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FINANCIAL DEVELOPMENT AND INCLUSION IN EGYPT, JORDAN, MOROCCO AND TUNISIA

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ABOUT THIS STUDY

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This study provides a snapshot of the status quo in Egypt, Jordan, Morocco and Tunisia regarding the development of the financial systems, with a focus on the financial development, the regulatory framework and financial inclusion. It will be used as a baseline for the definition of a research agenda that ultimately aims at providing sound recommendations for policy makers to improve developmental outcomes and, especially, the contribution of the financial system on sustainable economic growth.

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TABLE OF CONTENTS

LIST OF FIGURES

LIST OF TABLES

EXECUTIVE SUMMARY

The link between financial development and sustainable economic growth is complex. The academic literature published on this topic in recent years finds that financial development contributes to growth up to a certain tipping point. Beyond this tipping point, financial development would make the system more fragile. The benefits of financial development and level of the tipping point seem to vary between economies. Among the factors that contribute to the variance are the composition of the financial system (institutions and market based intermediation), access (financial inclusion) and efficiency (government interventions, allocation, etc.). The complexity of the relationship between financial development and economic growth requires the assessment of the factors affecting the relationship in order to determine the most effective policies.

In this study, we provide an assessment of the various factors determining financial development in terms of the financial sector structure, contribution to the economy and financial inclusion in four countries mainly Egypt, Jordan, Morocco and Tunisia.

The financial systems in these countries are underdeveloped, when compared to their European counterparts, but the level of development differs across countries, over time and depends on several factors (e.g. institutional development, property rights, and regulatory frameworks).

The overall financial development scores developed by Svirydzenka (2016), taking account of the depth, access and efficiency of financial institutions and markets, have increased in the four countries in the past couple of decades. In most cases, the increase in financial development levelled-off in most recent years, or even declined after the 2010-11 Arab Spring. Overall, Jordan has the most developed financial system, followed by respectively Morocco, Egypt and Tunisia. When performing the qualitative assessment based on the countries analysis, these conclusions are confirmed:

Jordan has relatively developed financial institutions and markets, with considerable financial depth and access, and average to low efficiency. Banking assets account for about 180% of GDP. Almost half of these assets are held in cash or government securities, which are primarily funded via private sector deposits. The financial ratios are, for the majority of the banks, well above the regulatory requirements. Moreover, it has the largest share of foreign owned banks in the MENA region. Despite the sizable credit to the private sector, lending to SMEs is relatively small with many SMEs being rather unbankable. There are also many residents unbanked, i.e.

without bank account or depending on family and friends for access to credit. There are several initiatives including microfinance and credit guarantees institutions to support lending to residents and SMEs. The non-bank intermediaries are rather small and include a small insurance sector and relatively large currency exchange sector. The financial markets are dominated by equity, of which the market value is equivalent to 70% of GDP. This is substantially less than the over 300% of GDP about a decade ago. In turn, the treasury bonds are gaining in importance, while the corporate bond market is negligible in size. Finally, financial regulations in Jordan follow the international standards.

Morocco has relatively developed financial institutions, with the highest levels of financial depth and access combined with the lowest efficiency-levels. In fact, banking assets represent about 120% of GDP, of which about two-thirds is controlled by just three banks. The Moroccan banks have expanded substantially in Sub-Sahara Africa to gain larger market access. The average financial ratios have been gradually worsening in the past couple of years. Nevertheless, there are many SMEs and residents without access to finance. Financial market development is limited. The companies listed on the exchange have a total market value equal to 50% of GDP. The insurance sector is relatively large compared to other south Mediterranean countries. The debt markets are small and illiquid. Treasury bonds dominate the public bond market and banks dominate the corporate bond market. There is also a modest market for mutual funds. The financial regulation has been reformed several times in recent years to align it with the international standards.

Egypt has a bank-based system with assets representing 120% of GDP. The banking sector is increasingly funding the government instead of the private sector, which is reflected in limited access to banking services for SMEs. Moreover, an increasing share of the loans is non-performing, showing the incapacity of financial institutions to manage the risks adequately. The non-bank institutions such as insurers, mortgage financers, leasing companies and others are modest in size but growing. The limited access to credit to the private sector (micro companies and SMEs) is somewhat relieved by providers of microfinance and credit guarantee companies which play a role in fostering financial access. The depth and access to the financial markets is limited. The market value of the listed companies represents less than 20% of GDP and the bond market almost exclusively consists of government bonds. The financial sector regulation and the accounting regime have been subject to several reforms to align them with international standards and reduce government interventions.

Tunisia has less developed financial institutions, with low levels of financial depth, access and efficiency. The total banking sector assets are equal to 120% of GDP. There is a large difference in the performance of private and public banks, with public banks reporting much higher non-performing loans reflecting their incapacity to manage their risk exposures. In recent years in the aftermath of the Arab Spring, the government has announced the privatisation of the three public banks and bringing supervision and regulation in line with international standards. The financial markets are the least developed among the four countries. Non-bank financial intermediaries are relatively small and include for example insurance, leasing institutions, factoring companies, venture capital and private equity. The market value of listed companies - mostly financial sector companies - is just 20% of GDP. The bond market is very small and Treasury bond dominated. The mutual funds are also small, but slightly larger than the bond market. A large share of residents and SMEs do not have access to finance.

To conclude, all four Mediterranean countries have large potential to develop their financial systems in order to develop the economy. There seem to be several commonalities in the areas where they can develop most. All four countries depend for their financial intermediation almost exclusively on the banking sector. Banks in these countries tend to allocate a large share of their funds to governments and liquid funds, crowding-out the lending to SMEs and households. Indeed, the levels of access to finance for SMEs and households in the four countries - in particular in rural areas - are rather low. The insurance sector, pension funds as well as capital markets are relatively underdeveloped, whereas alternative financial providers such as microfinance and Islamic institutions are growing in size.

FINANCIAL DEVELOPMENT: CROSS-COUNTRY COMPARISON

Rym Ayadi and Willem Pieter De Groen

Developing a regional financial market that intermediates savings into investment efficiently and safely can enhance economic growth, in particular in countries with a relatively small financial market. There is an extensive literature on the link between finance and economic growth (Ayadi et al., 2013). There are various ways in which finance contributes to the real economy. It provides information on (investment) projects, monitoring, risk management, diversification, pooling of savings and facilitation of trading (Levine, 2005).

Many scholars have also found a positive relation between finance and economic growth (Baghehot, 1873; Schumpeter, 1912; Hicks, 1969; King and Levine, 1993, Miller, 1998; Beck et al, 2000; Christopoulos and Tsionas, 2004; etc.), but this might not necessarily be due to a causal relation. Hence, Robinson (1952), for example, found the reverse, economic growth contributes to financial development.

There are many different aspects that seem to determine the magnitude of the contribution of finance to the economy. Financial development may in the short-term be less beneficial for economic growth due to financial crises than in the longer-term (Loayza and Ranciere, 2002). Moreover, countries with a liberalised capital account tend to have higher economic growth (Bekaert et al., 2001, 2005). High-income countries seem to benefit more from financial development than low-income countries (Rioja and Valev, 2004). Government control, weak institutions, inefficient allocation of financial resources seem to be the main explanations for this difference (Ayadi et al., 2013).

Banking sector development seems to deliver a higher contribution to economic growth. The development of the banking sector seems to contribute to economic growth, while the equity markets contribute neither more nor less. (Arestis et al., 2001; Rousseau and Watchel, 2000). Looking at banking sector development, La Porta et al. (2002) find that government ownership of banks is negatively related to the development of the banking sector and economic growth. Moreover, the quality of the banking sector seems to be more important than the quantity. The countries with more cost efficient banks have higher economic growth (Hasan et al., 2009). Moreover, a higher credit volume does not relate to growth (Koetter and Wedow, 2010). Arcand et al. (2012) find that credit above 80% to 100% of GDP does not contribute to economic growth. Potential explanations for this could be that higher volumes of credit enhance the potential misallocation of resources and potential for financial crises.

Casual observation shows that financial development has been lagging behind in the southern and eastern Mediterranean and, hence, financial systems have not been able to divert domestic savings as funding opportunities to private enterprises (Ayadi et al., 2013a). The reasons behind this development have been investigated and identified in Ayadi et al. (2013b). First, inflation has had a negative impact on private credit and deposits. The impact of price instability on deposits and loans is simply due to the incentives of savers and financial institutions to seek better investment opportunities with secured real returns – as opposed to uncertain nominal returns, as is the case in an inflationary environment.

Financial development seems to contribute to economic growth in the four selected countries (Egypt, Jordan, Morocco and Tunisia). Bolbol et al. (2005) suggest for Egypt, with many state owned banks, that bank development delivers less productivity gains than the development of stock markets. Abdelhafidh (2013) uses several indicators and find that grants and FDI have a positive causal relation with economic growth, while foreign inflows have the reverse causal relation. In Morocco and Tunisia grants stimulate economic growth, which leads to loan growth. Abu-Bader and Abu-Qarn (2008) find a causal relation between finance and economic development in five out of six South and Eastern Mediterranean countries covered (e.g. Egypt, Morocco, and Tunisia). Baliamoune-Lutz (2008) finds a stable long-term relationship between finance and income in Algeria, Egypt and Morocco.

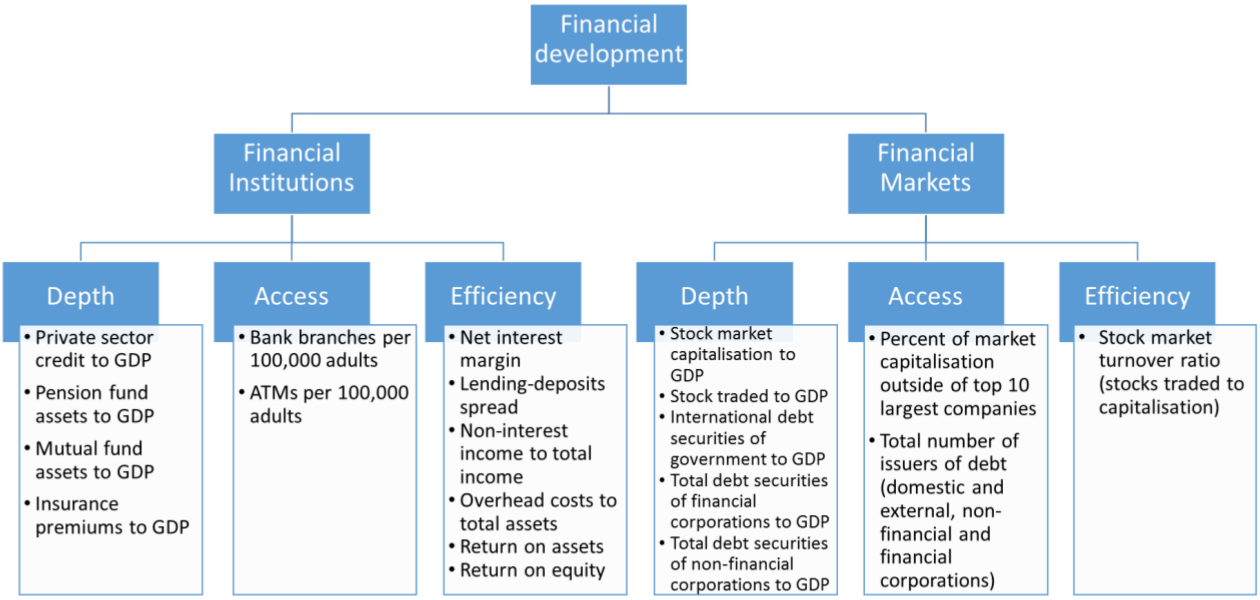
In what follows, we provide an overview on the status of financial sector development in the region. The data used covers the period from 1980 till 2014[1]. The countries covered in this study have underdeveloped financial institutions and markets as compared to their European Mediterranean peers. The level of development, however, varies across the four countries as each one of them exhibits a different path of development as will be described in details in the countries analysis.

