KfW

Morocco: Municipal Finance Reform Programme (FEC I-III)

Ex-post evaluation

OECD sector	24030 – Formal sector financial intermediaries	
BMZ project numbers	1995 66 415 (FEC I) 1998 65 148 (FEC II) 1998 65 965 (FEC III) 1995 70 383 (personnel assistance)	
Project executing agency	Fonds d'Equipment Communal (FEC)	
Year of evaluation	**2002**	
	Project appraisal (planned)	**Ex-post evaluation (actual)**
Start of implementation	2nd quarter 1996	4th quarter 1995
Finance, of which FC funds	37.39 million EUR (FC 28.42 million EUR)	37.39 million EUR (FC 28.42 million EUR)
Other institutions/donors involved	World Bank (104 million US$)	World Bank (139 million US$), USAID, EIB
Performance rating	**3**	
• Significance/Relevance	3	
• Effectiveness	3	
• Efficiency	3	

Brief description, overall objectives and project purposes with indicators

The overall objectives of the projects were to improve the delivery and quality of municipal services and infrastructure and to strengthen decentralization. The project purposes were the efficient provision of the municipalities with sustainable medium-term and long-term loans to meet demand for financing developmentally effective investments in municipal infrastructure and strengthening municipal financial autonomy.

The following indicators were defined for project purpose achievement:

- FEC I: Increased FEC volume of lending from 703 million dirham in 1993 to 1,200 million dirham in 1998 and actual availability of 50% of value added tax revenue for distribution at municipal level according to objective criteria.
- FEC II + III: (i) Increase in volume of payouts as planned in FEC, (ii) adherence to central bank regulations and meeting of financial performance indicators agreed on with the donors as of the end of 1998, (iii) conversion of FEC into a joint-stock corporation by December 1998 and (iv) adequate use of at least 90% and acceptable maintenance of at least 80% of the municipal services and infrastructure two years after final acceptance (sample of 10%).

Project design/Major deviations from original project planning and their main causes

No major deviations.

Key results of impact analysis and performance rating

From the end of 1995 to 1999 the pledged FC funds were released for payment to cofinance altogether 74 projects. Forty per cent of the financed projects were carried out by rural municipalities, 57% by urban municipalities and 3% were implemented in larger towns. By project type, the programme breaks down as follows:

- 16 road construction projects (44% of FC funds)
- 11 bazaars and shops as well as 7 shopping centres (20% of FC funds)
- 21 finance projects for fleets of vehicles, such as excavators, refuse trucks, etc. (10% of FC funds)
- 19 other projects, such as public lighting, water supply, bridges or central markets (26% of FC funds)

Average project volume amounted to EUR 650,000, of which an average of 76% (EUR 500,000) were confinanced with FC funds. The loan terms ranged between 5 and 10 years. The agreed selection criteria for project type (e.g. no projects in tourism) as well as maximum loan amount were kept to – with two exceptions.

As to target indicators, the projects recorded a mixed performance. The reform in distributing value added tax between government and municipalities assisted by the WB/FC project was successful. The project purpose indicator was not quite met in full (42% instead of 50%), but the official distribution key rose continuously in favour of the municipalities and more increases are expected.

During the project term, FEC made tangible progress as a financial institution: conversion into a bank; fulfillment of the indicators agreed with KfW/World Bank (gross margin, administrative efficiency and profitability) as well as the banking regulations of the Central Bank of Morocco; acceptable portfolio at risk. The aim of converting FEC in a joint-stock company (project purpose up to 12/1998) has not been achieved so far, however, and FEC lending activity in recent years has stagnated or declined if adjusted for special programmes.

Weakpoints, however, remain at investment project level: FEC has no acceptance and takeover documents on investments completed. Nor are statistics kept on the utilization and maintenance of the financed projects. Long-standing personnel estimate that the performance rate ranges between 60% and 70%, which falls short of the relevant indicator. The sample conducted for the ex-post evaluation of 9 investment projects confirmed this. A maximum of five only of the projects evaluated can rate as successful (adequate layout for the most part; relatively efficient implementation; high utilization; suitable maintenance). The deficits are partly due to FEC weaknesses in project consultancy and support. The most common reasons for frequent delays were political disagreements or the technical incompetence of the municipalities. As the instrument of municipal finance is relatively new in Morocco and the municipalities are at the beginning of a learning process, more modest targets and scheduled implementation times of more than two years would have been appropriate.

Only near on 17% (EUR 0.25 million) of the funds from the accompanying measure, partly to improve project planning in the municipalities, were used. The reasons for this on the one hand were the late marketing of the instrument and on the other conditions which were felt to be too expensive (finance of study costs for the municipalities through loans at 5% a year and a handling fee of 1%). The remaining funds were invested as planned in the management information system and for further training of the staff of the FEC financial and loan department.

Altogether, the programme objectives were only partially achieved and the overall objective only with shortcomings. Nevertheless, the programme has made an important structural contribution to the implementation of infrastructure projects by the municipalities. The project broke new ground in municipal finance and provided an important impetus for decentralization. The autonomy of the municipalities has increased substantially since project appraisal. There is also greater awareness of the importance of environmental impacts and suitable maintenance. So there has been a beneficial influence on the sustainability of these kinds of measure.

