state enterprises including introducing competition, corporatisation, reductions in operating subsidies and privatisation.

Municipal infrastructure sectors are similarly dominated by national institutions with tight control from the centre and tariffs largely disconnected from costs. Water is mainly managed by the state utility ONEP (in the process of being merged with the electricity utility ONE) with water provision in 12 cities being the responsibility of municipal enterprises whilst in the four largest cities it is provided by private operators through delegated management contracts. Storm water drainage has become an issue with a number of incidents in recent years. Solid waste management is poorly organised and under funded.

One of the challenges in the municipal and environmental sector will be the impact of the regionalisation of government which is enshrined in the new constitution. Whilst it is intended to bring services closer to local people there are many challenges to be overcome including changes to the fiscal transfer system, strengthening of investment strategies, building implementation capacity of local administrations and managing regional differences in terms of utility servicing costs and investment needs. Furthermore, there are major transition challenges in relation to utility tariffs: there is no tariff regulator or transparent methodology, tariffs are largely politically driven and below cost recovery levels and there is a high degree of cross subsidisation.

Potential investment areas

There are large scale investment needs in infrastructure, both transport and municipal, which can benefit from the Bank's proactive involvement. In light of the emphasis of other IFIs in Morocco on sovereign and sovereign-guaranteed structures, the Bank would offer particularly strong value-added in private, PPP and sub-sovereign projects.

In the municipal infrastructure sector, building on its experience in this area, the Bank could focus its involvement on further decentralisation and commercialisation of existing infrastructure, development of new infrastructure and development of the PPP market, also with an emphasis on non-sovereign and private structures.

Technical cooperation

TC activities identified in the infrastructure sectors will be structured first to define what is necessary to implement the EBRD approach and then to provide targeted support to achieve specific transition goals, including through project preparation. This work would be based on a thorough assessment of transition gaps and establishment of transition impact goals with a focus on commercialisation of service provision, tariff restructuring, public service obligation methodologies and corporate governance, as well as analysis of PPP legislation and options. As with all projects in this area the Bank will need to coordinate carefully with other IFIs to ensure that sufficient leverage is secured to achieve results. Early TC activities would be expected to include:

- Regulatory and legal framework assessments of transport sub-sectors where the Bank's profile is particularly relevant and would be most appropriately deployed. This TC would allow the Bank to engage with the authorities to complement the on-going efforts of other MDBs and develop future co-financing opportunities.
- An analysis of the current status of the provision of municipal infrastructure focused on the areas of particular relevance to the Bank's core competencies, namely fiscal decentralisation (including budget predictability), availability of independent revenue streams, operational independence, commercialisation of service provision, tariff restructuring, public service obligation methodologies, and corporate governance.
- Based on these initial studies, technical assistance to support the government in establishing primary and secondary legislation to enable sub sovereign borrowing. Key areas for support are likely to include the creation of predictable public service obligation payments for services delivered, secured transaction parameters, tariff formulas, cost management and client service focus.
- Also based on the findings of the initial assessment, TC to assist the Government in defining a gradual approach to increasing the direct revenues of utilities and removing cross-subsidisation across sectors and across regions, subject to affordability constraints.
- Project preparation for a certain number of specific projects that have been tentatively identified in both the transport and municipal sectors.

Annex 1: Sector Assessments

A 1. Corporate Sectors

A 1.1 Agribusiness

Transition gap: Medium

Key challenges: (i) support diversification to climate resilient crops and increase efficiency of input usage, in particular water and fertiliser; (ii) improve access to finance e.g. by increasing collateralisation options and simplifying the land tenure system; (iii) develop modern processing, logistics, specialised infrastructure and distribution systems.

Agriculture production accounts for only 13 per cent of Morocco's GDP but absorbs 41 per cent of total employment. The country's main agricultural commodities are cereal crops (wheat, barley), which account for about 61 per cent of arable land but represent only 18 per cent of agricultural value added. The average most favourite nation (MFN) tariff on agricultural products remains high, at 42 per cent, and the government has put in place additional protective tariffs at times of high food prices. Untargeted food subsidies cover flour and sugar for consumers, while subsidies to agricultural producers are small.

Primary agricultural production suffers from insufficient use of fertilizers, outdated machinery, inefficient subsidies and fragmented small land holding. Seventy per cent of farms are smaller than 5 hectares. Outdated and inefficient irrigation systems have led to an overuse and deterioration of water quality. Simple risk management tools, such as drought and hail insurance, are offered mainly by public providers at subsidised rates or in a public-private risk sharing framework. More effective and sophisticated instruments - such as weather indexed insurance products - are not well developed, leaving farmers with very volatile incomes. As part of the *Plan Maroc Vert* (Green Morocco Plan) the government has initiated reforms to increase sustainable agricultural production and to diversify away from water intensive grain crops. This plan includes a government support scheme for fruit and other vegetable production that adapts to Moroccan climate conditions, as well as long land lease schemes for foreign and domestic investors.

A complex land tenure structure poses further productivity constraints, with multiple legal regimes covering land ownership. In addition, rural credit remains limited and investment and working capital needs are largely met by retained earnings. Banks require real estate collateral even for short term credit and on average only 18 per cent of farmers have access to bank finance. However, Morocco did start a pilot project on warehouse receipt financing, including licensing of refrigerated warehouses in the coastal region for the fishing industry (mainly squid and octopus) increasing access to finance to the sector.

The majority of agricultural production is traded and exported unprocessed, leaving substantial room to develop higher, value-added, processed products. A distorted tax system with a 20 per cent VAT differential between primary production and agricultural processing and the lack of adequate infrastructure, including specialised storage, constrain the development of a competitive processing industry. The introduction of HACCP (Hazard Analysis and Critical Control Point) standards has been legislated in 2011, but implementation lags significantly behind with around 90 per cent of firms not in compliance with the requirements. International retail chains have entered the country successfully, covering a range of formats from small supermarkets to cash-and-carry (e.g. BIM) and hypermarkets such as Carrefour. However, this has so far been largely concentrated in the main cities. Regional cities and rural areas remain dominated by small corner stores.

A 1.2 Manufacturing and Services

Transition gap: Medium

Key challenges: (i) reduce the sector's dependence on phosphates; (ii) increase the overall competitiveness, productivity, and efficiency of the sector by further lowering import tariffs, introducing modern management practices and promoting higher levels of R&D; and (iii) improve the business environment by strengthening competition policy, increasing investor protection and contract enforcement and improving tax administration.

Manufacturing accounted for only 17.6 per cent of the country's GDP in 2010. Since 1999, there have been efforts to privatise and liberalise the economy: companies in the telecoms, industrial, and tourism sectors have been privatised. Ownership in the manufacturing sector is now largely private but the government owns the phosphate-chemical fertilizer industry and is also an important shareholder in the automobile assembly industry and in tyre manufacturing. The private sector share in gross national income was 75.6 per cent in 2009. SNI and ONE have significant holdings in the M&S sector, for example in construction materials. The new strategy of the companies is to reduce their controlling stakes in mature industries to the level of 20 per cent and reinvest the proceeds in other sectors. A new Programme of Economic Development, the *Plan Emergence* was launched in 2009. It highlighted as priority sectors the off-shoring, electronics, automobile, aeronautics, agribusiness and textiles industries, with the aim of increasing the country's overall competitiveness.

In recent years, Morocco has undergone a rapid process of trade integration. The most important trade agreements have been the Euro-Mediterranean Free Trade Agreement (FTA) with the EU, the Agadir Agreement with Egypt, Jordan, and Tunisia (within the framework of a greater Arab Free Trade Area), the US-Morocco FTA, which came into force in 2006, and the recent FTA with Turkey. The simple average MFN tariff for non-agricultural products fell to 14 per cent in 2009 from 30 per cent in 2002 and textile quotas were abolished in 2005. However, the tariff level is higher than in most central and eastern European transition economies, including Russia.

