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INVESTMENT POLICY REVIEW OF MOROCCO

Executive summary

Note by the UNCTAD secretariat*

UNCTAD's Investment Policy Reviews are intended to help countries improve their investment policies and to familiarize Governments and the international private sector with an individual country's investment environment. The reviews are considered at the UNCTAD Commission on Investment, Technology and Related Financial Issues. Investment Policy Reviews undertake an objective evaluation of the policy, regulatory and operational framework for FDI in developing countries.

The Investment Policy Review (IPR) of Morocco was initiated at the request of the Government. The project was co-financed by France, and a first draft of the IPR was presented at a national workshop, which took place in Rabat on 6 December 2006.

* This document was submitted on the above-mentioned date as a result of processing delays.

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CONTENTS

I. TRENDS AND IMPACT OF FOREIGN DIRECT INVESTMENT

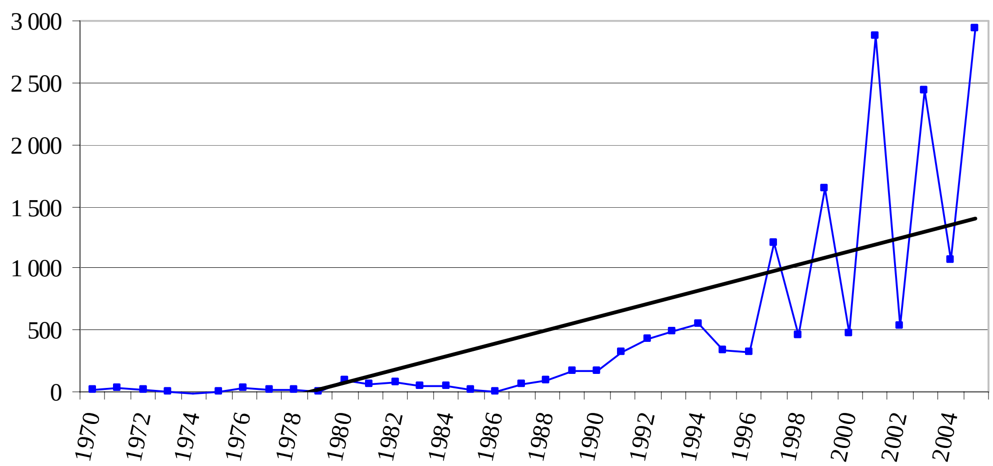
1. The point of departure of Morocco's FDI story is a series of reforms undertaken by the Government in the 1980s, which contributed to improving the country's macroeconomic prospects. These included economic liberalization, the privatization of a number of state-owned enterprises and the modernization of the financial sector. To this, one can add a number of investment-related measures implemented during the 1990s, including an investment charter, protection measures and bilateral investment treaties (BITs).

2. FDI started growing from the early 1990s. Much has been privatization-driven – $6.4 billion of the $10.7 billion of FDI inflows between 1993 and 2003. Two of the biggest operations in Morocco's successful privatization programme were the sale of Maroc Telecom to Vivendi Universal ($2.7bn) and the Régie des Tabacs to Altadis ($1.7bn). However, there has been important non-privatization FDI that has led to significant technology transfer.

3. Between 2001 and 2003 Morocco was the second most important recipient of FDI in Africa and the first in the Maghreb region. In 2002 and 2004 it reached record levels, with $1.07 billion and $2.93 billion of FDI inflows respectively. While inflows have been volatile, a look at FDI stock shows the results of Morocco's change in economic policy direction. In 1989 FDI stock accounted for 13 per cent of GDP. By 2005 it had reached 44 per cent. Over the last five years Morocco has been an important driver of FDI to Africa, and in 2005 it was the fourth most popular destination behind South Africa, Egypt and Nigeria. However, annually only 0.72 per cent of Morocco’s FDI inflows are due to reinvestment. This could indicate the presence of obstacles to investment and a lack of aftercare services.

4. Ninety per cent of FDI has been from Europe, with a significant portion from France and Spain as part of the privatization programme. However, there has recently been major growth in FDI from the Gulf, mainly for oil, tourism and property development.

FDI inflows to Morocco between 1970 and 2005
(Millions of dollars)
Black line denotes trend



Source: UNCTAD

5. In the last five years, most FDI has been to telecommunications (44 per cent), mainly due to privatization; manufacturing industry (27 per cent), with important increases in automotive manufacturing and aeronautical maintenance; banking, driven by privatization and acquisitions; services, driven by tourism; and natural resources and petrochemicals.

6. The Government is supportive of FDI. It created the Hassan II fund, financed partly from privatization receipts, to contribute to projects in which the Government has a particular interest. It has also signed two landmark trade agreements: the EU Association Agreement (in force since 2000), which will establish a free trade zone by 2010, and the free trade agreement with the United States (which entered into force in 2006).

7. In terms of impact, FDI has increased its position in relation to total investment in Morocco, passing from 6 per cent of gross fixed capital formation for the period of 1990–1995 to 12.7 per cent for the period of 1996–2004. In 2005 the figure reached 22.1 percent, which compares well with neighbours.

8. The strong flows of workers' remittances, which are estimated at 9 per cent of GNP, are seen by the Government to have investment potential. The Hassan II fund has a role to play in encouraging the diaspora to invest more.