The level of financial development is measured using the Index of Financial Development developed by Svirydzenka (2016). Figure 1 provides the pyramid with nine indices for financial development, which can be subdivided into financial institutions and financial markets which, in turn, can be subdivided into depth, access and efficiency. Depth, access and efficiency are based

[1] The database is publically available and can serve to delve into several research questions related to the financial development and inclusion.

on a total of 20 different indicators that are indicated below the sub-indices. The indices are available for 183 countries, but the focus of this overview is on Egypt, Jordan, Morocco and Tunisia. For the main indices, a comparison is made with the composite indices for eleven southern and eastern Mediterranean countries[2] (SEMCs) and seven EU Mediterranean countries[3] (EU-MED).

Figure 1: Financial development indices pyramid



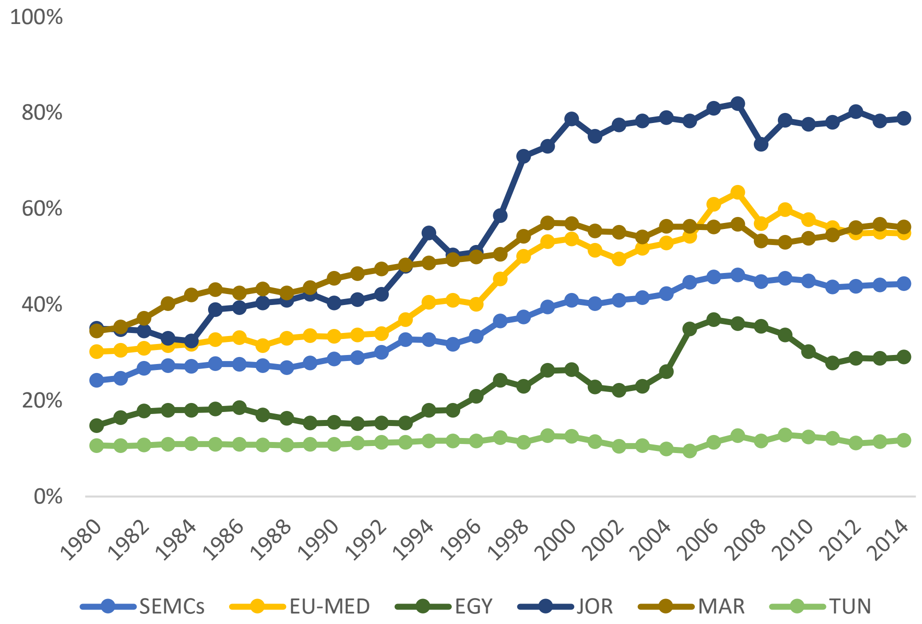
***Source**: Authors' elaboration based on Svirydzenka (2016).*

The nine indices are calculated based on the weighted average of the sub-indices or indicators directly below the sub-indices in the pyramid. The indicators are normalised after the exclusion of the 5% lowest and highest values. In order to extend the coverage and avoid structural breaks, missing values are estimated based on average growth rates when the indicator was not available for a given year and assumed zero when a value was missing for a particular country. The weights of the different indicators, or sub-indices, are based on a principle component analysis to capture as much as possible the information common to individual indicators. The values for the indices range between 0 and 1. A higher value indicates more

[2]Algeria, Egypt, Israel, Jordan, Lebanon, Lybia, Morocco, Palestine, Syria, Tunisia and Turkey.
[3] Cyprus, France, Greece, Italy, Malta, Portugal, and Spain.

developed markets, which does not necessarily mean that these financial systems are also more growth enhancing and stable[4] (Svirydzenka, 2016).

Figure 2: Overall index of Financial Development (1980-2014)



***Source**: Authors' elaboration based on Svirydzenka (2016).*

Figure 2 shows the evolution of the financial development index between 1980 and 2014. The financial development index has increased for all of the four Mediterranean countries. Though, there is a large variation in average growth rates. Tunisia had the lowest level of financial development throughout the entire sample period. It also showed nearly zero growth. Egypt started at a rather low level of development, but increased significantly over time. It reached a peak of development in 2006, just before the onset of the 2007-2009 global financial crisis. In the consecutive years, some of the previous growth was offset, stabilising in the period following 2011. Morocco started at relatively high levels of financial development in 1980, which levelled off at the end of the 1990s. It experienced a small drop during the global financial crisis and recovered in the years that followed. Jordan started around the same level as Morocco, but has grown more rapidly, in particular at the end of the 1990s. After the financial development index for Jordan more than doubled in the period between 1980 and 2000, growth came to a halt. Since then, the

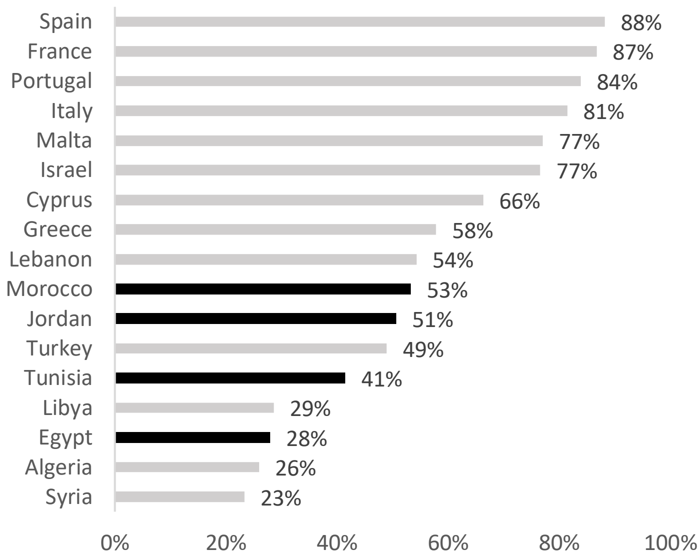
[4] See introduction for a review of the main literature on the relation between financial development and growth.

development index has remained quite stable, with the exception of the global financial crisis. Like Morocco, Jordan also experienced a sudden drop in the financial development index around the time of the global financial crisis. But it almost fully recovered in the years that followed the crisis. Jordan is also the only country that has a higher score than the average of EU-MED countries.

Looking more closely at the financial development components, the financial institutions are, in general, more developed than the financial markets in the Mediterranean countries. Hence, all four selected countries, except for Egypt, have a higher score for financial institution development than financial market development.

Financial institutions are most developed in Morocco, which in 2014 had a slightly higher score than Jordan. The banks, pension funds, mutual funds and insurers are less developed in Tunisia and particularly in Egypt, which has a score that is among the lowest in the southern and eastern Mediterranean.

Figure 3: Financial Institutions development (2014)



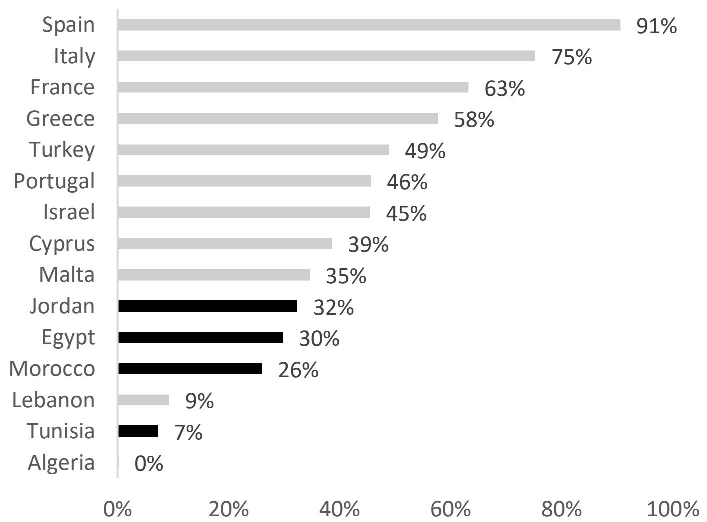
Source: *Authors' elaboration based on Svirydzenka (2016).*

Morocco's higher score is primarily due to the greater depth of its financial institutions. Morocco is even in the top quartile of the 183 countries for which financial institution depth has been calculated. Morocco also has the highest financial institution access score in the region, which is quite average from a global perspective. In turn, Morocco has the lowest score for financial institution efficiency. The scores for Jordan are - except for financial institutions efficiency - just below the scores of Morocco. It is, like Morocco, in the top quartile of financial institution depth and in the top half of financial institution access scores. The financial institutions efficiency score is higher than that of Morocco and in the top quartile of the global ranking. Tunisia notes substantially lower scores for financial institution depth and slightly lower scores for access. The efficiency score is only slightly higher than that of Morocco which is, like Tunisia, in the second quartile. Egyptian financial institution depth and access are the least developed, while relatively the most efficient. The scores for depth and access are actually in the third quartile of the global ranking. The efficiency score for Egypt is in the top quartile.

Overall, the low level of financial institution development is reflected in all three sub-indices. Financial institution depth is moderate in general, but low in Tunisia and Egypt. Moreover, financial institution access, measured in number of ATMs and bank branches, is relatively limited in all countries, but particularly in Egypt. The financial efficiency scores are also quite low, but comparable across the four countries.

Financial markets are for most countries in the world a substantially less important source of financing, which affects the scores. Indeed, financial institutions are more developed in terms of depth, access and efficiency than financial markets with the same score. The four Mediterranean countries are no exceptions with their bank based financial systems. The development of the financial markets in Egypt, Jordan and Morocco is fairly low but comparable with scores ranging between 26% and 32%. The development of the financial markets in Tunisia is even lower with just 7%.

Figure 4: Financial Markets development (2014)



Source*: Authors' elaboration based on Svirydzenka (2016).*

Comparing the four countries based on the three sub-indices for financial market development, Jordan combines the highest score for financial market depth, with a close to best score for access. In turn, their financial markets are among the least efficient. Egypt's financial markets have substantially less depth and access, but it is the only one of the four countries in the top quartile for financial market efficiency. Morocco has the second deepest financial markets, but their score is only slightly higher than that of Egypt. The score for financial market access is the highest among the four countries, but the score is almost identical to Jordan. Tunisia has the shallowest financial markets in terms of depth and access. Their financial market efficiency score is higher than that of Jordan and Morocco, but they are all very low.

Overall, the low financial market development scores are reflected in all three sub-indices. Financial institution depth is low for all countries, with a slight exception of Jordan that scores just outside the top quartile in global ranking. The same is true for financial market efficiency, for which the scores are also low, with the slight exception for Egypt. The access to most financial markets is relatively broad with Egypt, Morocco and Jordan at the bottom of the top quartile or top of the second quartile. Only the score for Tunisia is substantially lower. The financial efficiency scores are also rather low, but comparable across four countries.

To deepen the understanding of financial development in the four countries under investigation, four country studies are performed to examine the financial sector composition, regulations and financial inclusion in Egypt, Jordan, Morocco and Tunisia. The remainder of this study presents the results of the analysis and concludes.