As in Egypt, prices in the manufacturing sector are generally liberalised. Energy intensity compares favourably to the Bank's countries of operation, including the EU member countries, as some important steps have been taken to improve the use of energy. For example in the cement sector, energy use has been cut by one third over the last ten years with elimination throughout the sector of the dry process. R&D is mainly publicly driven and, with expenditures at around 0.6 per cent of GDP, Morocco scores less favourably than many of the Bank's countries of operation.

Competition policy is guided by the Competition Law adopted in 2000, but further amendments are necessary to bring the law to conformity with best international or EU standards especially in terms of implementation and oversight. In 2009, an antitrust agency (*Conseil de la Concurrence*) was established and its members appointed. However, it only has advisory capacity. In addition, a Directorate for Competition (*Direction de la Concurrence et des Prix*) was created within the Ministry of Economy (MAEG) and placed under the trusteeship of the Prime Minister with powers to draft and enforce laws and. lead competition enquiries. A new draft law has been submitted to Parliament in July 2011. It includes crucial provisions for strengthening the powers of the independent antitrust agency in line with EU standards - covering all key elements from independent investigations to the imposition of fines. This law is expected to be discussed in Parliament before the end of 2011.

Morocco ranks 94th out of 183 countries in the World Bank Doing Business Survey 2012. Morocco does reasonably well in terms of closing a business, but ranks low with regard to registering property (144th) and paying taxes (12th). A simplification of the tax system is viewed as essential to improve tax administration and to incentivise the informal economy to join the formal tax net. The business environment also seems to be suffering from insufficient and under-funded administrative capacity in the country. The public sector wage bill accounts for about 10 per cent of GDP. The enforcement of laws seems to be an issue, particularly in the area of intellectual property rights or shareholding transparency of joint stock companies. Notwithstanding recent very significant improvements, on protecting investors Morocco still ranks only 97th. Corruption remains a major problem, even though the government declares itself committed to overcome it. According to the Corruption Perception Index by Transparency International, Morocco is ranked 85th out of 178 economies, below Serbia (78th), but above Bosnia and Herzegovina or Egypt (91st and 98th respectively).

A 1.3 Real Estate

Transition gap: Medium

Key remaining challenges are: (i) further streamlining property-related bureaucracy, such as simplifying and speeding up the process of property registration or improving the availability of land information; (ii) further developing the affordable residential segment; and (iii) improving the quality of the office, retail and warehouse segments.

The tourism sector has been successful in attracting foreign investment and currently represents Morocco's second biggest industry. The hotel segment is well developed, with major international hotel operators present in the country. Although the up-market residential segment has been enjoying significant investment activity, the affordable segment still seems to be suffering from under-supply of quality stock. The office, retail and warehouse segments also seem to be in need of improving quality. However, supply in all segments is increasing and there are substantial investments in the main cities. Major international retailers (e.g. Carrefour, Max Mara and Zara) are present in the country (although the retail sector still largely consists of independent stores and markets). The government is supporting the development of the affordable residential segment by tax breaks and other initiatives. Further development of the tourism sector is targeted by the government's Vision 2020 strategy.

Foreigners are allowed to buy and lease land in Morocco (except for agricultural land), although the duration of the lease is limited to 15 years. The national registry and cadastre contain most land-related information. Registering properties may be further streamlined – according to the 2012 World Bank Doing Business survey, registering a property requires 8 procedures and 75 days (Morocco ranked 144th out of 183 countries on this dimension).

A 1.4 Telecommunication

Transition gap: Medium

Key challenges: (i) ensure full regulatory independence of the telecommunications regulator; (ii) further develop the telecommunications infrastructure (broadband internet); (iii) improve intellectual property rights; and (iv) develop high skilled human capital, which is necessary for the development of the knowledge economy.

There is competition in all the main segments of the telecommunications market: there are three main players in the fixed-line and mobile segments, and a number of internet services providers. However, the fixed-line incumbent, Maroc Telecom (MT), has a strong position in all segments. MT controls the biggest mobile operator, with over 50 per cent market share. It has been partially privatised and is now controlled by the French conglomerate Vivendi, while the state still maintains a minority stake. Broadband internet penetration is very low, at less than 2 per cent in 2010. On the other hand, Morocco has a well developed off-shoring industry, mainly providing services for French corporate customers. The government has been investing in a number of technology parks.

The telecommunications sector is regulated by the *Agence Nationale de Réglementation des Télécommunications* (ARNT), which does not appear to be fully independent. Its board is chaired by the prime minister and seems to have a limited ability to impose sanctions. The new draft law that has been submitted to Parliament in July 2011 includes crucial provisions for strengthening the powers of the independent antitrust agency (*Conseil de la Concurrence*) in line with EU standards - covering all key elements from independent investigations to the imposition of fines. This law also introduces the consolidation of the regulatory bodies under one – the *Conseil de la Concurrence*. Number portability has not yet been introduced. Weak intellectual property rights protection and lack of highly skilled human capital appear to be obstacles to the development of the knowledge economy. Morocco's Education and Human Resources sub-score of the World Bank Knowledge Index is only 1.95 out of 10, well below the average of 6.75 for the EBRD region and 4.35 for Egypt.

A 2. Energy Sector

A 2.1 Natural Resources

Transition gap: Large

Key challenges: (i) reduce energy import dependency, by improving efficiency and diversifying energy sources; (ii) take steps to privatise selected state-owned mining assets and encourage foreign direct investment in the phosphate sector; (iii) increase competition in the downstream petroleum products distribution sector and ensure open third party access to associated ports/storage infrastructure; and (iv) reduce government subsidies for petroleum products.

Morocco is almost totally dependent on imported fossil fuels (95 per cent of total energy needs). About two thirds of energy imports are represented by crude oil and petroleum products; one third by coal. The country's main natural resources consist of phosphates, followed by manganese, cobalt, lead, silver, copper and small resources of oil and gas. Being endowed with over 80 per cent of the world's estimated reserves, Morocco is one of the world's largest producers of phosphates. The production accounts for about 94 per cent of total mining production; one quarter of Morocco's total exports and about 3.5 per cent of the country's GDP.

The mineral extraction sector is controlled by two state-owned companies: the *Office Chérifien des Phosphates* (OCP), which controls the extraction of phosphates, and the *Office National des Hydrocarbures et des Mines* (ONHYM) that is responsible for the development of other mineral resources. They act both as companies in their respective sector and as regulators with rights to issue licences in accordance with government's decisions.

With the exception of phosphates, which are a state-owned monopoly, private participation is allowed in other extractive industries, usually in the form of a joint venture with state companies (e.g. Metalex Ventures Ltd. in diamond extraction, Dana Petroleum UK in offshore exploration and production of natural gas). Morocco has two refineries, with combined capacity of 154,901 bbl/d, both privately owned. The downstream petroleum products distribution sector has been opened to foreign entry, including Shell, Total and ExxonMobil, but competition remains limited because of strict regulation as well as logistical and storage constraints. A price control policy in place since 2000 subsidises the prices of liquefied petroleum products. Budgetary subsidies have been estimated at about 2.9 per cent of 2010 GDP.

The institutional framework for the mining industry is based on the Mining Code Bill No. 1-73-412 of 1973. The Government agency responsible for the oversight of the mining industry is the Ministry of Industry, Trade, Energy, and Mines. An Energy Strategy has been launched in 2009 and focuses on the diversification of energy supplies (including the construction of an LNG terminal), support for renewables (wind and photovoltaic) and the attraction of private investors (mostly into gas and oil exploration and extraction). There is no independent energy regulator and revenue transparency in the extractive industries is low. The country has not subscribed to the EITI.