9. In an environment of high unemployment (more than 12 per cent), TNCs have been responsible for significant job creation – 8,000 jobs in 2003. This has been accompanied by heavy expenditure on training. The textiles sector is one of Morocco's biggest employers, creating 2,500 jobs alone in 2005. FDI has stimulated positive transfers of know-how and technology. ST Microelectronics and Matra Automobile have set up research centres, and the growth of the aeronautical sector is seen as one of high potential.

Conclusions

10. The reforms undertaken by the Government contributed to relatively large inflows of FDI. The challenge is to ensure the sustainability of these flows and their contribution to the country's development objectives. Despite the sharp increase in FDI flows since the early 1990s, they remain volatile due to big privatizations. However, Morocco also receives strong greenfield investment, even though efforts to attract FDI have been reactive rather than proactive. The impact of FDI has been positive, leading to strong job creation, transfer of know-how and technology, and training of human resources. However, inflows are modest relative to the investment potential. An investor targeting strategy needs to be developed in order to respond to the sectors identified by the *Plan Emergence*.

II. THE INVESTMENT FRAMEWORK

11. Morocco considers FDI a priority. In recent years it has undertaken legal, institutional and regulatory reforms to improve the business climate. Incentives applying to both domestic and foreign investors have been put in place, and since 1995 an investment charter has replaced nine sectoral codes. However, administration is opaque and the judicial system complex.

Legislation on FDI

12. Morocco does not have an investment code. FDI is partly regulated through the investment charter, but many important measures on investment remain dispersed among

other laws, including incentives. The charter also mixes legal provisions with discretionary ones, and its unifying nature is undermined by a tendency for the Government to introduce incentives and measures specific to certain sectors. Many measures contained in the charter have not been implemented, despite a timeframe of 10 years, set in 1995, for implementing its provisions.

Entry and establishment

13. The Constitution guarantees the right to invest for all, with limitations where 'national economic and social needs so require'. The freedom to invest has been in place for a long time but has never been referred to in any legal text, including the charter. Licences, where required, are granted automatically if no reply is received from the Government 60 days after application. There is no avenue for appeal if the licence is refused.

14. The institutions in charge of investment are:

- The Department for Investment (Direction des investissements (DI)), which is part of the Economic Affairs Ministry and acts as an investment promotion agency (IPA) with a very small budget and only processes projects valued at over 200 million dirhams ($23 million);

- The Regional Investment Centres (Centres régionaux d'investissement (CRIs)), which act as regional one-stop shops under the auspices of the regional authorities;

- The Investment Commission (Commission des investissements (CI)), which approves special investment contracts and intervenes when problems arise from decisions made by the CRIs. It also rules on obstacles to investment within the administration and gathers information on general investment trends in the country;

- The Hassan II Fund, which provides financial contributions for investment projects in key sectors, usually projects with social objectives;

- Line ministries, which can directly sign contracts for investments below $200 million dirhams.

The competencies of these institutions overlap, and this issue is explored in chapter III.

15. Three types of administrative procedure exist for investors:

- Non-contractual regime: For any investment below 200 million dirhams, the CRI concerned processes the application;

- Contractual regime: This allows for an investor-state contract based on the negotiation of terms and conditions. The procedure for this is not specifically laid out. However, in practice, for any investment above 200 million dirhams or where a public contribution is sought, the first point of contact (a CRI or a line ministry working with DI) negotiates terms and then passes them on to relevant ministries for consultation and finally to the CI for approval. The application is then passed to the line ministry for signature;

- Exceptional contractual regime: For any project with social ends and seeking incentives or financial contributions, a special commission needs to approve.

Treatment and protection of foreign investment

16. The charter does not specifically refer to national treatment. However, there is no discrimination in law or in the experience of foreign investors to date. Further protection is provided by BITs, which also provide for national treatment and most favoured nation (MFN) status.

17. The constitution protects private property with the proviso that it may be expropriated by the state 'for economic and social development needs.' In theory, the state is not bound by international practice concerning public interest, non-discrimination and prompt and adequate compensation, although these conditions are provided for in BITs. In practice there has not been any abuse of the Government's powers. There is no restriction on the transfer or exchange of funds.

18. Although Morocco is a member of the International Centre for the Settlement of Investor Disputes (ICSID), access to it is only guaranteed through BITs. Otherwise, for investments under the contractual regime, the final arbiter is Rabat High Court. For matters concerning the CRIs, the Walis (regional governors) act as arbiters.

International agreements relating to FDI

19. Morocco is a member of ICSID, the Multilateral Investment Guarantee Agency (MIGA), the Inter-Arab Investment Guarantee Corporation and the Convention for the Investment of Arab Capital in Arab Countries. Morocco has negotiated 54 BITs and 46 double taxation treaties (DTTs). It is a member of the WTO. It has a free trade agreement with the United States and an association agreement with the EU, both of which afford investors in Morocco significant access to these markets. Other FTAs have been signed in the region.

Performance requirements

20. Performance requirements are imposed only where incentives are required and will be stated in the investor contract. However, it would be more transparent if the performance requirements for different incentives were stated in the charter.

Taxation

21. Morocco's fiscal system is one of the most criticized aspects of its investment environment. The method of calculation and payment of taxes is seen as complicated, with investors requiring a more stable, transparent and simple system. UNCTAD's survey reveals that Moroccan business believes the tax burden to be excessive and a hindrance to employment growth. The burden falls heavily on employees as well as employers in the domestic sector. Employers in the informal sector pay no tax, whereas employers in the export sector receive incentives.