FINANCIAL DEVELOPMENT AND INCLUSION IN EGYPT

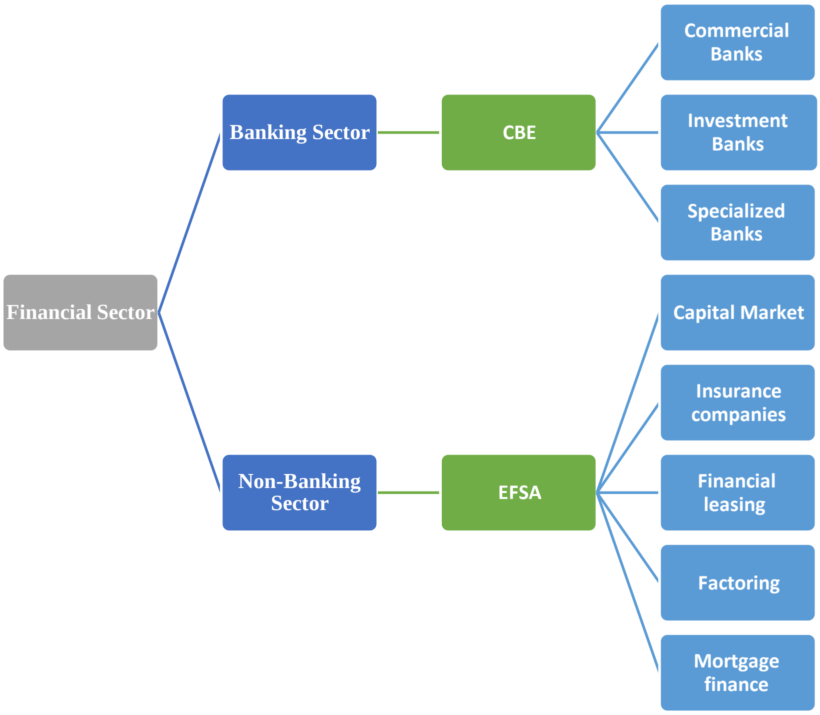
Taghreed Hassouba

This section provides a brief description of the structure and policies of financial institutions and markets, and an overview on financial inclusion in Egypt.

FINANCIAL SECTOR STRUCTURE

Banks in Egypt are the dominant financial institutions, as they control most of the financial assets and flows. Figure 5 provides a schematic overview of the types of financial institutions active in the Egyptian financial sector. The banking sector is supervised by the Central Bank of Egypt (CBE) and consists of commercial, investment and specialised banks. The other financial institutions are supervised by the Egyptian Financial Supervisory Authority (EFSA). The non-bank institutions include stock exchanges, insurance companies, leasing companies, factoring and mortgage finance.

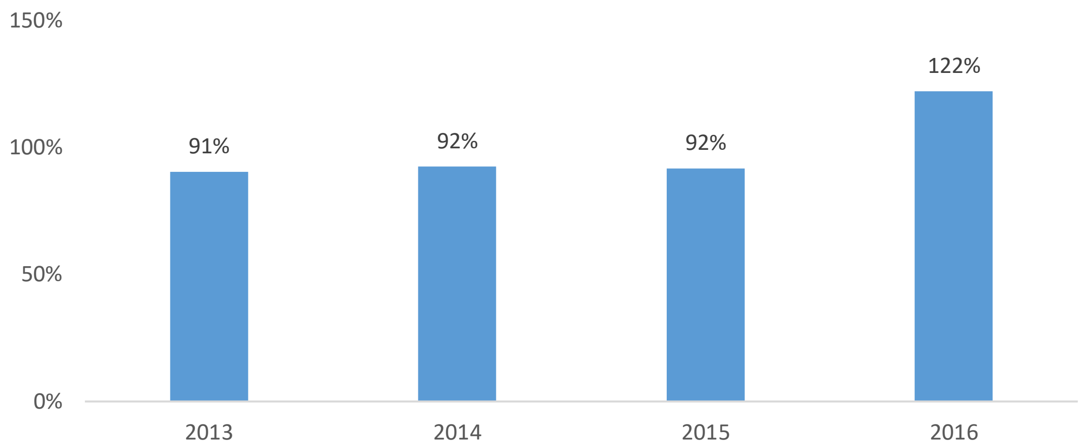
Figure 5: Egyptian financial system and its composition



Source: Authors.

The Egyptian banking sector has been growing steadily in the past few years. The size of the banking sector, compared to the size of the economy, grew from 91% in 2013 to 122% in 2016 (see Figure 6). The banking sector has, in the past few years, been subject to a wave of consolidation, just prior to the global financial crisis. In turn, the number of banks has decreased substantially due to mergers and acquisitions. The banking sector consisted of 38 banks at the end of 2015 (from 52 in 2005). The three largest banks control more than half of banking assets.

Figure 6: Size of Egyptian banks (% of GDP, 2013-16)



***Source**: CBE.*

Banks in Egypt can be classified according to business model and ownership.

Based on the business model, they are divided in three types:

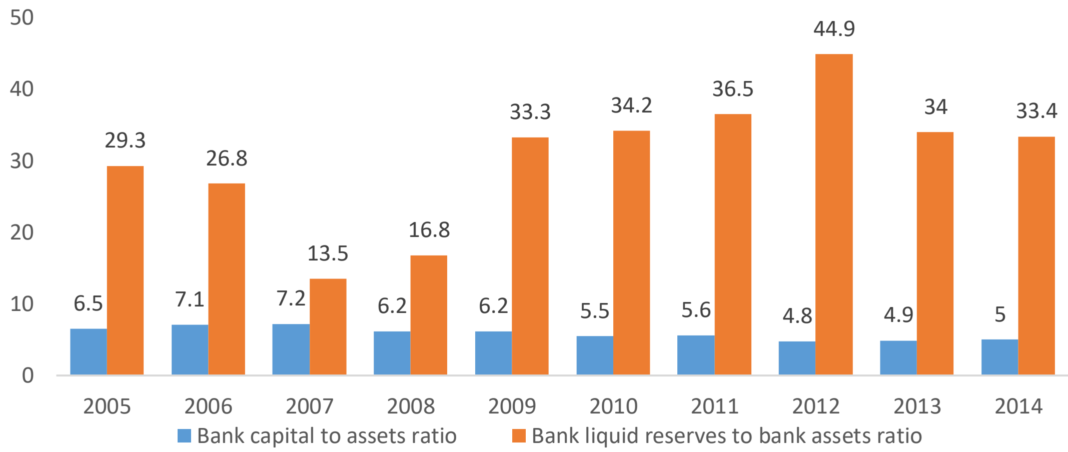
- *Commercial banks* that usually raise funds primarily with issuing checkable deposits, saving deposits and time deposits;
- *Business and investment banks* that carry out medium- and long-term operations as they assist corporations that issue securities;
- *Specialised banks* are basically public banks that undertake various operations in specific types of economic activities such as real estate, agricultural, exports and industrial development.

There are various ownership structures. The large majority of the banks are privately owned at the end of 2014 (28). But there are also five public and state-owned banks, as well as seven foreign owned banks, that are like the private banks registered as business and investment banks since their envisaged role is principally to raise long-term funds on the international financial markets and to promote investment (CBE, 2015).

Turning to the performance, profitability has improved in the past few years. Traditionally, the primary factors used to determine bank profitability are both the returns on bank assets and equity, and net interest rate margins (Flamini, 2009). The return on assets has increased from 0.7% in 2011 to 1.7% in 2015, while the return on equity has increased from 10.4% to 21.2% in the same period. The improvement was partially due to an improvement of the efficiency scores. The cost to income ratio decreased from 52.9% in 2011 to 45.7% in 2015 (Beck et al. 2017).

The CBE supervises banks operating in Egypt. It assesses the banks' compliance with the regulatory standards related to the minimum reserve requirements, liquidity ratios, as well as asset-liability matching, in terms of maturity and currency. Capital is vital for ensuring soundness for a banking system, since it presents a cushion against shocks, allowing banks to absorb losses and continue honouring claims. Banks in Egypt (excluding branches of foreign banks) have to maintain a minimum capital adequacy ratio of 10% as share of risk-weighted assets. It is worth noting that, according to the CBE, 2 out of the 40 banks did not meet the minimum capital requirements in 2013, while most of the other banks had capital ratios above 15%.

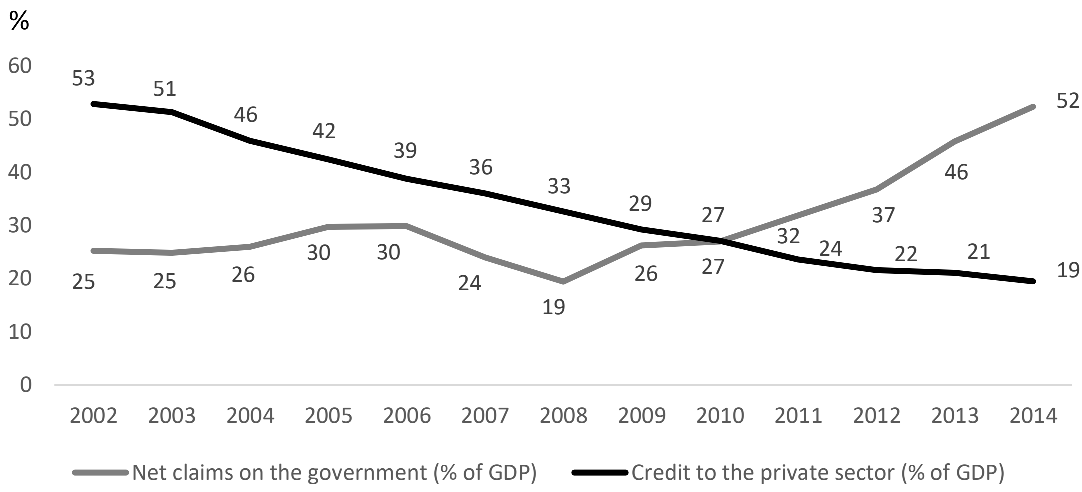
Figure 7: Solvency and liquidity position of Egyptian banks (%, 2005-14)



Source*: World Bank, World Development Indicators.*

Credit is the main asset-class for most of the Egyptian banks. Most of the credit provided is allocated to the Egyptian government. Indeed, the government deficit was primarily financed through local banks via treasury bills. The outstanding stock of Treasury bills has increased significantly from EGP 55 billion (€7.1 billion) in 2003 to EGP 533 billion (€61.5 billion) in 2014. To attract savings, interest rates on government bills and bonds have increased to reach, on average, 14% in 2014. The high demand from the government leads to the crowding out of private sector borrowers, which increasingly have problems obtaining credit (see Figure 8).

Figure 8: Net claims on the government are crowding out private sector credit



***Source**: Ministry of Finance, the Financial Monthly, various issues.*

The private sector borrowers are, however, in many cases defaulting on their loans. The quality of loan portfolio and the credit administration programme is considered to be the main factor affecting asset quality. Indeed, non-performing loans have gradually grown in the past decade, from 8.9% in 2005 to 26.5% in 2014. The high levels of non-performing loans are fuelled by a range of issues, including the lack of a well-functioning and efficient means of registering and enforcing property rights and limited information on potential clients and borrowers.

As for the capital market in Egypt, the Egyptian stock exchange is the sole stock exchange in the country. It has delivered a significant contribution to the economy. In Cairo and Alexandria, three types of securities are traded: i) common and preferred equity; ii) government and corporate bonds and iii) close-ended mutual funds.