A 2.2 Power

Transition gap: Large

Key challenges: (i) establish an independent regulator; (ii) pursue market liberalisation reforms, unbundling, and privatisation; (iii) liberalise the retail segment; and (iv) to create a wholesale market to attract new capacity to meet growing energy demand.

The power sector in Morocco is largely dominated by the state-owned vertically integrated company ONE (*Office National de l'Électricité*) under the supervision of the Ministry of Energy, Mines, Water and Environment. ONE fulfils the single buyer role for electricity. It also holds a monopoly in transmission and is responsible for distribution networks covering 55 per cent of consumers connected to the low voltage network. Out of the eleven remaining distribution networks, three are operated by private companies under delegated management contracts and the rest are controlled by municipalities. Most of them perform poorly. Service is not reliable, costs are difficult to account and electricity theft is widespread. ONE's share in generation has been decreasing in recent years; there are now three Independent Power Producers (IPPs) that account for close to 60 per cent of electricity domestic production (one of which is 48 per cent state-owned). Liberalisation in the sector has progressed in a piecemeal manner. The main development was in 2008 when the generation contracts were opened to IPPs, although some were unwilling to take ONE risk and benefit from government guarantees.

Currently there is no energy regulator and tariffs are set by the Ministry of Energy. Retail electricity prices are high relative to other EBRD countries of operation. However, several energy subsidies remain in favour of households, putting an increasing strain on public finances. ONE can not fully pass through costs to end users because prices are capped by the government. The resulting operating losses of ONE are covered by the state budget. Electricity demand has increased by approximately 8 per cent per year since 2000. The rise in demand was initially attributed to industrial development as well as the increase in rural electrification rate which has significantly increased from 19 per cent in 1992 to 94 per cent in 2007. While access to electricity remains high, improvements in quality of supply have been neglected. The rapid rise in demand has been addressed by the government though the introduction of private generators and the development of interconnection capacity with neighbouring countries, Spain and Algeria. Morocco relies on the interconnector with Spain to import 16 per cent of its electricity demand. ONE has a monopoly on imports of energy.

A 2.3 Sustainable Energy

Transition gap: Large

Key challenges: (i) upgrade the transmission and distribution system to absorb large intermittent renewable capacity; (ii) further develop interconnection capacity with Algeria and Spain; (iii) address the fiscal impact of RES support; (iv) develop a competitively traded electricity market for renewable energy, and (v) reform fuel subsidies and address institutional barriers to unlock potential for energy efficiency.

Morocco is an energy deficient country, importing close to 95 per cent of its primary energy demand. Coupled with rising energy demand and limited domestic fossil fuel reserves, the use and development of renewable energy technologies has been a priority for the Government, but has only recently become a major policy objective. Since 2008, the government under the National Energy Strategy and the National Priority Action Plan set a target to increase the share of renewables to meet 12 per cent of the country's primary energy demand by 2020 and 20 per cent by 2030. Ambitious programs exist to install 3 x 2GW of wind, solar and hydro by 2020 and reach 45 per cent of renewable energy in total generation.

Morocco has started to develop the legal and regulatory framework in order to achieve these targets. The government passed four laws dealing with renewables and energy efficiency in early 2010. Under these laws, a renewable energy agency as well as an agency to promote solar technology, were established. The laws provides financial incentives and government guarantees for renewable energy producers including long term off-take agreements with State owned ONE at pre-determined prices. The Wind Programme aims at attracting 2 GW of private wind generators by offering them competitively tendered support packages including SPVs with equity participation of ONE and state owned funds plus long term off-take contracts with ONE guaranteed by the state if needed. Despite the state support scheme, only one independently developed wind farm is operational and one more is in the tendering process. One more small wind farm was build and few others are being developed under the *EnergiPro* programme originally designed to promote industrial auto-generation based on fossil fuels. The country is also trying to develop its solar energy systems under the "Moroccan Solar Plan" managed by the especially established agency MASEN, which envisages various forms of state support to attract private IPPs. Morocco is part of several regional initiatives including the *Desertec Industrial Initiative* and *Transgreen/MedGrid* initiatives that aim to develop favourable conditions for the implementation of sun and wind power projects in the MENA region.

The existing renewable support schemes aim at creating a low risk environment for investors. However, in the absence of a wholesale market and competition in power generation, they put a strain on consumers and the public budget and may not be sustainable under a tight fiscal policy and in the presence of capped retail electricity prices.

The government also aims to achieve a 15 per cent energy saving by 2020. ANDEREE[5] has been recently set up with the objective to develop building/construction energy efficiency codes; develop thermal building codes for hospitals, hotels and housing and develop a local market for solar water heating systems. However, little attention has been paid to energy efficiency and demand side management. Large fuel subsidies continue to inflate the budget deficit and weaken incentives to use energy rationally.

A 3. Infrastructure

Overview of the transport sector: Morocco's transport system comprises 60,500 km of roads and about 1,100 km of conceded highways, a railway network of about 2,110 km,

[5] *Agence Nationale pour le Développement des Energies Renouvelables et de Efficacité Energétique.*

of which about 1,300 km are electrified and 295 km double track; 33 ports, including 12 international commercial ports; about 30 airport facilities, of which 15 are open to commercial traffic and 12 accommodate international flights. Transportation activities account for 6 per cent of the country's GDP, 15 per cent of the State's budgetary revenues and represent some 35 per cent of national energy consumption.

A 3.1 Railways

Transition gap: Medium

Key challenges: (i) restructure the railway incumbent ONCF by corporatising and fully separating infrastructure from operations and by implementing cost restructuring measures to improve its financial performance; (ii) strengthening the regulatory and institutional framework by separating the policy making, regulatory and operational functions into distinct entities, and by establishing an independent railway regulator; (iii) introducing third party access to the network; and (iv) introducing Public Service Obligation contracting.

Morocco has an extensive and relatively efficient railway system by North African standards. The vertically integrated national rail agency, the *Office National des Chemins de Fer* (ONCF), currently manages the overall rail traffic in Morocco, operating on a 2,110 km rail network (1,300 km electrified). It offers commuter and intercity passenger services throughout the country as well as freight transportation. ONCF has 8,300 staff and operates some 280 trains per day with 350 passenger coaches and 6,400 freight wagons. Traffic is growing rapidly (passenger traffic increased by about 7 per cent per annum and freight increased by about 2 per cent per annum in 1994-2010) and significant investments are required to accommodate this growing demand. Financing for infrastructure and rolling stock are provided by the state often through IFI loans (WB and AfDB).

Although the operational and financial performance of the railway agency is improving and compares favourably with other similar rail networks, the scope and scale of the sector reform agenda yet to be implemented remains challenging. Morocco has a blueprint reform plan that envisages the corporatisation of ONCF, the separation of infrastructure from operations and potentially the introduction of third party access to complement the services provided by the incumbent. There is no independent railway regulatory authority and the organisation of transport in Morocco is placed under the authority of the Ministry of Equipment and Transport. Regulation, safety and supervision are organised within the directorates of the Ministry. All the necessary components of successful railway reform – track access methodology; separation strategy; public service obligation contracting for infrastructure and passenger operations – remain to be developed and implemented.