22. The overall corporate tax burden has been reduced considerably from 44 per cent to 35 per cent through the introduction of company tax (IS), although this is still higher than that imposed in other comparable destinations for FDI. Companies can choose between the IS and income tax (IGR). The highest rate for the IGR is 44 per cent, despite a pledge in the investment charter to reduce it to 41.5 per cent, and this level is reached quickly. The standard rate for the IS is 35 per cent. Investors can deduct running costs and depreciation.

Losses can be carried forward for four periods. The DTT network is fairly wide and includes the home countries of Morocco's main investors.

23. VAT applies to all goods and services with the exception of exported goods and services. The normal rate is 20 per cent, although there are exceptions. According to investors, delays in VAT refunds go beyond the statutory period of four months. The tax authorities have recognized this and are looking to reform.

24. Over 10 local taxes exist, a reduction from 40 prior to 2005. The way the rules are applied means that 80 per cent of local taxes are generated by 20 per cent of companies. Companies also pay a trade licence tax (*impot sur patente*) which is based on the rental value of the business premises. As this acts to an extent as a tax on the value of investment, it is strongly suggested that this latter tax be removed.

Fiscal incentives

25. Morocco's incentives are less attractive for foreign investors than those provided by other developing country destinations for FDI. They are also dispersed among a number of texts and are hard to identify, although the 2006 budget makes an effort to bring them together.

- All companies exporting goods and services are totally exempt from the IS or the IGR for five years and enjoy a permanent 50 per cent reduction thereafter. The same benefit applies to companies supplying firms located in EPZs with finished goods and to hotels' foreign exchange earnings;

- Agriculture is exempt from the IS and IGR until 2011;

- Companies operating in Tangiers-Assilah province and Fahss Bani Makada enjoy a permanent 50 per cent reduction. Companies headquartered in Tangiers province for tax reasons and operating in Tangiers get a further 50 per cent reduction, leading to an effective IS rate of 8.75 per cent. However, none of these rates are specified in the charter, making them less apparent to investors;

- Incentives are also available in respect of the capital gains resulting from the sale of physical assets;

- Companies do not pay VAT on building materials or equipment;

- New companies and extensions of companies are exempt from the trading licence tax for five years. Beyond this period, companies are only taxed on the first 50 million dirhams of rental value. A permanent 50 per cent reduction is available in the provinces of Tangier Assilah and Fahss Bani Makad. Firms in EPZs and offshore financial companies enjoy a total exemption for 15 years;

- New buildings, extensions and building goods and equipment are totally exempt from urban tax for the first five years. Beyond this, the same exemptions and reductions apply as for the trading licence tax;

- However, there is a fixed charge of 25 per cent of the IS tax rate, payable by any company benefiting from IS exemptions.

Incentives in investor-state contracts

26. These are specified in the charter and are limited to the provision of land, external infrastructure and financial contributions for training.

Customs

27. Morocco's customs service has improved significantly and performs better than other countries in the region. Customs checks are now quick, targeted and efficient, and the process has been computerized.

EPZs

28. The only EPZ is in Tangiers port. Companies operating there are exempt from the IS for the first five years and then pay a rate of 8.75 per cent for the next 10 years, which matches the rates applied in the rest of the province. The EPZ lacks external infrastructure and linkages with the surrounding economy. However, investors appreciate its proximity to Europe, its fiscal regime, the removal of customs formalities and access to offshore banking facilities.

Management of capital and trade movements

29. Free transfer of dividends, disposal of assets and capital gains are allowed. Trade openness has improved considerably since WTO accession. Anyone can import or export, and all export restrictions and taxes have been removed, apart from licensing requirements relating to security or tans and hides. Export procedures have been simplified, although export and import procedures remain complex and long.

Employment

30. Legislation was considerably reformed with the introduction in 2004 of a new employment code. This was well received by investors. However, rules governing redundancy for technological, structural or economic reasons remain burdensome for investors, requiring prior authorization from the authorities in consultation with employee representatives. Investors have also complained about inadequate rules governing dismissal for gross misconduct. The employment code has no provisions for strikes, which means the right to strike is frequently abused. Maximum working hours were reduced from 48 to 44 hours a week with no reduction in wages, and the minimum wage was raised, all contributing to increased labour costs.

31. The rules for recruiting foreign personnel are vague, leading to varying interpretations by the authorities, whose decision cannot be appealed.

Land

32. Discrimination has been eliminated, although foreigners may not purchase land for natural resources or agricultural purposes. Furthermore, the land registry's coverage is limited, and it is often difficult to identify the real owner of land.

Commercial law

33. Since the early 1990s, a new commercial code, new accounting rules and a new law on companies have been adopted and commercial tribunals have been introduced. The legal

framework enforces contracts sufficiently, although debt recovery is still a problem. Company law is line with European standards, but only requires companies with a turnover in excess of 50 million dirhams to use auditors, leaving a large number of companies unaudited. This exacerbates the difficulties the Government faces in trying to contain the growing informal sector. Without an accurate picture of their finances, unaudited companies find it difficult to fully assess their own performance, access credit, or be granted bankruptcy protection by the courts.