The global financial crisis and the subsequent political crisis have contributed to a decrease in market capitalisation and turnover. The main stock market indices halved in value between 2008 and 2011; the EGX20 decreased from 10,716 to 5,888 and EGX 30 from 9,827 to 5,373. The exchanges have stabilised in recent years. In 2015, the companies listed in Egypt had a total market value of about €51 billion (17% of GDP). In turn, the number of listed small and medium-sized companies increased in recent years. The number of listed companies at the NILEX reached 33 in 2015, growing from 10 companies in 2010.

The bond market consists almost exclusively of government bonds. In fact, corporate bonds do not represent more than 0.1% and 0.5% of the total value and number of bonds traded respectively. Government bonds include treasury bonds, housing bonds and development bonds.

As per corporate bonds, they refer to bonds that are issued by corporations to finance business expansion, purchase of equipment and build facilities.

The Egyptian Financial Supervisory Authority (EFSA) is in charge of supervising the non-banking financial system. EFSA is responsible for licensing all entities practicing non-banking financial activities. Moreover, it regulates non-banking financial markets to ensure stability and efficiency, protect investors' rights and transparency.

Other non-bank financial services development remains rather modest in Egypt. Various reforms, targeting the non-bank financial sector, have also been enacted in efforts to deepen financial markets, including the restructuring of the insurance sector, the introduction of new financial leasing and factoring services, and the consolidation of regulatory and supervisory authority over non-bank financial institutions, under the Egyptian Financial Supervisory Authority in July 2009.

The insurance sector like many other non-bank financial services is underdeveloped. There are 30 insurers, of which 2 are publically owned, 10 private firms and 18 foreign private firms. Only around one million Egyptians (around 1% of the population) use insurance products. The insurance sector include: The *Re-insurance companies* include insurers that are specialists in issuing policies on properties, liabilities, persons, fund accumulation practices and settlement of compensations that fall due when risks materialise and reinsurers specialised in covering part of the risks on policies provided by insurers against a commission; *Cooperative insurance associations* are entities formed in accordance with the general principles of cooperation. They ensure that members enjoy an insurance system applied by and between them; *Private Insurance Funds* are established in associations, authorities, companies and other social relationships to fulfil the needs of individual members (medical treatments, pensions, etc.). They fulfil an important role in supporting the social protection provided by the government; *Government Insurance Funds* are assigned to cover the risks that insurers usually don't cover. Indeed, risks that are only considered to be covered by the government; and *Insurance Pools* is an option in the law that allows (re)insurers to establish, among themselves, insurance pools to manage an insurance branch or certain insurance process.

Mortgage finance has significantly evolved in recent years, but remains only a very small part of the Egyptian financial system. The number of investors reached 29,631 in 2011, up from only 3 in 2004. In 2011, the funds were almost all used to finance houses (95%), but there were also some for commercial (4%) and administrative real estate (1%).

The use of financial leasing is also very limited, though it could be an important financing option for small and medium-sized companies, start-ups and other parties that have insufficient working capital. The lessee will have the right to use a certain asset which is owned by a lessor (i.e. one will have the right to use the asset owned by the other party). Financial leasing is mostly used to fund real estate (39%), aeroplanes and floating vessels (18%) and cars (12%).

Venture Capital is private or public capital provided to start-ups and small businesses to finance their growth. These types of investment vehicles are associated with high risk, but they also have the potential for high returns. There are relatively few Venture Capital firms active in Egypt. Examples include: 1) Ideavelopers is a venture capital firm, founded in 2004, to help innovative start-ups become large companies. It is considered a subsidiary of EFG-Hermes Private Equity. The firm manages the Technology Development fund ($47 million fund or €40 million) focused on early stage technology companies. The firm invested about half of its funds in 17 companies operating in and outside Egypt. The firm’s main mission is to create a platform for promoting the development of SMEs across local industries, to enable it to become a major contributor in Egypt's advancement, employment, exports and GDP growth. On its evaluation, the firm looks for strong teams with differentiated offerings that target sizable markets and can consequently realise attractive financial returns; 2) Sawari Ventures is an international venture capital firm that invests in ideas that are considered to have the potential of turning into market-leading companies in the Middle East and North Africa (MENA) region. The firm main goal is to identify, serve, and provide capital for extraordinary entrepreneurs who are determined to change the MENA region. Since 2011, Sawari has made nine investments in Egypt, while Accelerator, its investment management subsidiary, has funded 75 start-ups amounting to around USD10 million or €9 million (Reuters, 2015). It has also provided seed funding to companies in a Cairo incubator. Six of the companies from the incubator accounted for 25% of the US patents coming out of Egypt in 2014 (Dolan, 2015).

While business angels started to grow slowly in Egypt, they are faster in executing duties compared to other finance companies. They negotiate lower terms and are willing to take more risk. One of these business angels in Cairo Angels that started to operate in 2012 by investing more than €0.6 million in 15 start-ups operating in export oriented sectors, especially the agricultural and energy sectors. Cairo Angels, in general, focuses on companies that have the potential to return 3 to 5 times the investment within a maximum of five years.

POLICIES FOR FINANCIAL SECTOR DEVELOPMENT

This section discusses the current legislative framework for financial institutions and markets, as well as the reforms undertaken in recent years.

Government actions in financial markets include creating and regulating these markets, intervening in these institutions through different regulatory tools, in addition to intervening directly in the capital markets via providing direct loans with the purpose of repairing financial markets failures. Many government policies, including those pertaining to tax, bankruptcy, and accounting have an effect on financial markets. Some of the above actions are regarded as improving financial markets, while others are substitutes for financial markets (Stiglitz, 1993). The 2008 global financial crisis showed that active state intervention in the financial sector can help maintain economic stability, drive growth, and create jobs. Moreover, the state has a very important role, especially in providing supervision, ensuring healthy competition, strengthening financial infrastructure by promoting transparency of information and reducing counterparty risk (World Bank, 2013).

Egypt has a long history of state interventions in the economy that takes different forms, starting from setting ceilings on interest rates, to high reserve requirements and ownership of banks (Mohieldin, 1995). These interventions distort both banking and non-banking sectors. On the banking side, the existence of heavy barriers to entry, the absence of sufficient exit mechanism, the existence of prudential regulation problems, and the non-disclosure of information. On the capital markets side, problems resulting in intervention include credibility problems, the expansion of public sector enterprises, the relative low cost of bank loans, and also non-disclosure of information (Mohieldin, 1995). Moreover, in both, legal infrastructure is considered to be the main obstacle to the exchange of credit information, as the existing banking and data protection laws did not allow lenders to disclose client information to the market (World Bank, 2013).

The best practices suggest that the main purpose of these interventions should be with the purpose of encouraging contestability through the entry of well-capitalised institutions and the timely exit of insolvent ones, addressing distorted rather than restricting competition, improving the flow of information, strengthening the contractual environment, and better aligning private incentives with public interest without taxing or subsidising private risk-taking (World Bank, 2013).

During the last decade, Egypt implemented the Financial Sector Reform Programme (FSRP), launched in September 2004. The main objective of the FSRP was to enhance the soundness of the financial sector and foster the emergence of an efficient, private-led financial system that serves

Egypt's development and growth objectives. Moreover, the banking regulation was broadly in line with international standards. The programme was divided into two phases:

The first phase (2004-2008) with the objective of building a more diversified and balanced financial system, reforming the banking sector, developing non-bank financial institutions and securities markets, increasing private participation and enhancing competition.

The second phase (2009-2012) focused on improving financial intermediation and enhancing access to finance, with a particular focus on specialised commercial banks and non-bank financial institutions (World Bank, 2010).

Table 1: Financial Sector Reform Programme main achievements

Phase I (2004-2008)	Phase II (2009-2011)
Supporting of bank mergers to improve the banks' efficiency considerations and financial solvency resulting in decreasing the number of banks in Egypt.	Implementing Basel II in Egyptian banks in 2012/2013 to improve the risk management process.
Doubling the number of branches from 1,795 to 2,530 during the period (2004-2010).	Preparing a specialised team in the supervision and control sector to monitor the bank's commitment to Basel II.
Setting of public commercial banks' financial restructuring process.	Expanding the scope of government payment automation projects.
Setting up of a plan to deal with non-performing debts.	
Repayment of total non-performing debts of the public sector in 2010.	

***Source**: CBE achievements report.*

Before this reform, the financial sector of Egypt suffered from public sector dominance where public banks did not adhere to international standards, financed state owned enterprises, and accumulated non-performing loans. Moreover, private banks operated in a non-competitive environment that resulted in inefficient banking practices, a lack of suitable instruments and limited access to financial services. Non-banking institutions did not have a suitable regulatory environment. This is why, after the reform significant progress has been made in the consolidation of the banking sector, privatising one state-owned bank, pursuing the restructuring of the remaining three state-owned commercial banks, and building a supervisory capacity at the CBE by signing a memorandum of understanding and protocol with the European Central Bank and four of the Euro System National Central Banks, to provide a two-year technical assistance programme.

In addition, the non-bank financial institution legislative framework has also been reformed to further deepen the capital market, restructure the insurance sector, develop a well-functioning mortgage market, activate financial leasing, and factoring. This was coupled with the creation of the Egyptian Financial Supervisory Authority (EFSA) in 2009. The latter is responsible for supervising and regulating the non-banking sector. Moreover, the authority is also mandated to limit inconsistency risks and regulating the dissemination of information related to non-banking financial markets. Consequently, the insurance sector was reformed at both the regulatory and company level, i.e. one of the three state-owned (direct) insurance companies was privatised. Moreover, a new system of mortgage finance started to emerge for a more sustainable housing finance market (World Bank, 2010). EFSA is, as supervisor, also responsible for the regulation of non-banking financial markets and instruments.

FINANCIAL INCLUSION AND ALTERNATIVE SOURCES OF FINANCE

Financial inclusion means that individuals and businesses have access to useful and affordable financial products and services that meet their needs in terms of transactions, payments, savings, credit and insurance. In theory, these services should be delivered in a responsible and sustainable way.

Financial inclusion efforts focus on the large outreach of financial services to all households and businesses, in particular women and the young through financial literacy training programs and promoting access to financial services, particularly payment services, savings and insurance products.

Recently, digital financial services have grown in a way that is facilitating transfers, payments and, in certain cases, credit provision services such as Mobile network operators (MNOs) in order to promote financial inclusion. According to CBE statistics, in 2015, 3.8 million mobile wallets were used in Egypt accounting for 6.7 million transactions.

Traditional financial access means assessed via the number of borrowers from commercial banks, commercial bank branches per 100,000 adults and number of automated teller machines per 100,000 adults are rather low as shown in Table 2. The aforementioned digital financial services might make the development of a physical infrastructure for cash and banking less relevant and hence financial inclusion benefiting from this new trend.

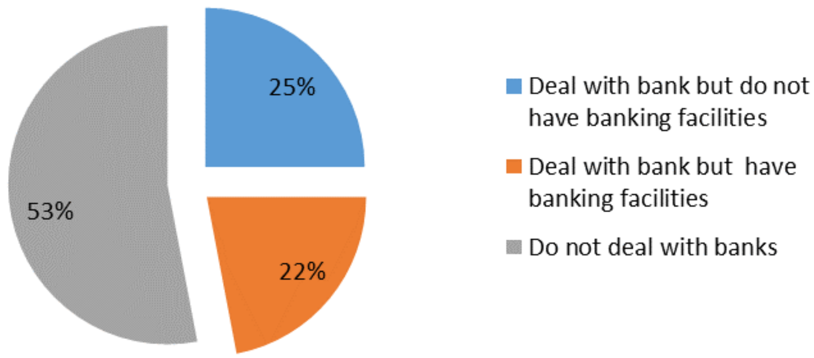
Table 2: Financial Inclusion Indices 2015

	Egypt
Borrowers from commercial banks (per 1,000 adults)	99.64
Commercial bank branches (per 100,000 adults)	4.53
Depositors with commercial banks (per 1,000 adults)	440.38
Automated teller machines (per 100,000 adults)	13.45

Source: International Monetary Fund, Financial Access Survey

Moreover, access to finance for SMEs is also an important issue. Based on the census of the Egyptian Banking Institute, about 47% of SMEs in Egypt deal with banks and only 22.4% have access to banking facilities (see Figure 9).