A 3.2 Roads

Transition gap: Medium

Key reform challenges: *(i) further develop the available financing structures, particularly for secondary roads; and (ii) introduce PPPs.*

The road network currently spreads over 60,500 km of roads and highways, including 32,080 km of paved roads. Roads remain the main mode of transport, since they provide at least 90 per cent of intercity passenger traffic and 75 per cent of freight transport (excluding phosphates, which are transported by rail). The classified road network is under the jurisdiction of the Ministry of Public Works and Transport (MPWT). The Directorate of Roads and Road Traffic (DRCR) manages national, regional and provincial roads. DRCR operations are organised through the 16 regional and 29 provincial offices of the MPWT. The motorway network is relatively well developed (as of July 2010 – 1,100 km with several hundred under construction) and is managed by a state corporation *Autoroutes du Maroc* (ADM) under a concession agreement. ADM is responsible for operation and maintenance, toll collection and the development of the network. ADM has a significant revenue base, mainly from tolls, and has raised long term finance for investments in the domestic market. There are no roads PPPs in Morocco.

Funding for road maintenance is currently generated from two sources - the Road Fund (*Fonds Spécial Routier*, FSR) and the general budget. The FSR, a Treasury Special Account, is funded by a number of road user charges, notably fuel taxes, a vehicle registration fee, and an axle-load tax for heavy goods vehicles. The *Caisse pour le Financement Routier* (CFR) was established in 2004 as a public entity with administrative and financial autonomy to mobilise financing for rural road development through borrowing, with the FSR being used to repay loans. When fully functional, the CFR's borrowing capacity will significantly increase the funding available for rural roads. Motorway maintenance, and partially construction, is funded by user tolls. External contractors undertake all road rehabilitation and periodic maintenance and about 50 per cent of routine maintenance.

A 3.3 Port Sector

Transition gap: Medium

Key reform challenges: *(i) improving the regulatory oversight and transparency of the sector; (ii) increasing the capacity and independence of the National Ports Agency; (iii) strengthening private sector investments and operations; and (iv) achieve efficiency improvements in the country's port operations.*

Morocco enjoys a favorable geographic location with its 3,500 km coastline and a network of commercial ports along its coast. Ports play a central role in the national economy, handling the transit of nearly all of the country's external trade.

Key structural reforms were pursued in 2006, with the creation of a new national port authority (ANP) that is separated from the commercial operations of Morocco's ports.

The ANP is in charge of the Morocco's thirty-three port sites and is in charge of ensuring adequate provision and maintenance of the port infrastructure facilities whilst allowing for private sector operations of port terminals. Since the establishment of ANP, private investment in port infrastructure has increased and operating costs have reportedly come down. Still, private sector participation and efficiency improvements should be further promoted.

With policies in place to stimulate private sector engagement, the key remaining transition challenges are to strengthen regulatory oversight; improve the transparency and efficiency of operations of the national port landlord ANP; and to introduce PPP arrangements for port operations.

Overview of the municipal infrastructure sector: According to the 2010 Moroccan Water Strategy, access to water for urban areas in 2009 was widespread, with a 92 per cent of individual connections to the network and 85 per cent in rural areas. However, the wastewater sector is substantially less developed than potable water and rural areas are in general lagging behind with reported access to improved sanitation (water and sewage). Only 8 per cent of the collected wastewater is being treated before discharge. Urban transport in Morocco is underdeveloped and travel in urban areas takes place mainly in private cars and taxis. The share of public transport (by bus) accounts for only 14 percent of all travel in Casablanca and ca. 4 percent in Marrakech. Currently Morocco produces around 5 million tonnes of solid waste per year and this is expected to increase by 20 per cent in 2020. Only 70 per cent of waste is collected and less than 10 per cent of collected waste is being disposed of in an environmentally and socially acceptable manner. There are reportedly around 300 uncontrolled dumpsites in Morocco.

A 3.4 Water and Wastewater

Transition gap: Large

Key challenges: (i) the restructuring and commercialisation of water utilities (reduction of losses, labour restructuring and productivity improvements); (ii) establishment of a national regulator for tariffs; (iii) tariff reform to improve cost-recovery; and (v) further development of PPPs financing of water and wastewater systems.

The administration of water is relatively decentralised. The Water Code of 1995 introduced River Basin Organisations as nodal agencies for water administration at the regional level. The key players in the water sector, beside the River Basin Organisations, include the Directorate General of Hydraulics, which plans and develops water resources, and nine Regional Authorities for Agricultural Development (RAADs), which develop and maintain water distribution networks, acquire and distribute water, collect water charges and provide farm inputs and extension services. There is also a National Office of Potable Water (ONEP), which acquires and distributes water on a retail basis to households and industries and on a bulk supply basis to municipal/provincial governments.

In 2002, The Moroccan government pursued the decentralisation agenda by giving municipalities the full responsibility of water supply and sanitation services. Therefore, municipalities have four options: (1) manage directly water services; (2) create an independent public provider and delegate the management of water services; (3) delegate the management of water services to ONEP; or (4) delegate the management of water services to private firms. As a result, there are 13 independent public operators (*régies*), 4 private operators under a concession/delegated management contract and ONEP.

ONEP, which is state owned but in principle legally and financially independent, is now developing the capacity to finance itself and can borrow to finance system extensions and renovations. It is the major water producer and distributes water to 416 urban centres, 198 small rural centres and about 3,656 douars.[6]

Private operators serve around 20-30 per cent of the population. The first management contract, for Casablanca, was awarded in 1997 to Lydec (Suez), by direct negotiation. The second concession, for the capital Rabat, was awarded in 1999 to Redal (Veolia), also by direct negotiation. With time, the process evolved to become more transparent, involving public tendering. This procedure resulted in management contracts being awarded to Amendis (Veolia) for two other major cities (Tangiers and Tetouan) in 2002. The delegated management contracts have had some shortcomings in terms of funding of network extensions.

Many waterworks are in a poor state of repair. Unaccounted-for-water estimates range from 25 to 40 per cent. Metering is common while water theft is widespread and difficult to address. The Water Law of 1995 introduced the user/polluter pays principle and Morocco is reported to be the only country of the MENA region in which operational costs are covered through tariffs. The operating cost coverage ratio is 100 per cent in Rabat and Casablanca but falls below operational costs is some other areas. There are cross-subsidies between regions and sectors. Investment funding remains dependent on IFI financing and aid, which has been substantial. From 1996 to 2006, 14 million additional users (nearly half of the population) have been connected to drinking water supplies. Still there are substantial investment needs in areas such as wastewater collection and treatment, rural water supply, and also drainage.

Tariffs are set locally, based on a nationally approved block system (consumption bands) for both private and public suppliers. The tariffs vary widely across municipalities – the lowest block tariff are between USD 0.155 per m^3 and USD 0.45 per m^3, whereas the highest block tariff category ranges between USD 0.537 per m^3 and USD 1.76 per m^3. There is no independent regulatory agency in Morocco. Within the government of Morocco, responsibilities for water supply and sanitation are shared by various Ministries. The Ministry of Energy, Mining, Water and Environment (*Ministère de l'énergie, des mines, de l'eau et de l'environnement*) is in charge of water resources management and bulk water supply, while the Ministry of Interior is in charge of supervising water distribution and sanitation carried out by municipal utilities. Within the Ministry of Interior, the *Direction de l'eau et de l'assainissement* (DEA) assists local governments with water and sanitation issues, and plays an active role in planning, implementing, and supporting the operations of basic water and sewerage infrastructure. The Directorate of Public Utilities and Concessions (DRSC), also part of the Ministry of the Interior, monitors the performance of *régies* (public enterprises) and concessions.

6 A camp or nomadic village.

A 3.5 Solid Waste Management

Transition gap: Large

Key challenges: (i) tariff reform to improve cost-recovery based on the polluter pays principle; (ii) capacity building to improve planning capacity; (iii) expansion of modern landfill facilities and introduction of higher recycling standards; and (iv) further development of PPP schemes.