34. The rules for companies facing financial difficulties and bankruptcy are applied weakly and often too late, and judicial capacity is weak. Procedures for setting up a limited company are lengthy and complex. As a result, only 21 per cent of all investors establish such companies. National and local commercial registers are being renewed and computerized, while the technical capacity of the commercial courts needs to be strengthened.

Intellectual property

35. Morocco adheres to the main intellectual property treaties and has revised its laws in line with its TRIPS obligations. Furthermore, its FTA with the United States provides for the application of even stricter intellectual property rules.

The informal sector

36. The size of the informal sector is estimated at 36.4 per cent of GNP. The Government is taking steps to support companies in the informal sector and encourage their formalization through measures that are being or will be put in place. These measures include the creation of business centres, providing access to microcredit and enabling SMEs to access government contracts. These measures are important, as the annual fiscal loss attributable to the informal sector is estimated at 7.5 billion dirhams. The informal sector has also been linked to smuggling, which counts for 12 per cent of imports, and piracy and fakes, which are estimated at 58 per cent of output. Morocco has legislation to combat piracy but is not enforcing it sufficiently.

Privatization

37. The law was introduced in 1990 with the start of the privatization programme. A new draft is being considered. Investors perceive the privatization process as being transparent, although the intervention of the competition authority would enhance this further.

Competition and government procurement

38. Morocco has a competition law. However, its wording lacks precision, and certain anti-competitive practices are allowed if they help further 'technical or economic progress'. However, the nature of the competition authority is problematic. As a consultative body, it has no power of decision or sanction. It formulates recommendations to the Prime Minister's office, which must then make an administrative decision. Decision-making powers also rest with governors of *prefectures*, the inter-ministerial committee and line ministries.

39. Morocco's law on government procurement is seen as transparent and compares well with international practice. However, it favours Moroccan bidders, which runs counter to Morocco's commitments at the WTO and its association agreement with the EU. In addition, delays in payment can range between six and nine months. Unethical behaviour in the

awarding of contracts is a problem that the judiciary has not had the capacity to tackle effectively.

Judiciary

40. Many potential foreign investors perceive the capacity of the judicial system as weak and as a major obstacle to investment. The system is regarded as operating slowly, leading to uncertain outcomes (conflicting and unenforced judgements), and lacking transparency. Furthermore, the system could be strengthened through better training of judges and staff. With regard to arbitration, there are restrictions on the leeway and decision-making powers of the arbiter and on the enforceability of international arbitration decisions.

Conclusions

41. Morocco's recent history of economic policy reforms and their contribution to attracting FDI will not be enough to ensure the sustainability and positive economic impact of investment inflows. The process of renewing the regulatory and institutional framework that was initiated by the Government in the 1990s should be accelerated in order to eliminate the obstacles to investment that this chapter has identified.

42. It is recommended that, as a priority, the Government consolidate all texts related to the general investment regime in a clear and transparent investment code. This code should include precise procedures to follow, should clearly protect investors, should be credible, should provide for standards of treatment, and should not be restricted to a defined period. It is essential that fiscal incentives be regrouped into a fiscal code in order to make the fiscal framework for FDI more transparent. While the 2006 budget regroups all current incentives, which is a step in the right direction, a fiscal code would be a more appropriate place.

43. The institutional framework for investment would greatly benefit from the elimination of the overlap of roles between the different institutions in charge of investment. It is recommended that an investment promotion agency be set up and be given sole responsibility for developing an investor targeting strategy. This should also lead to a simplification of investment procedures.

44. The legal framework does not represent an obstacle for FDI in Morocco, but there is considerable uncertainty about the effective application of FDI-relevant law. The third set of recommendations therefore concerns medium- to long-term improvements in governance in a number of areas, including the judiciary, intellectual property, land and competition.

III. STRATEGIC PERSPECTIVES

45. Chapter III examines investment promotion efficiency and proposes a strategic framework to attract FDI and ensure that, in line with the Government's industrial policy, it supports the sectors identified in the *Plan Emergence* (electronics, agribusiness, processed seafood, the automotive and aeronautical industries, offshoring of services, and handicrafts). The principal actors in investment promotion are the Department for Investment (*Direction des investissements* (DI)) under the Ministry of Economic Affairs, and the Regional Investment Centres (*Centre régionaux des investissements* (CRIs)) under the regional governors, who in turn are under the Ministry of the Interior.

46. The DI is in charge of promoting all direct investment to Morocco in general, negotiating investment treaties, investment facilitation, promoting certain sectors and industries, research and analysis on investment, cooperation with the CRIs, policy advocacy across government to improve the investment environment, servicing of the Investment Commission (*Commission des investissements)*, which approves strategic projects, and international cooperation. It currently has a staff of 65.

47. The CRIs provide one-stop-shop services in 16 regions. Their main tasks are to be a point of entry for all investments below 200 million dirhams ($23 million) in their region, to troubleshoot administrative delays, to provide advice to investors and to promote investment in their regions.

48. The overall system works to an extent, as witnessed by the significant investment flows that have entered the country. However, CRIs need to improve in order to attract higher-value-added investment, as set out in the *Plan Emergence*. The performance of the CRIs also varies by region.