Figure 9: SMEs Access to Finance



Source*: El-Said et al (2013).*

Microfinance is an important alternative financial access instrument. It not restricted only to lending, but it could include forms of financial leasing, Murabaha, trading and so forth. In the provisions of this law, microfinance means offering finance for production or commercial purposes, with the value determined by EFSA and it shall not exceed EGP 100,000 (approximately €5,000).

Nearly 450 microfinance institutions operate in the country, including four banks which are Banque du Caire, Bank Misr, National Bank of Egypt and Bank of Alexandria as well as more than 400 NGOs. But the market is, nevertheless, relatively concentrated with the largest microfinance institutions responsible for nearly 85% of beneficiaries. Prevailing products include individual loans to finance existing small and medium enterprises (SMEs), which account for roughly 50% of beneficiaries, and solidarity group loans to finance people with limited income. Furthermore, there are service companies which were recently introduced in Egypt, such as Reefy and Tanmya[5].

Looking at the distribution across gender, despite the fact that in terms of the number of beneficiaries, males and females have equal shares, the share of males is twice that of females in terms of the amount of funds.

Another instrument to enhance access to finance is via he Credit Guarantee Company's (CGC), which main objective is to contribute to economic development through the support of micro, small and medium scale enterprises (MSMEs) in attracting funding. More specifically, CGC provides guarantees to MSMEs with no collateral, or with inadequate collateral and track record to obtain the funding from a financial institution without a guarantee. CGC covers a percentage of the risk associated with the enterprises, besides providing guarantees to MSMEs.

The CGC has seven branches providing a nationwide coverage. The shareholders of CGC consist mainly of banking institutions. During the period (1991-2013) the CGC guaranteed bank credit reached €1.2 billion, while the CGC issued guarantees to MSMEs registering €0.6 billion.

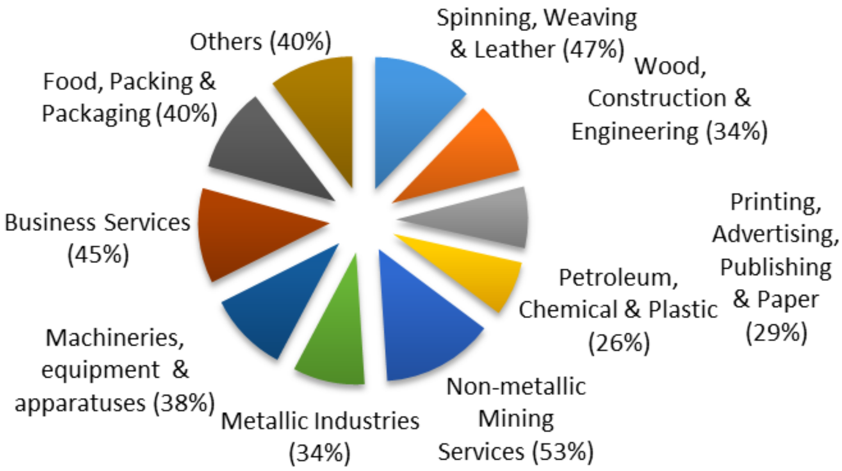
CGC provides its services under the following programmes:

- *Small and Medium Scale Enterprises (SMEs), including the Factoring Activity Guarantee* is based on guaranteeing credit facilities and loans offered by lending institutions (banks) to all SMEs under CGC's criteria.
- *Health Care Providers Programme (HCPP)* aims at raising the health service standard, enhancing the medical service offered to citizens, especially in rural, remote and underserved areas, as well as generating job opportunities for physicians and pharmacists, to boost the performance standard and increase their incomes through guaranteeing the loans presented to these target groups.
- *Small and Emerging Businesses (SEBs)* target small and micro enterprises where CGC extends a 100% guarantee to different banks, with the purpose of providing the finance necessary for the development of such a target group. A chain of successive loans is issued and presented to the target group by the participating financial institutions and NGOs throughout Egypt, under CGC supervision and follow-up.
- *Poverty Alleviation and Employment Generation Programme (PAP)* has generated new job opportunities to more of the public, achieving an accumulated total of 25,334 job opportunities generated since Programme inception.

[5]Reefy introduce its finance in cooperation with CIB while Tanmya introduces its finance in cooperation with Egyptian Gulf Bank.

- *Industrial Modernisation Programme Credit Guarantee Fund (IMP CGF)* aims at contributing to the development and modernisation of the Egyptian industrial sector, through a new mechanism that efficiently contributes to the achievement of this goal, by providing banks with guarantees to hedge the risks related to medium-term loans.

Figure 10: Guarantee amount/Total Amount of Credit (GCC)



***Source**: CGC (2013).*

Finally, in Egypt, there are also financial institutions that work under the Islamic Sharia law, which have an independent status from all governmental authorities. There are in total three types of Islamic financing institutions:

- Formal Islamic banks;
- Islamic bank branches inside formal conventional banks;
- Informal Islamic banks.

Egypt is one of the first countries to permit the operation of Islamic banks, the process begun with the special law of 1977, which was followed by the establishment of Faysel Islamic Bank of Egypt (FIBE) that started operating in 1979. FIBE is a commercial bank under an Islamic label.

Nowadays, Sharia-compliant shares of commercial bank deposits have grown from 9.7% in 1977 to 10.3% by the end of 2013. The number of banks has increased to six, including FIBE, Al Baraka Bank, the Egyptian Gulf Bank, the National Bank for Development, Abu Dhabi Islamic Bank and the Egyptian Saudi Finance Bank.

Following the expansion of Islamic banks and increasing popularity among Egyptians, many traditional banks opened new branches operating according to Islamic financial principle. Bank Misr was the first commercial bank to open its Islamic branch in 1980.

FINANCIAL DEVELOPMENT AND INCLUSION IN JORDAN

Nooh Alshyab and Serena Sandri

The main components of the Jordanian financial sector are banks, insurance companies, financial intermediation and services companies, specialised credit institutions and microfinance companies.[6]

In total, financial assets reached JD 47.2 billion (€50.1 billion)[7] by the end of 2014. The assets of licensed banks were JD 44.4 billion (€47.1 billion), which corresponds to 94% of total financial assets. The remaining sectors, such as capital markets, the insurance sector, and the microfinance sector play a rather marginal role. The size of the banking system, relative to GDP, is at 178% relatively high compared to other countries in the region.

A large banking sector may contribute to the risk of a sovereign debt crisis and regional political instability. Concerning public debt, the government is making efforts to consolidate public finances (IMF, 2015). Concerning political instability, Jordan has been exposed to many external shocks in recent years, the most important of which have been the financial crisis and Arab Spring, which have severely affected the Jordanian economy (Alshyab and Khasawneh, 2013) and which has, among else, caused the disruption of gas imports from Egypt, as well as the Syrian crisis and the massive inflow of refugees.

Nevertheless, according to the International Monetary Fund (IMF, 2015), Jordan is successfully maintaining its monetary and political stability, via adopting prudent fiscal and monetary policies. To praise the efforts of the country, the IMF has disbursed to Jordan US$ 396.3 million (€364 million) as the last instalment of a granted US$ 2.1 billion loan (€1.9 billion).

Looking at the soundness of its financial and banking system, Jordan has a safe liquidity position, with a share of liquid assets to total assets, being around 52% in 2014, according to the

[6] If not differently specified, the information and data reported in the text stem from the very comprehensive Financial Stability Report by the Central Bank of Jordan.

[7] Figures in national currency, JordanianDinar (JD), have been converted into US$ using the fixed exchange rate of 1.410 US$/JD. Convertion into the Euro is based on the variable exchange rate as indicated by the Central Bank of Jordan in the Annual Reports for the years of interest. In particular, the exchange rate was 1.063 Euro/US$ in 2013, 1.061 Euro/JD in 2014, and 1.296 Euro/JD in 2015.

Central Bank of Jordan (CBJ). This share can be further disentangled as a share of cash of 27.5% and a share of securities of 24.5% of total assets.

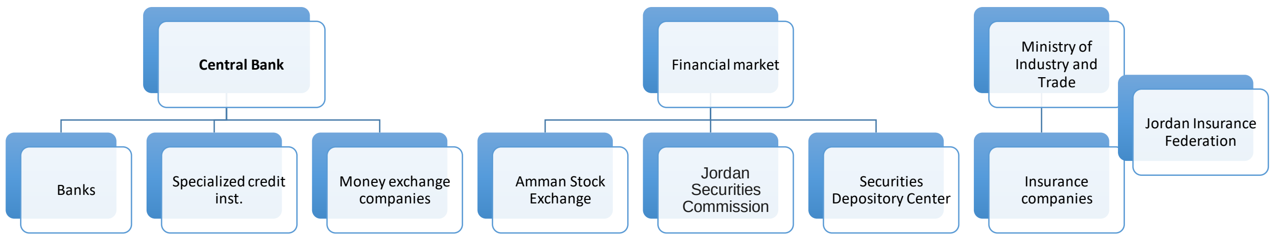
FINANCIAL SECTOR STRUCTURE

The financial sector in Jordan is dominated by banks. The main supervisory authority of the banking sector is CBJ, which was constituted in 1964 as an independent and autonomous corporate body, whose capital is entirely government owned. The CBJ succeeded the Jordan Currency Board which had been established in 1950. The main objectives of the CBJ are to maintain monetary stability in Jordan, to ensure the convertibility of the Jordanian Dinar, to pursue banking and financial stability in the Kingdom, and to support the fostering of economic growth.

The main institutions building the banking sector are banks (national and foreign commercial banks and Islamic banks), specialised credit institutions, which are mostly public institutions, and money exchange companies.

The Amman Stock Exchange, which is an independent non-profit entity, together with the Jordan Securities Commission, and the Securities Depository Centre, is in charge of supervising the capital market. The insurance sector is then directly supervised by the insurance directorate of the Ministry of Industry and by the Jordan Insurance Federation.