The collection, transfer and disposal of household municipal waste are a responsibility of the municipalities, which are under the administrative oversight of the Ministry of Interior. In the area of industrial waste, the responsibility for the management of waste is with the companies. As of 2008, private firms operating on the basis of concession contracts collected two-thirds of urban waste nationwide.

Waste disposal in sanitary landfill has been historically neglected by municipalities and waste is generally disposed in open dumps (currently about 300 open dumps). Some 82 per cent (up from 70 per cent in 2008) of municipal solid waste produced in urban areas was collected in 2010, but less than 30 per cent (up from 10 per cent in 2008) of this is disposed of in an environmentally and socially accepted manner. Less than 1 per cent of the SWM was composted, 10 per cent (~33 per cent of the recyclable part) was recycled, 28 per cent landfilled, and 62 per cent dumped into uncontrolled dumps. As of 2010, there were 10 operational sanitary landfills, 15 being rehabilitated, 3 constructed and 50 programmed for 2010-2020). There are around 16 operational treatment units/centres of industrial wastes (physical chemical treatment).

Private sector participation is represented by a dozen of private operators, mostly in waste collection but increasingly in landfill operation. The total annual turnover for collection, transfer and landfilling activities is estimated at about EUR 120 million, of which about 88 per cent are from collection. The main operators are Moroccan subsidiaries of internationally known European companies and big groups. Nearly 80 per cent of the current market (collection and landfilling) is controlled by four subsidiaries of international groups (Ecomed, Tecmed, Veolia, Segedema). Seven companies control nearly 96 per cent of the current market. Contractual relations vary: for collection there are outsourcing management contracts with a major part of the investment from the subcontractor, and a part from the municipality; for disposal there are BOT contracts for the new sanitary landfills.

The new Concession Law and the provision of ad-hoc subsidies by the *Direction Générale des Collectivités Locales* (DGCL) for municipalities to upgrade their municipal SWM have been recently enacted However, there is a need to improve competition and transparency at the bidding stage, as well as accountability at the municipal level. Meeting the requirements of the new Solid Waste Law will generate a substantial challenge for local budgets, as user cost recovery is limited or non-existent. While the law allows user charges, in practice only a small fraction of the costs of solid waste collection and disposal is covered by them. The Minister of Interior has appointed a coordinating entity in charge of the development of a national CDM Programme to facilitate municipalities' access to the carbon market. Several CDM projects are under consideration in the solid waste management (SWM) sector in Morocco. So far the only large scale investment programme was financed by a 2009 World Bank loan.

A 3.6 Urban Transport

Transition gap: Medium

Key challenges: (i) tariff reform to improve fare box ratios; (ii) capacity building to improve planning capacity, (iii) tackling high congestion in larger cities through a combination of regulatory and market-based instruments; and (iv) decentralisation and commercialisation of urban transport services.

Municipalities are in charge of urban transport provision. Some larger cities (e.g. Casablanca) have established urban transport planning and management agencies and there is a plan to deploy this type of planning authorities to each large metropolitan area. Only few large urban areas (including Casablanca and Marrakech) have well developed urban transport master plans through which decision makers can elaborate strategies.

Financial performance is fragile across the sector, largely due to low tariffs and intense competition from other modes of transport. Public investment from the state budget has been focused on new LRT systems, and municipalities and operators appear to have underinvested in rolling stock. Congestion is a major problem that hampers effective urban transport service delivery.

Private transport modes are fast increasing. Inter-modal competition is fierce, with about 50 per cent of the market taken by shared taxis. Bus services are characterised by weak response to the growth of the cities, leaving large areas underserved, as well as by inefficient design of the bus routes, unreliable schedules, frequency and speed. In all but one of the ten largest cities, bus services are provided by private operators, including in Casablanca (RATP 20 per cent), Rabat (Veolia 50+ until April 2011), Marrakech (National Express). LRT systems (trams) are operational in Rabat and under construction in Casablanca. Beyond public transport, urban roads are marred by traffic congestion in bigger municipalities hence requiring investments to streamline traffic flows, better car control parking and roll-out automated traffic management. Finally public lighting systems are underdeveloped and un-modernised.

The basic fare policy in all cities is that the private operators should fully recover costs from their revenues. As fares are relatively low (about USD 0.5 equivalent for most trips in Casablanca) fare revenues are below cost recovery.

The organisation of the sector involves numerous delegated management contracts with private sector operators, however recent experience shows that the standing of these operators and contracts can be deficient hence raising sustainability questions.

The regulatory responsibilities are not well defined and the responsibilities of different agents – municipalities, other local governments, and central governments – often overlap. However, efforts have been made to improve capacity. A National Commission for Urban Transport was established and the General Directorate of Local Governments has created a fund to provide technical assistance to local governments. The contractual relationships between cities and operators may need adjusting. The norm is to pass the demand risk to operators even in case of public service obligation routes. Service quality regulation is weak.

A 4. Financial Institutions

A 4.1 Banking and Finance to MSMEs

Overview of the banking sector: overall, Morocco has modernised its banking and financial system and credit growth to the private sector has accelerated in recent years. Furthermore, its microfinance model is an example for the MENA region. Nevertheless around 33 per cent of firms still perceive access to finance as a major or severe obstacle to doing business.

Banking[7]

Transition gap: Medium

Key challenges: (i) increase banking penetration and financial intermediation, especially in rural areas; (ii) further privatise the banking system (six state-owned banks account for 25 per cent of total banking assets); (iii) increase competition (the top 3 banks account for 66 per cent of assets); and (iv) mobilise long-term resources, so as to provide more long term lending to the economy, especially in local currency.

As of end 2009, the Moroccan banking system comprised 19 banks, of which six were state-owned banks and 13 private-owned, including seven foreign-owned. The Moroccan-owned private banks accounted for 54 per cent of assets, state-owned banks for 25 per cent and foreign-owned banks for 21 per cent. The sector is highly concentrated with the top 3 banks (Attijariwafa Bank, privately-owned and listed on the Casablanca Stock Exchange; *Banque Centrale Populaire*, owned by the state and the regional *Banques Populaires*; and BMCE Bank, privately-owned and listed on the Casablanca Stock Exchange) accounting for 66 per cent of total bank assets. The next three largest banks are foreign-owned, each by a major French banking group, and have an aggregate market share of 24 per cent: SGM (*Société Générale Maroc*, 56 per cent owned by *Société Générale*), BMCI (*Banque Marocaine pour le Commerce et l'Industrie*, 67 per cent owned by BNP Paribas), and *Crédit du Maroc* (subsidiary of *Crédit Agricole*). In total, the top 6 banks account for 90 per cent of total bank assets.

Banking assets totalled 113 per cent of GDP (close to 112 per cent in Croatia and far above all other EBRD countries of operations except Slovenia); while the deposits/GDP ratio stood at 82 per cent (which is far above all of our countries of operation except Bulgaria (80 per cent) and Slovenia (113 per cent), but below the eurozone average (108 per cent).

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[7] Please note that key figures are as of the end of 2009, as the 2010 annual report of the Moroccan central bank has not yet been published.

The Moroccan banking system has not been strongly affected by the global financial crisis, mainly due to its limited exposure to the international markets. However, the banking system has been indirectly affected by the crisis through the real economy. NPLs represented 5.5 per cent of banks' portfolio (4.2 per cent for private banks), and were provisioned at a 74.1 per cent rate (77 per cent for private banks).