49. With regard to the DI, its weaknesses are both institutional and strategic. It lacks autonomy from its parent ministry (unique for the region), funding and business experience. The IPR proposes the creation of a new quasi-autonomous investment promotion agency (IPA) under a newly formed Ministry of Investment. While the ministry would set investment policy, the IPA would be charged with designing and implementing an investment promotion strategy. The advantage of an investment ministry is that it will enable investment issues to be discussed in cabinet on the same level as other issues.

50. The new IPA's functions could include:

- Development of sector-specific promotion projects (business propositions targeted at investors in particular sectors) by specialized teams;
- Improved communications with investors on investment opportunities by a business communications team;
- Cooperation with the CRIs;
- Secretariat support for the Investment Commission.

It should be noted that overseas offices are not envisaged in the IPR.

51. The aim of the new IPA should be to be a regional leader in the next five years, measured on the basis of its success in attracting and facilitating FDI, promoting reinvestment and developing linkages with local business. It is recommended that the IPA be fully state-funded, with mixed public-private funding used only for the development of sector-specific investor-ready proposals. The DI should enjoy unrestricted access to government and should have credibility with the private sector through private sector representation on its board.

52. The development of sector-specific promotion projects is important The Irish Industrial Development Agency and the Welsh Development Agency are good examples of this practice. They selected the call centre market on the basis of its comparative advantages of lower labour costs and good telecommunications. They then specifically targeted call centre investors by proposing a special fiscal regime and highlighting the flexibility and multilingual nature of their workforce, which could take calls from across the United States

and Europe at any hour. The point here is not to promote call centres, which Morocco has done well in attracting, but to illustrate proposition targeting. This should be borne in mind as Morocco strives to attract higher-value-added investment beyond the call centres. Based on experience elsewhere, the budget for developing each sectoral proposal should be $260,000 and limited to three years. The proposals should be developed through market research, followed by limited trials of the proposal and then targeted selling to appropriate investors.

53. These proposals then need to be integrated into a coherent communication system. The IPA's business communication strategy should depend on active contacts with potential investors, Moroccan partners and commercial networks and intermediaries. It should aim to reposition the country as a lower-cost (but not lowest-cost) and high-value-added production centre close to Europe, an entry point to the Maghreb region, a portal to Africa and a market opportunity in itself.

54. At the same time, communications between the IPA and CRIs need to be improved. The CRIs should be integrated into the IPA's commercial strategy in order to ensure message coherence, with the role of the CRIs brought to the fore.

55. The IPA's communications strategy should be driven by commercial teams responsible for targeting, reaching out and making first contact with investors. Aside from the sectoral promotion projects, the documentation put out by the IPA should include an annual report, an annual digest of investor business performance, an annual report on the business climate, and information notes on selected topics. The website should be kept updated and be multilingual.

56. There is considerable scope in Morocco to increase reinvestment rates. Improvements in the operational environment would help in this regard. A special establishment and aftercare team should be set up to assist investors from the time of their decision to invest through selection of sites, establishment, selection of potential local suppliers and links with local agencies. While this function will be a priority for the IPA, its role should remain at the coordination level. Day-to-day matters should be handled by the CRIs. In addition, efforts to put investors in touch with local suppliers will need to be accompanied by a local supplier upgrading scheme.

57. The current relationship between the IPA and the CRIs needs to be improved. The two levels overlap and interact on a number of matters, including establishment, arbitration and investment promotion. At the same time, several CRIs are progressing towards being regional development agencies, with the ability to develop propositions and market their regions actively, as well as advocate changes in their provinces' business environments and assist TNCs.

58. The CRIs are a heterogeneous group in terms of region type, promotion capacities, administrative procedures and quality of service. The IPR proposes creating service agreements between the IPA and CRIs, based on each CRI's capacities:

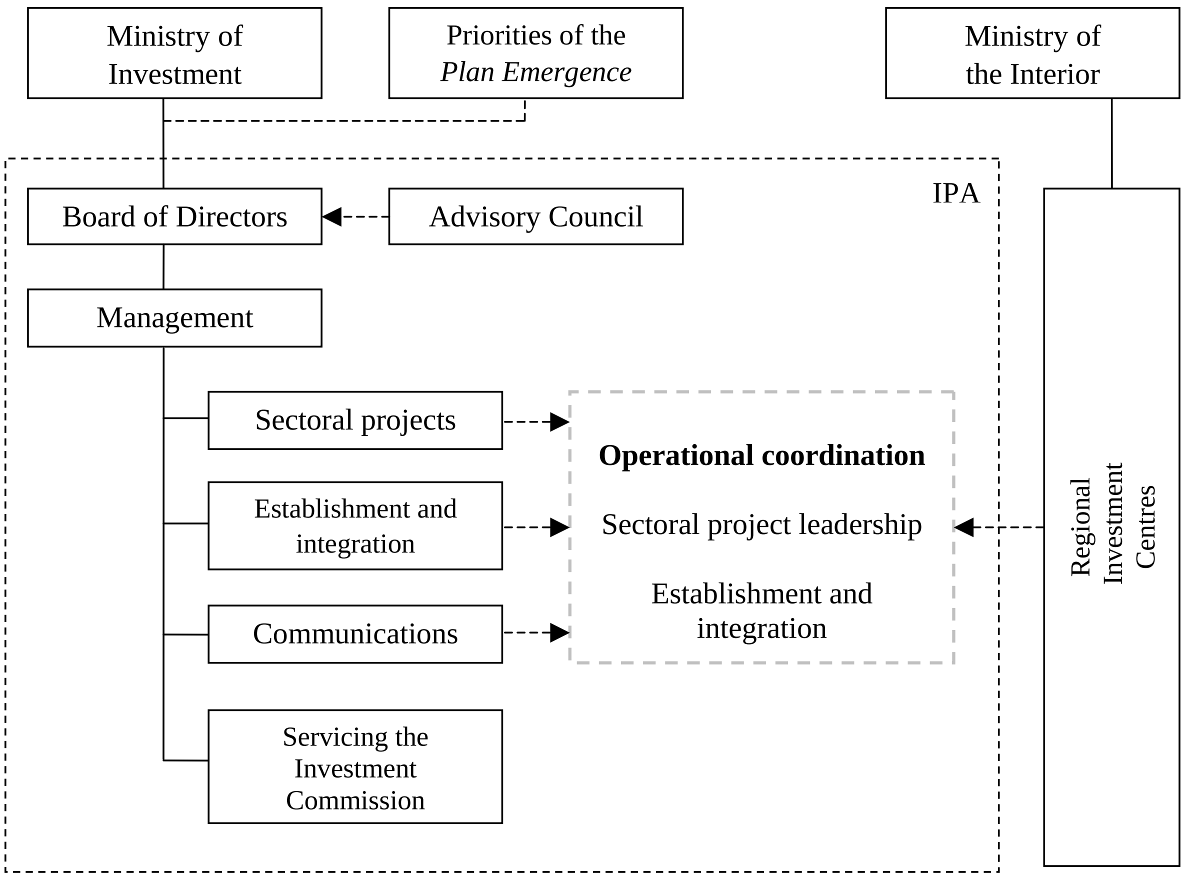
- First-level agreements would require CRIs to maintain a minimum set of standards on documentation, services offered and upkeep of databases;

- Second-level agreements would involve the harmonization of investment promotion strategies, active contribution to investment facilitation and aftercare, and participation in product development projects;

- Third-level agreements would see CRIs participate financially and with staff in sector promotion projects.

The aim of the IPA should be to graduate as many CRIs as possible to third-level agreements.

59. The proposed structure for the IPA is shown below. Its effective functioning will rely on strong collaboration between the Ministry of Investment and the Ministry of the Interior, in charge of the CRIs.



Conclusion

60. Morocco is advised to strengthen its institutional framework for attracting investment, especially if the country wishes to support the *Plan Emergence* by attracting FDI to the six sectors it identifies. Morocco would greatly benefit from an autonomous investment promotion agency with a clearly defined relationship with the CRI and other actors. This agency will differ from the current DI as it will actively solicit investment, instead of merely assisting investors. This means moving from reactive investment promotion to an investor targeting strategy.

61. This chapter defines the terms of reference and structure of this new IPA in order that it may face the challenge of ensuring sustainable investment flows of higher added value to

the priority sectors of the *Plan Emergence*. To this end, the IPA will play a crucial rule in the national innovation system.