Figure 11: Financial system in Jordan



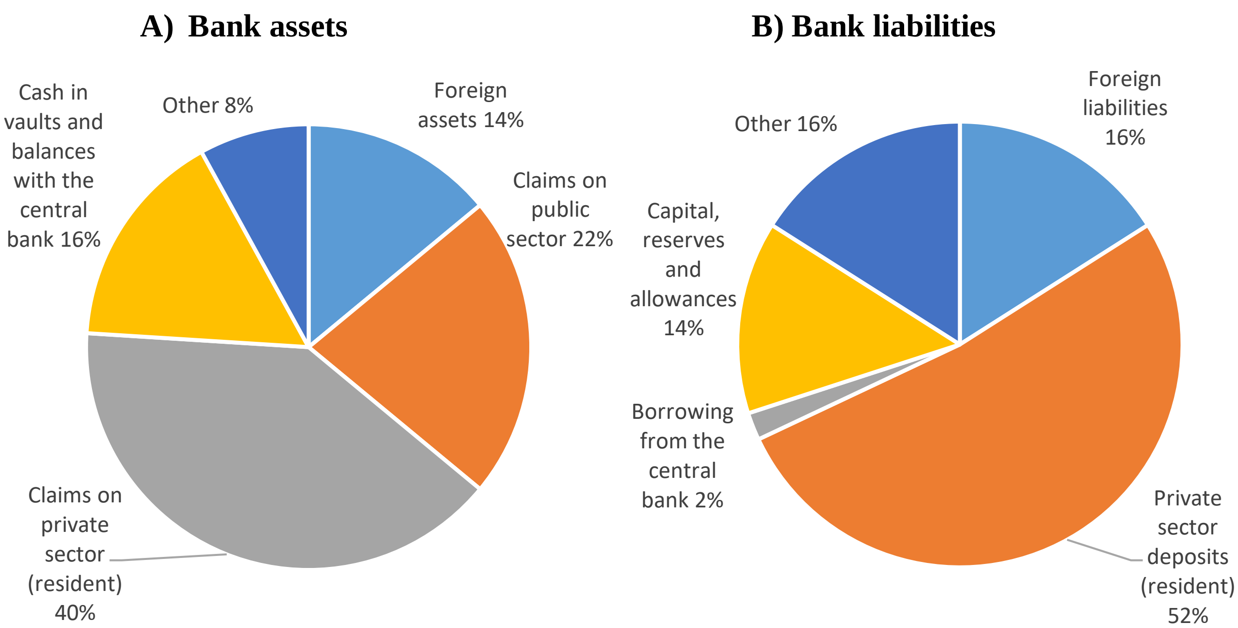
***Source**: Authors' elaboration.*

This section will first discuss the structure and performance of the banking sector. Afterwards, the capital markets and other financial services will also be discussed.

The Jordan banking sector includes different types of banks. There are in total 25 banks, which predominantly include domestic banks (16). Among the domestic banks are also 3 Islamic banks. Moreover, there are also 9 subsidiaries of foreign banks, including one Islamic bank. Even though Jordan is a small country, in 2014, all banks combined had 767 branches and 78 offices.

The banking sector is characterised by a slowly declining, but still high level of concentration. At the end of 2014, the largest five banks held 54% of banking assets and the largest ten 76% of those assets. Foreign ownership of banks is the highest in the whole MENA region, as the capital share of foreigners approximates 47%. In fact, there are no regulatory restrictions for foreign participation. After a decline in 2010 and 2011, this share rose again, reflecting the confidence of investors in the Jordanian banking sector.

Figure 12: Average composition of bank balance sheets (2010-14)



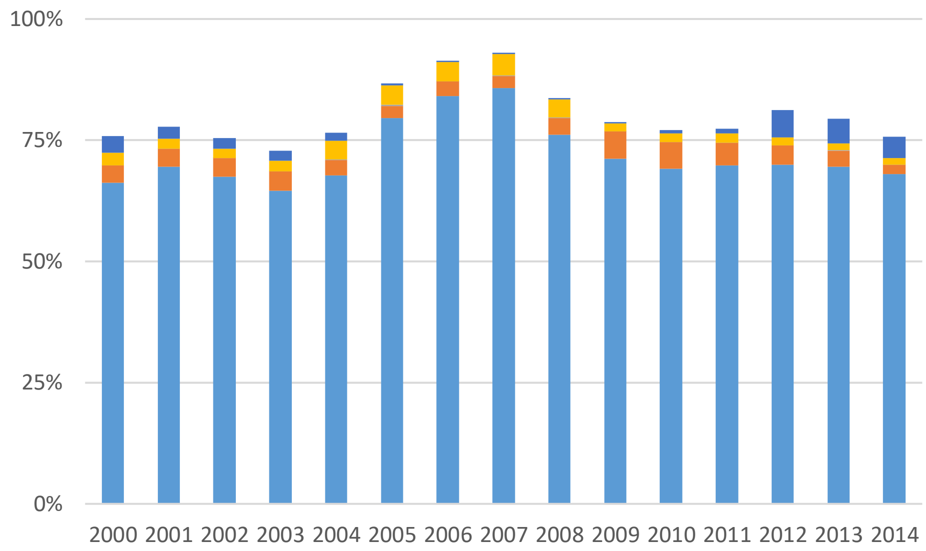
***Source**: Authors' calculation based on data on CBJ (2014).*

Total assets and liabilities of commercial banks in Jordan has increased 6.4% annually in the period between 2010 to 2014, to reach JD 44.9 billion (€52.2 billion) in 2014.

Claims on the private sector represent the most important usage of assets (JD 17.8 billion or €20.7 billion), with almost 40% of total banking assets. In addition, claims on the public sector were almost 25% of total assets (€12.8 billion). Overall, claims represented around 65% of total assets in 2014. Turning to liabilities, the main component is represented by private sector deposits. It amounted to 54% of total liabilities (JD 24 billion or €25.4 billion).

The outstanding credit facilities reached JD 19.3 billion (€22.4 billion) in 2014, which is around 77% of GDP. Credit facilities are mostly provided in the local currency, as only sectors which raise income in foreign currency are allowed to obtain facilities in these currencies. In all other cases, credit needs to be granted in Jordanian Dinars.

Figure 13: Distribution of credit facilities by borrower (% of GDP)

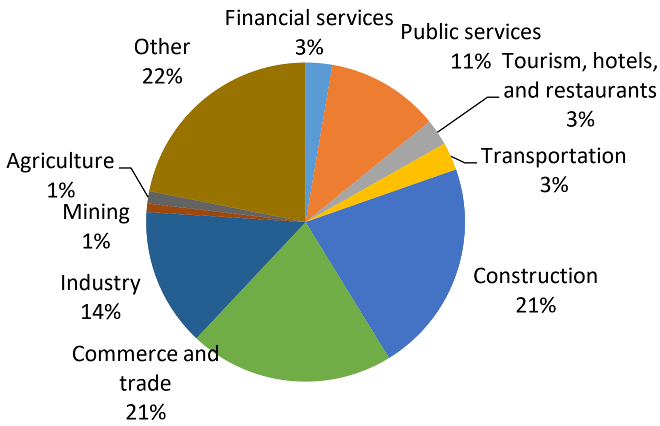


Source: *Data from (CBJ, 2014).*

As Figure 13 shows, the largest share of credit facilities is represented by credit to private residents, which reached JD 17.3 billion (€20.1 billion), or 68% of GDP, in 2014 - equivalent to 89% of total credit facilities. The remaining credit is mostly provided to the public sector. The predominance of credit to the private sector also emerges from looking at the average distribution of credit facilities by borrowers between 2000 and 2014.

Considering the allocation of credit facilities by sectors of economic activity, in 2014 the construction sector received 23.6% of total credit facilities, trade and commerce received 19%, 13% goes to industry, and 11% to public services and utilities. The overall picture is that credit is mostly allocated to the tertiary sector, rather than to industry. A similar distribution of credit by economic activity emerges when considering the average for the period 2000-2014 (see Figure 14).

Figure 14: Average distribution of credit facilities by sector (2000-14)



Source: *CBJ (2014).*

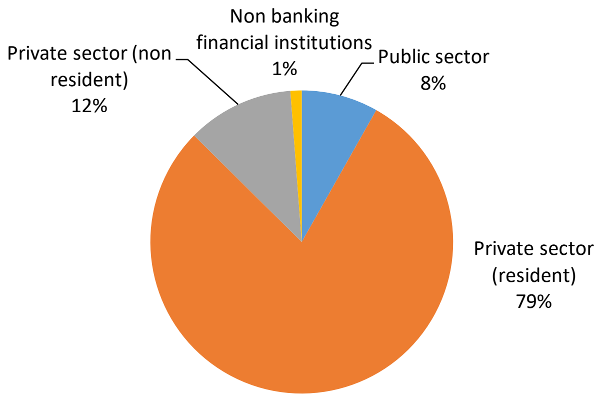
The main beneficiaries of credit facilities were companies (42% in 2014). The share of credit facilities granted to large companies represented on average 45% between 2008 and 2013 and has witnessed a downward trend, except in 2009. The increase of credit facilities granted to households has made up for this decline. Households received 36% of total credit facilities in 2009 and 42% in 2014. Credit granted to the government and to the public sector also increased to 8% in 2014.

SMEs receive a small share of credit. They received 8.5% at the end of 2014, compared to 10.9% in 2008. This is particularly small, considering that almost 76% of the applications for credits were submitted by SMEs. According to a study of the Central Bank of Jordan, the main reasons for rejecting SME credit applications were weak financial position and insufficient funds, non-compliance with credit policy, poor solvency and lack of commitment and arrears with the banking system.

The credit facilities granted to households represent a large share of the total credit facilities granted privately (42% in 2014). Out of household debt, the largest share was provided in the form of mortgage loans, which represented 40% of total household credit. The remaining share of household debt was split between personal advances (40%), car loans (8%) and other consumable expenditure (12%).

Looking at bank liabilities, it emerges that deposits are the main source of funds, constituting 68% of total liabilities in 2014. Private sector deposits were equal to 96% of GDP. In total, 79% of total deposits belong to private entities and 8% to public entities.

Figure 15: Distribution of depositors by type of depositors (2014)



***Source**: Authors' calculation based on data from (CBJ, 2014).*

Almost 57% of deposits are time deposits, 30% are demand deposits, and the remaining 13% are saving deposits. About 20% of deposits are denominated in foreign currencies (CBJ, 2014).

The banks in Jordan are relatively sound. The capital adequacy ratio was 18.4%, well above both the 12% requirement set by the Central Bank of Jordan and the 8% recommended by the Basel Committee.

Leverage ratios (equity over total assets) between 2008 and 2013 remained assessed around 13%, which is also a comfortable level compared to the minimum requirement of 6% of the CBJ. The high leverage ratio seems to be linked to the banks' decision to increase their capital and to keep a large part of their profits, signalling a solid capital base.

Table 3: Financial soundness indicators for the banking system in Jordan

	2008	2009	2010	2011	2012	2013
Capital Adequacy Ratio (%)	18.4	19.6	20.3	19.3	19.0	18.4
Nonperforming Loans/Total Loans (%)	4.2	6.7	8.2	8.5	7.7	7.0
Coverage Ratio (%)	63.4	52.0	52.4	52.3	69.4	77.0
Leverage Ratio (%)	12.9	13.0	13.1	13.1	13.3	12.9
Return on Equity (ROE) (%)	11.5	8.8	8.8	8.3	8.6	9.9
Return on Assets (ROA) (%)	1.4	1.1	1.1	1.1	1.1	1.2

Interest Margin/gross income (%)	71.3	71.6	74.3	70.1	76.6	77.6
Net Profits Before Taxes (JDm [€m])*	564.3 [830]	460.4 [642.2]	523.4 [693.9]	516.6 [719.1]	587.8 [755.2]	719.5 [955.6]
Net Profits After Taxes (JDm [€m])*	400 [588.3]	333 [464.5]	365.7 [484.8]	382.3 [532.2]	413.9 [531.8]	501.8 [666.4]
Liquidity Ratio (%)	141.2	159.1	161.4	152.9	143.5	149.1
Growth Rate of Total Assets (%)	11.4	7.4	9.6	7.9	4.3	9.1
Growth Rate of Customer Deposits (%)	13.2	12.1	10.9	8.3	2.4	10.5
Growth Rate of Credit Facilities (%)	17.2	2.1	8.6	9.8	12.5	6.3

** 1 JD=1.401 US$, fixed exchange rate.*
***Source**: Data from CBJ, 50th Anniversary (2014).*

The increase in deposits exceeds the increase in credit facilities. The liquidity ratio is almost 150%, whereas a liquidity of 100% is required. Overall, the Jordanian banking system seems to have a safe and sound level of liquidity: the share of cash and cash balances to total assets reached 27.5% and the share of (highly liquid) securities portfolio to total assets 24.5%. In total, liquid assets represent almost 52% of total assets.