The loans/deposits ratio stands at 91 per cent, similar to our countries of operation, which range between 80-90 per cent (as compared to 120 per cent in the eurozone). Deposit growth slowed considerably from 11 per cent in 2008 to 3 per cent in 2010. This is attributed largely to a decline in remittances, exports, and FDI; the reliance on external factors suggests a structural lack of domestic savings. Liquid assets declined from 18.6 per cent of totals assets in 2008 to 12 per cent in 2010. To address their cash needs, banks have issued CDs and bonds to pensions and mutual funds, and have borrowed on the interbank market and from the Moroccan Central Bank (Bank Al Maghrib).

Loans to the private sector accounted for 93 per cent of total loans. Long term loans represented 29 per cent of total loans in 2010. However, the banks' long-term resources are limited, thus the banking system takes a large degree of maturity mismatch risk. The need for long-term finance will be exacerbated by the large number of infrastructure projects which the government has set as priorities for the coming years. In this context, the development of long-term funding, especially in local currency, should be a priority.

In terms of outreach, the banking system counts a total of 4,425 branches, i.e. 14 branches per 100,000 inhabitants (compared with 15 in Romania or 44 in France), and 4,144 ATMs. The Grand Casablanca region has the highest banking density with 29 branches for 100,000 inhabitants, and also accounts for 40 per cent of total deposits and 63 per cent of loans extended. Little less than 50 per cent of Moroccans have a bank account. In 2009, the postal savings system was converted into a bank, Al Barid Bank, in order to provide payments and lending services to the low income, non banked population that had been served by the postal savings system. Al Barid operates a network of 2800 locations and is implementing mobile services. It offers household credit products, including mortgages (to 15 years) and consumer loans (to 2 years). The portfolio is very small at this point; most of the bank's assets are government securities, along with some CDs and bonds of other banks.

Household credit (consumer credit and housing loans) was 197.8 billion dirham at end-2009, about 1/3 of total lending by credit institutions. Consumer credit stood at 5.6 per cent of GDP, supplied by 19 consumer credit companies. Bank-owned consumer credit companies accounted for 97 per cent of assets, and the sector is quite concentrated with the top 3 and top 5 companies accounting for 57 per cent and 71 per cent of assets respectively.

A deposit guarantee system was created in 1993, managed by Bank Al Maghrib. It covers up to a maximum of dirham 80,000 (EUR 7,000 equivalent) for deposits of customers (including corporates) of banks under liquidation. The Fund is worth 8.7 billion dirham, i.e. 1.4 per cent of total banking deposits, and is funded by banks' contributions.

Bank al-Maghrib (BAM) is responsible for the regulation and supervision of all the Moroccan financial system including banks, microfinance institutions and non-banking financial companies. BAM has fostered the implementation of the Basel Core Principles for Effective Banking Supervision (BCPBS) and has implemented the Basel II capital accord since June 2007. The Moroccan regulatory framework applicable to the banking sector is in line with international standards for banking supervision, and is in accordance with Basel Committee's recommendations and the Financial Stability Board (FSB).

The level of systemic support of the Moroccan Government to the banking system has been considered historically high. However, some rating agencies (included Moody's) have recently downgraded the level of expected support given the erosion of the local economy, and reduced fiscal policy flexibility, resulting in a potential gap between the Government's own debt capacity and its willingness to support the system.

Finance for Micro, Small and Medium-sized enterprises

Transition gap: Medium

Key Challenges: (i) broaden access to financing for MSMEs; (ii) simplify requirements for MSME borrowers and expand beyond collateral-based lending; and (iii) improve financial literacy and bankability through training and technical advisory services to small entrepreneurs.

MSMEs account for over 93 per cent of active enterprises in Morocco and contribute to over 38 per cent of GDP and 46 per cent of total employment.[8] Loans to MSMEs account for around 24 per cent of total loans. However, the SME sector still presents a number of structural weaknesses such as lack of competitiveness, low capitalisation, under-funding, as well as poor productivity and limited management skills. The high level of informality and the lack of innovation are also pointed out as important obstacles to MSMEs development. Indeed, the informal economy accounts for about 37 per cent of employment and 20 per cent of GDP. This distorts competition in the SME sector and reduces the effectiveness of government policies.

Access to finance for smaller SMEs remains scarce, with significant impact on employment. This is as much a reflection of the SMEs as it is of the banks, which practise asset-based lending, while SMEs often lack sufficient collateral, equity, and formalisation of management and accounts. In that regard, some banks are trying to develop lending to a specific category of small businesses which they call "mini-finance": the small SMEs that are too large to be clients of the micro-finance institutions and too small to be served by more traditional banking products.

Although 12 microfinance institutions operate in Morocco, the sector is highly concentrated, with five institutions holding 95 per cent of the total outstanding credit. The average loan is dirham 5,000 (EUR 440). After several years of very dynamic growth (>50 per cent yearly), Moroccan microfinance institutions have been affected by the financial crisis, which led to higher NPLs and declining loan volumes in 2009-10.

[8] OECD report: *Compétitivité et développement du secteur privé. MAROC, Stratégie de développement du climat des affaires.*

Measures were taken, including the identification of borrowers with multiple loans, and the sector is now recovering. Needs remain large, however, given the proportion of the population which is below the poverty line. Some restructuring of the sector may be necessary to foster growth on the basis of sound banking principles and to facilitate access to finance, including in remote rural areas or poor urban areas.

In 2006, Bank Al Maghrib (BAM) conducted a regional campaign to raise awareness on SME financing. Five axes of intervention were identified and implemented:

1. Financial information: creation of a Credit Bureau, online consultation of financial statements, standardisation of minimum elements to be included in a loan application (BAM directive of 1st April 2005);
2. Assistance: creation in 2002 of the National Agency for the Promotion of SMEs (ANPME), signing in 2005 of a partnership agreement between the professional group of Moroccan banks (GBPME) and the federation of SMEs: implementation in 2008 of a regional framework to guide SMEs and assist them in loans preparation;
3. Governance (public/private sector consultation): elaboration in 2008 of the Moroccan Code on Good Governance Practices adapted to SMEs;
4. Guarantee system (BAM, Ministry of Finance);
5. Increase SMEs' competitiveness.

In 2009, the Government implemented a National Pact for Industrial Emergence. One of its 3 Pillars aims at increasing SMEs' competitiveness. To that aim the National Agency for the Promotion of Small and Medium Enterprises (ANPME) launched two new programmes. The first, called Imtiaz, is designed for companies with development plans who wish to take advantage of assistance worth up to 20 per cent of their investment in tangible and intangible assets. The subsidy can be up to five million dirham. The second programme, called Moussanada, is designed to help SMEs in the process of modernising and improving their competitiveness by setting up operational support programmes which are accessible to all businesses.

Eleven credit guarantee schemes have been funded by the state, working closely with commercial banks and supporting access to finance for MSMEs. The largest of these is via the *Caisse Centrale de Garantie* (CCG), founded in 1949 to provide partial credit guarantees to risk-share SME loans with originating banks. CCG's overall guarantee portfolio is 3 billion dirhams, with an annual volume of 1.3 billion. The average loan size is 250,000. CCG pricing for guarantees on long and medium term loans is 2 per cent flat. For shorter term (working capital) it is 0.5 per cent. The fee is paid by the borrower. CCG sees its impact not as reducing the interest rate paid by SMEs but expanding access and enabling longer maturity lending.

Guarantees are available to all banks. CCG only receives requests for guarantees when the risk is moderate to high, and the bank does not wish to underwrite the loan on its own. CCG reports that 90 per cent of requests come from situations where a bank thinks the project is viable but the collateral is insufficient, for example the company has no real assets or insufficient equity, or where there is some collateral, but the bank would have to reduce the amount lent without the CCG guarantee. CCG shares risk pari passu with the originating bank (no first-loss guarantees). The amount of risk share varies from

50 per cent up to 60 per cent for exporters and growing companies, and 70-80 per cent for start-ups and very small companies 80 per cent.