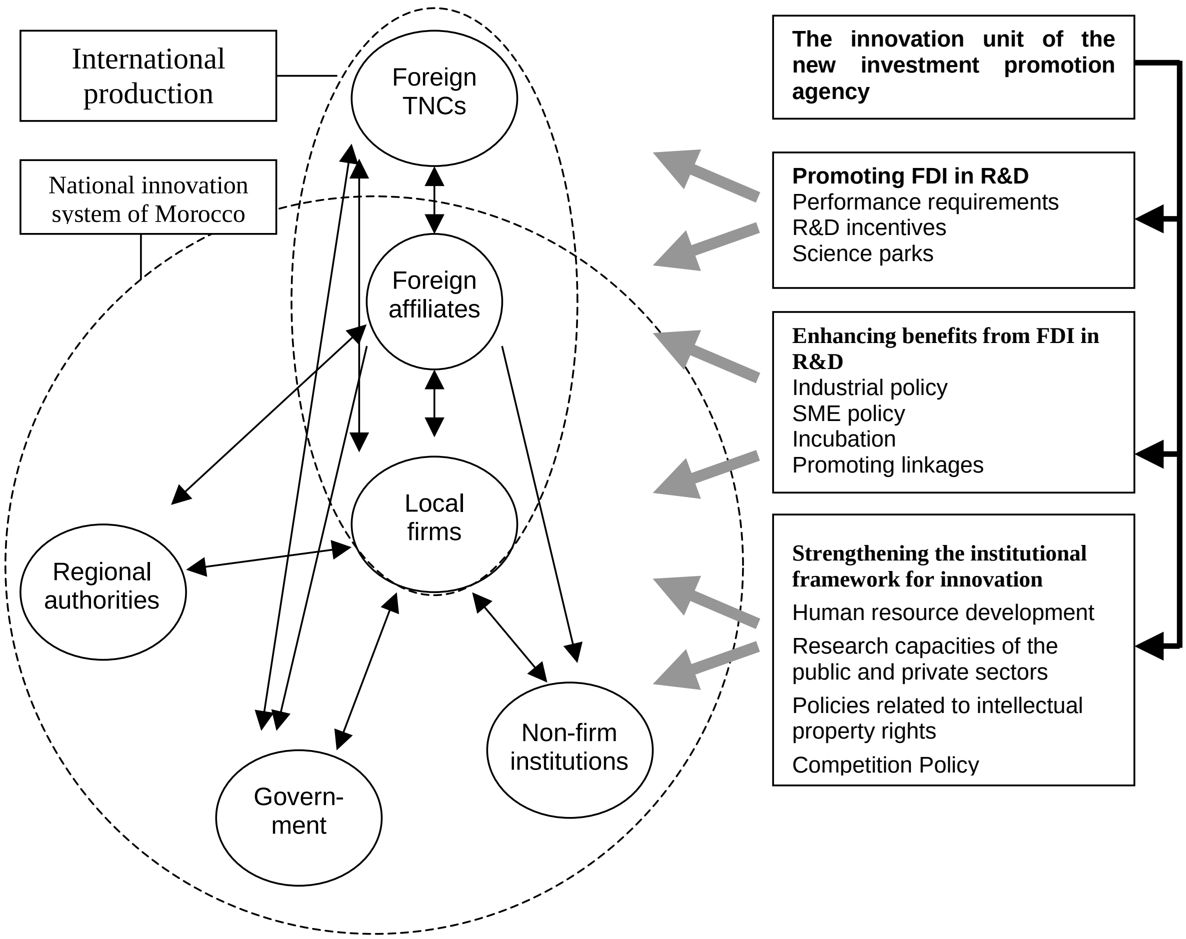
IV. USING FDI TO STIMULATE TECHNOLOGICAL UPGRADING AND INNOVATION

62. In order to accelerate structural change, raise its technological level and move its production up the value chain, Morocco would be well advised to aim at increasing FDI in sectors with higher value added. This means enhancing its technological and human resources.

63. While Morocco has experience in attracting technology-based investment, if it wants to build on its success to date, the national innovation system needs to be strengthened and its links with FDI tightened. This chapter discusses these issues within the context of the *Plan Emergence* and the Science and Technology Research Strategy (*Stratégie pour la recherche scientifique et technologique)*. The model used is one developed by UNCTAD for the national innovation system (NIS), which describes the interactions between different actors involved with FDI and R&D.

64. The strength of Morocco's national innovation system depends on the quality of the system's different actors and the vigour and depth of the interactions between them. The key catalysers in Morocco's NIS are the quality of human capital, the presence of a competitive local private sector, and access to capital. At the same time, its national innovation system relies on stable economic and political conditions, local leadership by the Walis (regional governors), entrepreneurship, and appropriate policies and incentive structures.

65. Local companies need to be the cornerstone of the NIS, as it is their role to absorb and implement new productive techniques. TNCs are also important, as they import technology into Morocco through their affiliates. Stronger links between local companies and TNC affiliates are therefore important.



66. The results of a close examination of Morocco's NIS are given below.

Non-firm institutions

67. A number of bodies exist for the promotion of R&D, such as the National Science and Technology Research Centre (*Centre National pour la Recherche Scientifique et Technique)*; the state secretariat on scientific research in the Ministry of Education, Science and Training; the inter-ministerial committee on scientific research, chaired by the Prime Minister; the *Academie Hassan II*; as well as the national fund for scientific research and a national fund to help technological investors.

R&D Expenditure

68. Between 1998 and 2003, total R&D spending relative to GDP tripled to 0.75 per cent. This intensity compares well with Argentina, Greece, Poland, Turkey, India and China. However, the private sector's share of R&D spending needs to be increased, as state spending dominates massively. At the same time, universities should orient their research more towards private sector needs.

Human resources

69. Tertiary enrolment has doubled in the last 25 years to 350,000. However, enrolment rates remain below those of Egypt, Tunisia and Jordan. Students are also favouring social science degrees at the expense of science. Investors add that management and organizational skills are not being taught at universities.

70. There is a shortage of skilled labour. In order to broaden the financial basis for training, a training system funded jointly by the public and private sectors should be explored. One possibility that was used successfully in Singapore was for the Government to provide facilities and the TNC to provide training staff and work experience.

71. Another issue highlighted by the IPR is that university personnel devote only 10 per cent of their time to scientific research, as this activity is not considered essential to career advancement.

Attracting the diaspora

72. Morocco has made an important contribution to R&D worldwide through those researchers who have emigrated. The Government set up the FINCOME forum in order to tap into this diaspora, based principally in Europe, as a source of business contacts and finance links. However, overall policies to attract the diaspora are incoherent. Furthermore, given their skills, returning migrants could also be used as a way of attracting more FDI. Lessons learnt from other countries show the importance of financial incentives in this regard.

Finance

73. The financing of R&D remains underdeveloped and dominated by the public sector, and the lack of credit facilities hampers the growth of small innovative start-ups. Some new sources of public sector finance have emerged, aimed at SMEs. These include funds from the EU and GTZ. The venture capital sector has expanded vastly with the recent arrival of four large venture-capital firms; 51 per cent of their funds are from abroad. Nevertheless, private sector financing needs to increase much more compared to that provided by the public sector.