Asset quality seems to have improved, as the ratio of non-performing loans to total loans decreased, from 8.5% in 2012 to 7.0% in 2014. This downward trend is both due to the increase in total loans and to the decrease in the amount of non-performing loans. The increasing trend in the coverage of non-performing loans reached 79% at the end of 2014 (CBJ, 2014).

The profitability of the banking system in Jordan is slowly recovering from the downward trend of recent years. Nevertheless, it isn’t large, even in a regional comparison. Return on assets (ROA), which was 1.7% in 2006, declined as a result of the global financial crisis to 1.1% by the end of 2009. ROA started to increase in 2013 and was 1.2% and 1.4% in 2014. Also, the return on equity (ROE) shows a similar dynamic. In general, concerning the profitability of the banking sector, Jordan has an average position in a regional comparison (CBJ, 2014).

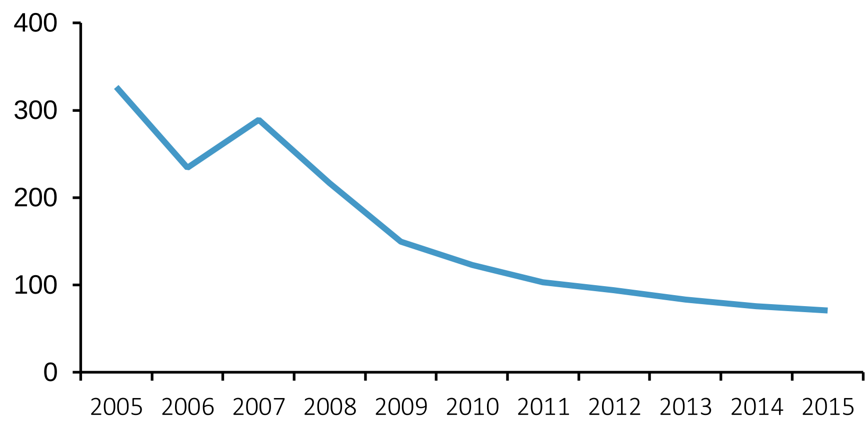
For the capital market contribution, the trade of public shareholding companies was started in Jordan in the early thirties, long before a market for securities was established. In 1930, the Arab Bank was the first public shareholding company, followed, one year later, by Jordan Tobacco and Cigarettes, Jordan Electric Power in 1938, and Jordan Cement Factories in 1951. The trade of securities was, however, first organised and ruled in 1976, when the Amman Financial Market was established.

The functions and supervision of the financial markets were then assigned, by the Securities Law of 1997, to three independent institutions, thus taking over and separating the functions of the Amman Financial Market:

- *Jordan Securities Commission (JSC)* pursues the aims of regulating, monitoring, and developing the Jordan capital market for all aspects related to registration and trade of securities.
- *Amman Stock Exchange (ASE)* was established as a non-profit independent institution with the function to provide a regulated market for trading securities. Since February 2017, the ASE has become the Amman Stock Exchange Company (ASE Company), which is a public shareholding company, completely government owned.
- *Securities Depository Centre (SDC)* is a public utility institution, which holds the ownership registers of all issued shares.

According to data by the ASE, market capitalisation was around JD 18 billion (€23 billion) in 2015, corresponding to 70% of GDP. The number of listed companies reached 228 by the end of 2015. Compared to market capitalisation, however, traded value is low, with a total of JD 3.4 billion (€4.3 billion) in 2015 (ASE, 2016). This is linked to the low free flow of trade and to the low turnover ratio of 37.3%.

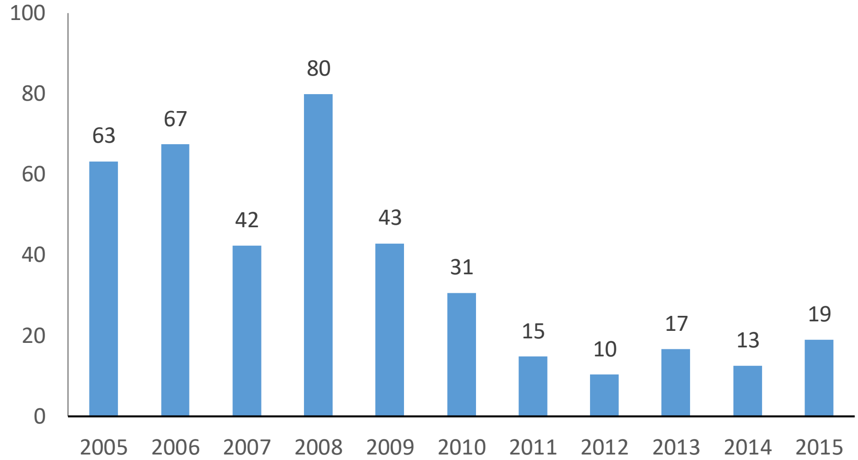
Figure 16: Market capitalisation as share of GDP



***Source**: Amman Stock Exchange (2016).*

In general, both market capitalisation and value traded show a declining trend over recent years. The relative importance of the capital market to GDP is also declining. Capital markets, thus, play a very marginal role in the Jordanian financial sector.

Figure 17: Value traded as share of market capitalisation (%)

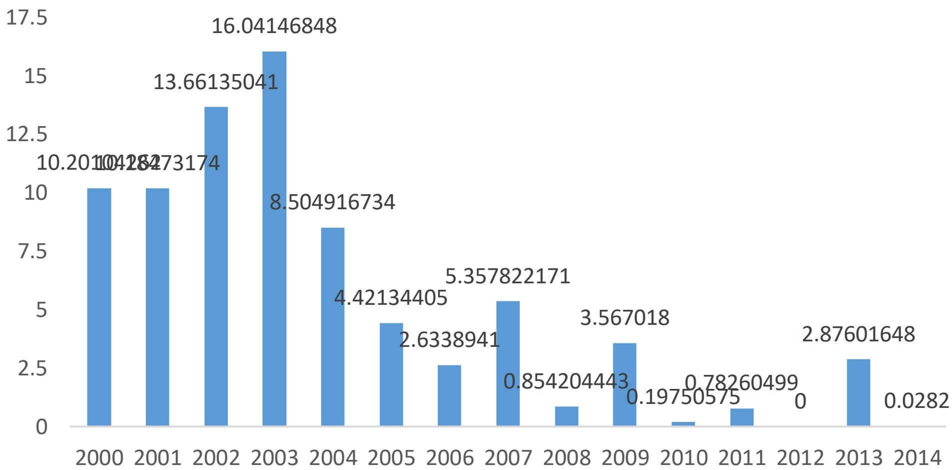


Source: *Amman Stock Exchange (2016).*

On average, between 2005 and 2015, the share of foreign ownership of shares was almost half of the market capitalisation.

The bond market of the Amman Stock Exchange is not an important component of the financial system in Jordan. The market is very volatile. Value of traded bonds is negligible with, for instance, only 0.01% of GDP in 2013 and a maximum of 0.15% of GDP in 2003.

Figure 18: Value of bonds traded in US$ (ml)



Source: *Amman Stock Exchange (2015).*

The bonds traded at the Amman Stock Exchange are corporate bonds, Treasury bonds, and public entities bonds. In January 2017, the Central Bank of Jordan for the first time issued the so-called Individual Savings Bonds (ISBs), which are discussed in the financial inclusion section.

Treasury bonds are becoming increasingly important for the financing of the state. Banks are more and more exposed to government debt through investing in government bonds, but also through credit facilities to public institutions with a government guarantee.

The insurance sector comprised 25 insurance companies with a total paid up capital of JD 218.3 million (€232 million) in 2013 (CBJ, 2014). In 2014, the total assets of insurance companies were JD 844.2 million (€895.7 million) (CBJ, 2014), representing a 3.4% share of GDP. Jordan is, herewith, below the average of other emerging countries (Rodney, 2010).

Total premium payment reached JD 537 million (€683 million) by the end of 2015. The most important type of written premiums is constituted by motor vehicle insurance, representing 40% of total premiums in 2014. Medical insurance represents the second largest type of premiums, with a share of 27% in 2014. Fire, accident, maritime, and life insurance premiums follow in descending order.

The system is highly concentrated in life-insurance, where the specialised American Life Insurance Company (ALICO) dominates. The general insurance non-life market is less concentrated. The sector is regulated by the Jordan Insurance Federation.

The exchange sector has recently experienced significant growth, both in terms of coverage and of size. There are 143 licensed companies and 131 branches active in the currency exchange sector.

Also, the currency exchange sector is supervised by the Central Bank of Jordan, which extends its authority both onsite and offsite. The sector is regulated by the Currency Exchange Law, which has been added by several instructions and amended throughout, to keep pace with the rash development in the sector, to protect customers, and increase security and stability of the sector. In particular, the minimum capital required for licensed exchange companies has been increased by 200%.

Table 4: Selected indicators on currency exchange services (2014)

Indicator	JDm (€m)
Business size	169.7 (180.1)
Capital	80.4 (85.3)
Financial guarantees offered	25.5 (27.1)
Purchase of foreign currency	6,181 (6,558)
Sales of foreign currency	6,190 (6,568)
Return on capital (%)	4.4
Return on assets (%)	2.1

Source: *CBJ (2014).*

POLICIES FOR FINANCIAL SECTOR DEVELOPMENT

Over recent years, Jordan has put considerable efforts into reforming and better regulating the financial sector. The new legislation is, in general, inspired by the principle of financial inclusion and focuses on improving the financial infrastructure of the sector, enhancing consumer protection, increasing banking and financial literacy, expanding and facilitating access to credit for SMEs, and regulating the microfinance sector. As a result, in 2015, an amendment of the Banks' Law targeted the application of best corporate governance practices, both in regard to commercial banks and to Islamic banks.

In the same year, the Exchange Law, redrafting the requirements for licensing exchange companies, and the Micro-Finance Companies' bylaws were approved. Among others, a new department has been created in the Central Bank of Jordan, with the specific task of supervising the microfinance sector. The law further assigns to the Central Bank of Jordan, the authority to decide on the prerequisites and preconditions for entering the market.

As general principles, the Central Bank of Jordan has paid attention to ensuring monetary stability, to controlling inflation and, herewith, to supporting investments and savings. Among the interventions of monetary policy for 2014, the Central Bank of Jordan has cut the rediscounted rate by 25 basis points (from 4.50% in 2013 to 4.25% in 2014) to stimulate investment.

Since 2015, the Jordanian Dinar has been pegged to the US$. In 2014 the foreign reserves amounted US$ 14.1 billion (€11.6 billion), which represents around 40% of GDP and covers around seven months of imports of goods and services. This signals, according to international standards, a comfortable level of foreign reserves and marks an improvement in the monetary stability of the country.