In some key strategic sectors identified by the government CCG co-finances loans. The bank then offers a mixed loan – their portion at the market rate, and CCG funds at 2 per cent. The mix is capped at 30-40 per cent CCG funds, and there are caps on the overall amount. The targeted sectors are industry, hotel renovation, and education.

While credit information services are available to financial institutions and to the public, the absence of regular updates and the low coverage are a key impediment to access finance by MSMEs. The lack of a registration system for movable assets prevents banks from accepting enterprise's assets as collaterals.

Access to finance for MSMEs might be improved by alleviating collateral requirements and moving to more value added and innovative sectors. MSMEs would benefit from training and consultation since improving entrepreneurial skills is necessary to build an effective business environment in the country. Engaging in downscaling programmes, combined with the provision of credit lines for MSME financing, should also help local banks achieve this target.

A 4.2 Insurance and Other Financial Services

Transition gap: Medium

Key challenges: (i) support the development of independent customer credit companies; (ii) increase competition in insurance, consumer credit and leasing; (iii) support the development of the private pension and mortgage markets.

Insurance

In 2010, the Moroccan insurance sector counted 17 companies. The distribution network includes traditional insurance agents and bank distribution models (both insurance within banking groups and marketing affiliations). Insurance premia stood at 2.85 per cent of GDP, of which 30 per cent of life insurance and 69 per cent of non-life insurance, including 32 per cent of auto insurance. The share of life insurance has been growing relative to the share of mandatory auto insurance.

The sector is quite concentrated with the top three players (Wafa Assurance, Royale Marocaine d'Assurances-Alwatanya and Axa Assurance Maroc, all private owned) accounting for 55 per cent of premia, and the top 5 for 74 per cent. The sector also comprises one domestic reinsurer, the Central Reinsurance Company, which is state-owned.

Significant progress has been made in insurance sector supervision, exercised by the Department of Insurance and Social Welfare Directorate of the Ministry of Finance. Regulations are based on the EU insurance directives, including advanced provisions on corporate governance and internal controls. The Department reviews insurance products both from the perspective of compliance and consumer protection. The Department reports that Solvency 1 is in advanced stage of implementation and it is preparing the sector for Solvency 2. The Department has signed a 5 year “Program Contract” calling on the insurance sector to increase insurance penetration and provide better products including products targeting specific segments of the population such as micro-insurance. Separately, the Ministry of Agriculture and Fisheries has agreed in August 2011 to introduce multi-peril crop insurance with a private company. This product will be commercialized for the next season, with low cost to small farmers. Government will finance around 70 per cent of the product, with the subsidy varying by the size of the farmer. Small farmers will pay only 10 per cent of the fee, large farmers 50 per cent.

An independent insurance authority is to be created under a law passed August 25 2011 by the Government, pending signing by the King. The authority is to be independent of political control and to have a supervisory and regulatory role.

Pension Funds

Three pension pillars are in place. The largest pension provider is the Government PAYG system. This system has some features that may not be sustainable, such as indexation to the current salary of the last position held. There are also funded employer-provided pension funds for civil servants, para-statal, and private companies. Banks offer individual pension accounts.

Leasing

Six leasing companies are active in Morocco. The leasing over GDP ratio stood at 4.9 per cent. The leasing sector is also quite concentrated, with the top 3 companies accounting for 68 per cent of assets in end 2009. NPLs represented 5.7 per cent of total leases.

Mortgage Finance

About half of the 198 billion dirham in household credit in 2009 was for housing (15 per cent of GDP). The average maturity of housing loans was 17 years; two thirds of these loans have fixed interest rates. The weighted average rate was 5.35 per cent in 2009.

About 20 per cent of housing loans, worth 23 billion dirhams, are supported by Government programs administered by the *Caisse Centrale de Garantie*. CCG began providing mortgage guarantees in 2003 to support the Government’s policy on social housing and low income housing. These provide guarantees of up to 70 per cent for the low cost housing FOGARIM program for low or irregular income clients who did not have access to bank loans. Other CCG programs include FOGALOGE, a program for middle class, private market wage earners with low wages, and the “Cities Without Slums” program, for which CCG provides up to 80 per cent guarantees.

There is a functioning property registry; however, many properties remain unregistered. The Government has undertaken to encourage registration by reducing the fees, requiring property registration for access to certain services, and conducting a public information campaign.

A 4.3 Private equity

Transition gap: Medium

Key challenges: (i) develop locally based Fund managers and (ii) further develop the institutional investor base.

Within the Maghreb, Morocco is perceived as having a developing private equity industry, which however remains rather fragmented. A number of established players, such as Argan Invest (part of BMCE group), Maroc Invest (part of TunInvest-AfricInvest Group), CDG Capital (part of state-affiliated CDG Group), Kantara Morocco (part of Albraaj), Almamed and Upline Investments (part of BCP) have a positive track record locally, while several new fund managers, including regional funds such as Aureos capital, Riva y Garcia and Viveris, have started to establish footholds.

More than 100 companies have received financing from private equity investors for about dirham 2 billion in 2008. However, as in other countries in the region, the growth in fundraising activities from 2005 to 2008 resulted in a significant gap between funds raised and investments, representing about two-thirds of dry powder in Morocco. This gap is mainly the result of two factors: funds raised during the period (mainly in 2007 and 2008) did not have enough time to deploy before the crisis and a lack of management and investment expertise.

As of 31 March 2010, 18 management companies had raised dirham 6.7 through 29 funds. Funds are raised from international development organisations (36 per cent), financial institutions (24 per cent) and insurance companies (16 per cent). Half of the funds come from abroad. 28 per cent of funds are sector funds and 32 per cent are regional funds focusing on Maghreb and Africa. As of 31 March 2010, about 2 billion dirham had been invested in 101 companies. Half of investments are between dirham 3 million and dirham 30 million and 3 quarters of companies in which funds are invested are located on the Casablanca-Rabat axis. About 1 billion dirham have been disinvested in 34 companies, achieving an average internal rate of return of 24 per cent. Half of the exits are done through selling shares to shareholders and about a quarter through IPOs (respectively 14 per cent and 60 per cent in value).

There are a number of government programs to encourage targeted private equity. As part of its tourism development strategy, in 2007 the Ministry of Tourism helped form several real estate development funds focused on the hospitality industry. These were funded by local institutional investors (insurance, pension funds, and investment funds).

The *Caisse Centrale de Garantie* provides portfolio guarantees for PE funds. At the creation of a fund, CCG will guarantee up to 50-60 per cent of the portfolio, and looks for 7-8 per cent on exit. They have guaranteed two funds so far. CCG also has a Public-Private Partnership framework to invest in funds that will invest in smaller companies, with turnover under dirham 100 million, and average investment size of dirham 20 million. A first closing on two funds is expected in September 2011.

The Ministry of Commerce and Industry is similarly looking to develop PPPs for venture capital. The Ministry reports that there are a number of VC funds, some of which are focused on technology, but more capital is needed. There are tax incentives to

VC investment. Currently the law restricts such investment to SMEs and puts constraints on the composition of the assets of funds if they are to qualify for the tax incentives set up for VC. The sector regulator, *Conseil Déontologique des Valeurs Mobilières* (CDVM), is working on changes to the law that will make it possible to invest in larger companies and in different asset types such as debt, guarantees, and convertible debt under the tax-advantaged VC scheme.