The developmental impacts of the project can be summarized as follows:

Municipal finance programmes only make sense, if the municipalities can rely on secure income flows. If this is not the case, appropriate reforms need to be implemented. In cooperation with the World Bank, the FEC I-III programme succeeded in establishing this necessary condition. The municipalities today have a higher budget and greater autonomy than at project appraisal. The projects thus make a major contribution to strengthening local authorities and effectively support ongoing democratization.

For the majority of the Moroccan municipalities, FEC is the sole provider of long-term credit; many investments would not have been made without it. Thanks to the FC funds, FEC was able to raise its equity capital by 30% and thus meet the central bank provisions on equity capitalization as well as gain access to domestic capital market finance independently of donors. On the other, only approximately 60% of the projects can be rated as successful, which means the project contribution to increasing the availability and quality of municipal services and infrastructure was only achieved to a limited degree.

In a summary assessment of all the above cited impacts and risks, we assess the <u>developmental effectiveness</u> of the project as follows:

- The programme objectives were only partially achieved. The favourable developments in municipal reform as well as the financial performance of the bank must be set against the failure to convert the bank into a joint-stock company, FEC's stagnant growth and the relatively weak results of the financed investment projects. We nevertheless accord the projects a **sufficient degree of effectiveness** (**Subrating 3**).
- The programme is of high developmental **relevance**. FEC is still frequently the only provider of long-term investment finance, particularly for rural municipalities. In cooperation with the World Bank, the programme has made a major contribution to developing the financial market for municipalities and has had a sustainable beneficial impact on the application of environmental criteria in municipal finance projects. The project has prevented the development of parallel structures such as social funds and provided effective support to ongoing democratization in Morocco. On the other hand, due to shortcomings in conceptual design, implementation, use and maintenance in a relatively large percentage of individual projects, the overall objective was not attained to the full extent. Altogether then, we assess the **relevance/significance** as **sufficient** (**Subrating 3**).
- Problems in governance structure and particularly the organizational and operational structure resulting in too many coordination problems and duplications make for relatively inefficient procedures and implementation of the financed projects by FEC. On the other hand, FEC's financial efficiency is satisfactory. Altogether, the accompanying measure had only a marginal impact on the efficiency of the institution or the quality of the financed projects. On balance, we therefore accord the projects a **sufficient degree of efficiency** (**Subrating 3**).

Weighing up the effectiveness, efficiency and significance/relevance, we rate the **developmental effectiveness overall as sufficient** (**Rating 3**).

General conclusions applicable to all projects

The programme shows that municipal finance at market conditions is possible in Morocco and that executing institutions can operate cost-covering. Assistance via equity participation makes sense in this context as it strengthens the capital base of the intermediary and enlarges the scope for refinance on the national or international capital market.

The main lessons learnt for organizing future FC measures in municipal finance projects are as follows:

a. As these programmes are very complex they call for a long-term perspective. Key to success is ensuring that the municipalities are properly prepared (budgetary responsibility, adequate financial resources in the municipalities), which is often only possible when a large measure of political influence can be exerted - possibly by cooperating with other donors. Moreover, building up a financial institution in keeping with project needs takes several years.

b. Know-how-transfer through specific planning and technical assistance at municipal level is important. Project design must cater for this and set clear incentives for using external technical know-how.

c. There is a tendency for participants to overscale projects. In municipalities the reasons are usually political in conjunction with partly dysfunctional political control at municipal level. With private financial intermediaries, it is the prospect of increasing profitability together with the relatively low credit risks of municipalities. The motive with public financial institutions can be performance rating measured by the volume of annual new loans to municipalities and the aim of cost-effective operations or minimum profitability. To counter the risk of oversizing investments, debt service in similar programmes should as far as possible (e.g. in profitable investments such as shopping centres, slaughterhouses, etc.) be financed from the earnings of the financed project. This would induce municipalities and banks to make a more detailed and critical appraisal of individual projects and also facilitate finance by private commercial banks.

Legend

Developmentally successful: Ratings 1 to 3
Rating 1 Very high or high degree of developmental effectiveness
Rating 2 Satisfactory degree of developmental effectiveness
Rating 3 Overall sufficient degree of developmental effectiveness

Developmental failures: Ratings 4 to 6
Rating 4 Overall slightly insufficient degree of developmental effectiveness
Rating 5 Clearly insufficient degree of developmental effectiveness
Rating 6 The project is a total failure

Criteria for the Evaluation of Project Success
The evaluation of a project's "developmental effectiveness" and its classification during the final evaluation into one of the various levels of success described in more detail below concentrate on the following fundamental questions:

- Are the **project objectives** reached to a sufficient degree (aspect of project **effectiveness**)?
- Does the project generate sufficient **significant developmental effects** (project **relevance** and **significance** measured by the achievement of the overall development-policy objective defined beforehand and its effects in political, institutional, socio-economic and socio-cultural as well as ecological terms)?
- Are the **funds/expenses** that were and are being employed/incurred to reach the objectives **appropriate** and how can the project's microeconomic and macroeconomic impact be measured (aspect of **efficiency** of the project conception)?
- To the extent that undesired **(side) effects** occur, are these tolerable?

We do not treat **sustainability**, a key aspect to consider for project evaluation, as a separate category of evaluation but instead as a cross-cutting element of all four fundamental questions on project success. A project is sustainable if the project-executing agency and/or the target group are able to continue to use the project facilities that have been built for a period of time that is, overall, adequate in economic terms or to carry on with the project activities on its own and generate positive results after the financial, organizational and/or technical support has come to an end.