Attracting technology-based investment

74. The IPR advises Morocco to take further steps to attract technology-based investment. Based on the number of investment projects announced, the country comes second in the Eastern and Southern Mediterranean region after Israel. However, this does not take into account the size of each investment. A number of cases illustrate Morocco's attraction of technology-based FDI:

- Matra's auto-engineering branch is developing an R&D centre and a test track (09/04/2004);
- The French firm SQLI is establishing a development platform (26/09/2003);
- The Spanish firm Simon is setting up an R&D centre in Casablanca (04/10/2004);
- STMicroelectronics created a design and software development centre in Rabat (01/02/2003);

- Vivendi Universal increased its share in Maroc Telecom from 35 per cent to 51 per cent (15/11/2004);
- The French firm Unilog created a joint venture with a subsidiary of France Telecom (23/08/2004);
- Valeo extended its industrial activities by creating an R&D centre for automotive spare parts and wire harnesses (2003).

75. Technology-based investment is starting to bear fruit. The share of high-technology exports in total exports is now higher than in India, Poland, Slovakia and the Maghreb as a whole. More information on the impact of technology-based FDI needs to be collated and would be essential to the IPA in targeting appropriate investors and assisting TNCs to locate suitable suppliers.

Linkages

76. The efficiency of an NIS depends very much on the linkages that bring together its different actors. These linkages include the actual and tacit exchange of know-how, mobility of human resources, and collaboration on innovation activities. They also include linkages with other countries in the form of foreign investment. Yet there appears to be little collaboration between the private and R&D sectors.

77. A number of networks and fora have been set up by the Government to encourage greater collaboration. In addition, intellectual property rights have been strengthened; public assistance for investment projects to purchase land and pay for infrastructure and training has been increased; and fiscal incentives have been introduced. These efforts have shown some success, with sectors such as biotechnology and nanotechnology demonstrating potential.

78. However, a survey carried out in 2000 shows that only 10 per cent of university research projects have private sector connections. The survey also pinpointed the lack of R&D foreseen by SMEs in their activities and noted that little R&D is subcontracted, that there was little knowledge of programmes aimed at private sector innovation, and that these programmes were more symbolic than concrete.

79. In the light of this, the authorities may well be advised to simplify the fiscal incentives available, orient them towards favouring linkages between TNC affiliates and Moroccan R&D institutions, and raising overall awareness of the incentives and support programmes available. The overall aim should be to increase the private sector's share of R&D expenditure.

Role of the regional authorities

80. Regional authorities could have a role to play in strengthening the NIS, as experience in Santa Catarina (Brazil), Valencia (Spain) and Emilie-Romagna (Italy) have shown. In these cases, local chambers of commerce established training and research centres targeted at assisting and maintaining local industrial clusters. In Morocco, this role could be undertaken by the CRIs acting in concert with the local chambers of commerce.

Conclusions

81. It appears that Morocco has the conviction to progress on investment and innovation. It has the qualified labour, a relatively high intensity of R&D expenditure, and a number of

TNCs deciding to position their R&D activities in Morocco. However, private sector expenditure on R&D remains low, SMEs tend to be disconnected from the NIS, the teaching and university systems are not geared towards innovation, and there is little encouragement to use Moroccan R&D resources.

82. The recommendations of this chapter concentrate on how the NIS and FDI can support each other. In order to attract the kind of FDI that stimulates technological development, it is recommended to: create an innovation unit within the new IPA; create a working group under the Prime Minister's office to ensure that government measures in favour of encouraging innovation are coordinated, coherent and, to the extent that attracting R&D-weighted FDI is desirable, relevant to market needs; and modify fiscal incentives for R&D.

83. In order to bring FDI to bear on technological development, it is recommended that the Government continue to encourage greater collaboration between universities and TNCs on curriculum development in order to increase the relevance of engineering and business courses, as has already been done with the local private sector; and establish jointly funded training centres where the Government provides the facilities and the TNCs provide the training staff and work experience opportunities.

84. All these recommendations would benefit from strong inter-ministerial coordination.

V. CONCLUSIONS AND RECOMMENDATIONS

85. The issuing of the investment charter, as well as a number of reforms in the 1990s and the privatization programme, have contributed to increasing FDI inflows to Morocco. Coupled with this, the country's proximity to Europe, the availability of low unit labour costs and efforts to improve the business climate and open the economy are factors that have made the country attractive to investors. However, while Morocco has performed relatively well in attracting FDI, it has so far not followed a concerted FDI promotion and targeting strategy, made efforts to improve investors' perceptions of the investment climate, or encouraged close links between affiliates of foreign enterprises and the local economy.

86. The authorities therefore need to address the following four challenges:

1. Revise the framework regulating FDI:
   - (a) Issue a unifying investment code;
   - (b) Issue a fiscal code that encompasses all fiscal regulations and incentives;
   - (c) Issue an arbitration code;
   - (d) Undertake reforms on land, industrial disputes and the faster implementation of laws;
2. Strengthen the institutional framework:
   - (a) Create a new IPA to harmonize investment promotion, follow through with investors, coordinate closely with CRIs, and spur innovation-based FDI;
   - (b) Reform judicial institutions;
   - (c) Strengthen the competition authority;
3. Develop a proactive investment strategy in order to increase inflows and encourage reinvestment;

4. Strengthen Morocco's national innovation system:

(a) Create an innovation unit in the future IPA;
(b) Establish a committee to ensure policy coherence;
(c) Strengthen fiscal incentives related to R&D;
(d) Establish joint TNC-Government training centres.

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