A 4.4 Capital markets

Transition gap: Medium

Key challenges: (i) further develop the local stock exchange; (ii) further develop the corporate bond market (including securitisation) (iii) develop products such as asset-backed securities and covered bonds, which could help rebalance banks' maturity mismatch while supporting the growth of mortgage financing, and (iv) develop the framework for basic derivatives to provide FX and interest risk management tools that will enable the exchange regime to be more flexible.

There is an active interbank money market and central bank repo market, spurred in part by the slowdown in deposit growth since 2008 and the increased funding gap, for which deficit banks tap the interbank market and the Central Bank. The Central Bank provides sufficient liquidity to keep the interbank rate close to the policy rate.

Morocco's debt market was introduced in the mid-nineties. Treasury bills and Treasury bonds are auctioned weekly with 13, 26, and 52-week maturities, while the T-bonds are issued with maturities of 2, 5, 10, 15, 20 and 30 years. Public sector bond issuance accounts for 95 per cent of total outstanding debt. Government debt securities are mainly held by local banks (30 per cent), insurance companies and mutual funds (25 per cent each) and the *Caisse de Dépôt et de Gestion* (10 per cent).

Corporate securities are issued in the Moroccan fixed income market but non-government securities account for less than 5 per cent of total debt outstanding, mainly consisting of commercial paper predominantly issued by non-financial companies, certificates of deposits issued by local municipalities and "bills of financing companies" which are issued by leasing companies.

Morocco's debt secondary market is relatively liquid and operationally efficient. Trading volume is improving due to an active repo market. Most of the corporate bonds are issued by larger, listed companies, including banks. Both unlisted bonds and listed bonds are registered with CDVM. There is more debt issued outside the stock market than there is listed.

Morocco has the third largest stock exchange in Africa after South Africa and Egypt, and it has been growing steadily since 1993 when it underwent major reforms driven by the Ministry of Finance. This created a new limited company where the shareholders were stockbrokers and also a central depository, and the CDVM as the market authority. The CSE has installed an electronic trading system, and is now organised as two markets: the Central Market and a Block Trade Market. In 1997 the central depository was created. All listed securities are dematerialised.

As of June 2011, the market capitalisation of the Casablanca Stock Exchange (CSE) stood at Dirham 528 billion, or 72 per cent of the country's GDP, higher than most EBRD countries of operations except Ukraine (98 per cent) and Russia (127 per cent). A total of 77 companies are listed on the stock exchange. Banks, telecommunication companies and real estate are the most represented sectors in market capitalization. Investors dominate the main segment with 75 per cent of transactions, while individuals account for only 22 per cent.

The securities regulator, *Conseil Déontologique des Valeurs Mobilières* (CDVM), was created in 1993. The *Bourse* is a professional association and does not have the power to regulate markets. Regulation is enforced by CDVM, which is looking to gradually transfer parts of that to market operators.

CDVM became member of IOSCO in 2007, and considers that its legal framework complies with international standards. In August, 2011 the cabinet adopted a draft bill to transform CDVM from a public entity to an independent authority, to expand its authority and create greater regulatory efficiency. The cabinet also adopted another bill on IPOs, reinforcing disclosure requirements, providing greater flexibility to use the internet, and requiring adoption of IFRS by all listed companies.

There are 2 or 3 funds that securitize bank loans. The initial legislation only enabled securitization of guaranteed debt; the 2010 reforms enabled any type of debt to be securitized, including future debt. There is a project underway with IFI assistance to develop covered bonds, expected to be completed in 2012. A bill on futures has been adopted by the cabinet and sent to parliament. The Ministry of Finance is examining a draft on real estate funds (REITs). These and the other reforms mentioned are likely to proceed only after elections, and will depend on the priorities set after elections, but CDVM reports that there is political consensus on reforming and developing the capital markets.

The derivatives market has yet to develop. The tax treatment of certain instruments, such as cross-currency swaps, is not clear, and this has hampered banks looking to expand these products. The *Bourse de Casablanca* is looking to develop the regulatory framework for an independent clearing house for both cash products and derivatives. Currently the stock exchange manages settlement risk without the benefit of novation.

A project to create an international financial center, Casablanca Finance City, was initiated in 2010 under the Moroccan Financial Board. This initiative intends to create a financial center linking African markets and companies (in particular those of Francophone West Africa) to international investors. Tax and development incentives will be provided to encourage financial institutions to co-locate at the CFC site. An FX section on the CSE is being considered to attract African companies to list on the exchange to attract investment by both Moroccan and international institutions.

Annex 2: Summary of challenges, opportunities and priorities

Operational priority	Transition challenges	Potential investments	Indicative TC priorities
Financing **private enterprise**	• lack of diversification given the dominant role of the phosphates industry • large role of the government in the economy • need to develop competitiveness, productivity and efficiency • improve the business climate	• direct financing in locally (typically family) owned mid sized companies • providing acquisition or expansion finance to purchasers of majority stakes from SNI • long-term or mezzanine finance for selected larger corporates (eg in the steel sector)	• TAM/BAS operations • support for introduction of the LEF Facility or similar
Modernising the **agribusiness** value chain	• insufficient investment; insufficient credit and poor infrastructure • weak sector organisation; • fragmented, wasteful and inefficient production methods • dominance of SNI and its affiliates	• investment to support the greater exploitation of the full value chain • finance for local private entities • investment in companies that compete with current monopolies and semi-monopolies • transfer of skills.	• roadmap to reform the sector (as part of the World Bank “food security initiative”) • training to food producers' associations and sugar farmers • technical, managerial and financial management improvement project for targeted agribusinesses
Deepening the **financial** sector	• banking sector exposure to maturity mismatch • limited capital markets development • limited availability of finance though the banking sector for SMEs, particularly smaller firms. • low penetration of non bank financial services. • lack of management and investment expertise for equity funds	• issuing long-term bonds on the local markets and supporting the issuance of capital markets products • fostering competition in international trade finance (via TFP) • financing and restructuring of the microfinance sector • promoting a stronger, more diversified domestic private equity industry • developing a stable international, regional and local investor base	• supporting the development of local capital markets (also as part of the Deauville Partnership “Private Sector Development Initiative”) • technical assistance to support the deployment of the Bank's SME products • study to identify weaknesses and opportunities in the NBFI sector

Operational priority	Transition challenges	Potential investments	Indicative TC priorities
Supporting Morocco's **sustainable energy** strategy	• dependency on imported energy • poor energy efficiency throughout the power, industrial and residential sectors and low level of renewable energy penetration • state-controlled vertically integrated energy sector	• energy efficiency investments in power sector, industrial and agricultural companies • independent and small-scale renewable energy projects • "green mortgage" products. • Public projects that support private sector development and drive sector reform • private sector PPPs, including construction of new thermal power plant	• study to estimate the market size for energy efficiency and small scale renewable energy • energy audit framework, especially in industry • technical, financial and legal assessment of the distribution sector, focussed on tariff methodology, commercialisation and energy efficiency, including smart metering
supporting **infrastructure** reform and the decentralisation of **municipal services**	• financing and decision-making highly centralised • municipal service providers do not operate on an independent or commercial basis • inadequate tariff methodology and non-cost reflective tariffs • inadequate regulatory framework for PPPs and other forms of private sector participation	• private sector investments in infrastructure, through PPPs and similar structures • investments in municipal services moving towards corporatisation, commercialisation and tariff reform • key investments linked to sector reforms	• regulatory and legal framework assessments of transport sub-sectors • analysis and reform roadmap for municipal services, focused on decentralisation, private participation and tariff reform, including eliminating cross-subsidies • technical assistance to develop revised regulatory framework for municipal services • project preparation such as feasibility studies for specific projects.