In 2011, as a reaction to the global financial crisis, the Central Bank of Jordan published some instructions to mitigate the exposure of the banking sector to the real estate market. The credit concentration instructions prescribe that a loan on the total direct credit extended for real estate buying and/or building, should not exceed 20% of total client deposits. In the same direction as increasing the capability of the banking sector to face real estate market risk, there is the Capital Adequacy Instructions of 2008, which, in compliance with Basel II requirements, set an increased capital level for housing loans with a high Loan-To-Value (LTV) ratio.

The Jordanian banking sector complies with Basel II capital requirements and the authorities are working to complete the implementation of Basel III requirements. In December 2015, the Central Bank of Jordan released a draft of instructions for the implementation of Basel III capital requirements.

FINANCIAL INCLUSION AND ALTERNATIVE SOURCES OF FINANCE

Financial inclusion is a key to promoting economic development and defeating poverty, and the World Bank Group targets the goal of Universal Financial Access (UFA) by 2020.

In general, access and use of financial services in the Middle East is among the lowest in the world (Demirgüç-Kunt et al., 2015). Looking at the case of Jordan, it emerges that even though the coverage of financial services is higher than compared regionally (excluding the Gulf countries), increasing financial access is an important target.

However, financial inclusion, which means lack of access to financial services for disadvantaged groups in society, is also related to the existence of alternative sources of finance, targeting the unbankables. In this regard, Jordan also has well developed markets for microfinance and for alternative sources of finance, specifically Islamic finance. In particular, microfinance is very closely linked to social activity but is, at the same time, also provided for profit-making institutions. Islamic banking services also have a long standing tradition in the country and are well developed in attracting and serving the needs of a growing segment of customers.

Indicators for financial inclusion include measures on access, usage, and quality of financial instruments. Starting with account penetration as a share of adult population, it emerges that Jordan is above the regional aggregated average, with around 25% of adults having an account with a bank, or another type of financial institution, or with a mobile money provider, versus 14%

in the Middle East, and 62% globally. Further, 16% of female adults and 16% of adults in poorest households have an account.

Table 5: Account penetration in Jordan, Middle East, and World

Account penetration: share of	Jordan	Middle East	World
Adult population	25%	14%	62%
Female population	16%	9%	58%
Adults in the poorest 40% of households	16%	7%	54%

***Source**: Demirguc-Kunt et al. (2015).*

According to the data by the World Bank's Financial Access Survey for 2016, the number of Automated Teller Machines (ATMs) per 100,000 adults has increased from 22 in 2007 to 29 in 2015. Banking density, proxied by the number of bank branches per 100,000 adults, has remained constant since 2007. Further, also reflecting the concentration of population and of commercial and economic activities, banks seem to be largely concentrated in the three largest cities. Between 2007 and 2015, commercial banks have considerably increased their number of branches by 36% from 637 to 896. The large majority of these branches are located in the three largest cities in the country.

A further indicator for assessing financial inclusion is the GDP share of loans from commercial banks lent to households and SMEs. Outstanding loans with commercial banks in 2015 represented almost 79% of GDP, whereas total outstanding loans to private households (33%) and SMEs (7%) did not exceed 40% (World Bank, 2016).

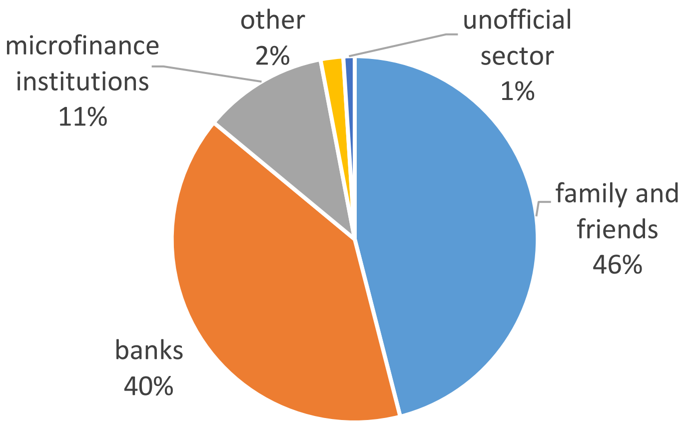
In 2016, INJAZ[8] agreement with the Central Bank of Jordan, commissioned a survey on financial inclusion. The survey referred to a sample of 1,140 respondents between the ages of 18 and 80.

The large majority of the adults that do not have a bank account indicate that there is no need to have one (about 69% of respondents). Moreover, mistrust towards the banks and religious reasons were 22% and 9% respectively of the unbanked respondents' motivations for not having a bank account. The survey confirms there is low credit penetration. In fact, only about 17% of individuals obtained borrowing from banks and micro companies and 7% of SMEs received bank credit facilities.

[8]INJAZ was founded in 1999 as a project by the USAID initiative Save the Children. INJAZ is currently an independent, non-profit Jordanian organisation, targeting education and training in the country.

Figure 19 represents the responses concerning the sources of funding for individuals who borrowed during 2015. Almost half of borrowers were lent money from family, friends, and further unofficial sources, whereas the remaining half were from banks and microfinance institutions.

Figure 19: Sources of funding for individual borrowers (2015)



Source: *INJAZ Survey (2016).*

The authorities are aware of the importance of targeting financial inclusion to promote sustainable and more equitable development. The Ministry of Planning and International Cooperation in 2011 released a national policy framework for inclusive finance and the Central Bank of Jordan has announced the launch of a national strategy for financial inclusion for 2020. The strategy should address the campaign to promote financial awareness, the protection of financial service recipients, SMEs' support, micro-finance services and online payments. Further targeted aspects are female financial inclusion.

The authorities have further launched a project on spreading financial and banking literacy among the population. In particular, financial and banking literacy courses will be integrated in the school curriculum from the seventh grade onward. Moreover, the mass media will also be used to enhance the financial literacy of, in particular, women and people in rural areas (CBJ, 2014).

Further, in 2016 the Central Bank of Jordan issued the first so-called Individual Savings Bonds (IBSs). The IBSs provide an interest rate of 4.25%, which is higher than the general interest rate applied on deposits. The IBSs are designed to encourage individuals to save. The underwritten amount of IBSs approximated JD 28 million. (€36.2 million) (CBJ, 2016).

The provision of credit services to people otherwise excluded by the credit market, also known as microfinance, is an important sector in Jordan. Microfinance first started in Jordan in 1998, thanks to the project Access to Microfinance and Improved Implementation of Policy Reforms (AMIR), financed by USAID for around US$ 40 million (€36 million). It was the fourth largest in the region, in terms of outreach (Sanabel, 2010). In 2013, the total gross loan portfolio of microfinance institutions (MFIs) was US$ 173.2 million (€130 million).

Table 6: Main facts of the microfinance sector in Jordan (2010-13)

Year	Gross loan portfolio	Active loans	Active borrowers
	JDm (€m)	(nr)	(nr)
2010	64.2 (68.3)	177,128	167,590
2011	76.7 (77.7)	221,931	200,754
2012	101.8 (111.8)	272,411	243,793
2013	122.9 (130.6)	302,840	282,631

Source*: Jordan Microfinance Network – Tanmeyah*

The microfinance sector has expanded both in terms of outstanding loan portfolios and in terms of the number of active borrowers. The microfinance sector experienced further growth in 2014 and has reached a total lending portfolio of JD 158 million (€168 million), which has increased to JD 180 million (€233 million) in 2015 (CBJ, 2014).

The sector is characterised by a plurality of actors, with different legal status. In particular, the not- -for-profit licensed companies operating in the sector are Alwatani (National Microfinance Bank), Middle East Microcredit Company (MEMCC), Microfund for Women (MFW), Tamweelcom, and Vitas Jordan (former Middle East Micro Credit Company). In turn, the for-profit companies are Al Ahli Microfinance Company (AMC), Al Amin, and FINCA Jordan. Further institutions providing microfinance services are the United Nations Relief and Works Agency for Palestine Refugees in the Near East (UNRWA) and the governmental Development and Employment Fund, Reyada (DEF). Also Cairo Amman Bank, a commercial bank, has started providing microfinance.

The market is becoming more transparent, with the most important companies reporting to Sanabel, the Microfinance Network of Arab Countries, and/or to MIX Microfinance World.

The authorities in Jordan are aware of the importance of the microfinance sector for alleviating poverty and, therefore, much effort has been undertaken over the past years to regulate this sector. The first National Microfinance Strategy, prepared in 2005, was updated in early 2011, under the leadership of the Ministry of Planning and International Cooperation (MoPIC). Since 2013, the Central Bank of Jordan has also extended its supervising authority to the microfinance sector. The legal framework and the regulation for the microfinance sector was approved in 2015 (Microfinance Bylaw No. 5 for 2015).

The reform of this sector is inspired by the G20 Principles for Innovative Financial Inclusion. In 2013, the European Union budgeted €35.2 million to support financial and technical assistance to the Microfinance reform process, aimed at developing and implementing a Financial Inclusion Strategy (Tanmeyah, 2013).

Since the deep financial crisis of 1989, several institutions have been established with the aim of improving the stability of the banking sector and increasing confidence in it. Among these non-banking financial institutions, there are the Jordan Loan Guarantee Corporation and the Deposit Insurance Corporation.

The Jordan Loan Guarantee Corporation was established as a public shareholding company in 1994, with a paid up capital of JD 7 million (€8 million). In 1997, the capital was increased to JD 10 million (€12 million) and then increased to JD 29 million (€37 million) at the end of 2016. The main objective of the Jordan Loan Guarantee Corporation is to support SMEs and export credit in providing creditors with loan guarantees. In 2015, the corporation guaranteed 872 loans with a value of JD 54 million (€69 million). The corporation also provides important support to the exporting sector, via its Export Credit Guarantee Programme. In 2015, under this programme, 1,083 shipments for an overall value of JD 54 million (€69 million) were guaranteed.

The Deposit Insurance Corporation was established in 2000, as a financially and administratively independent corporation with the aim of protecting bank depositors, encouraging savings and, herewith, increasing the stability of the banking sector. The deposit Insurance Corporation's main duty is to reimburse members with a maximum coverage limit of JD 50,000 (€64,000) per depositor that the Central Bank of Jordan decides to liquidate. After an amendment to the Insurance Corporation Law in 2016, the Deposit Insurance Corporation was enabled, to also insure Islamic bank depositors. The deposit protection covers about 75% of all deposits.

Jordan can be considered as one of the first countries which gave attention to Islamic finance through the creation of the Orphans Fund Development Corporation, a fund for orphans' assets to be managed in accordance with the principles of Sharia, the Islamic law.

In 1978, a temporary law to rule the establishment of the first Jordanian Islamic bank, namely the Jordan Islamic Bank, was issued and in 1979 the bank started its operations. With 73 branches, around JD 4.2 billion (€5.4 billion) total assets, and with profits before tax of around JD 73.7 million (€95.5 million), the Jordan Islamic bank can be currently (2015) considered as the biggest Islamic bank in Jordan. The Hashemite Kingdom of Jordan was among the first countries to introduce the concept of Muqaradabonds, which were thought to be and encompassed by the temporary law of the Jordan Islamic Bank of 1978 as one of the tools to be adopted for long-term funding of major projects. In 1997, the Arab Islamic Bank was established as an independent Islamic bank in its goals and objectives. In 2009, the Jordan Dubai Islamic Bank was also established. Then, in 2011, the Saudi Al Rajhi Islamic Bank started providing banking services in Jordan.

Recently, Jordan has witnessed the emergence of a new generation of Islamic financial institutions, including First Finance Company, Isra Investment Company, and Islamic Finance.

Table 7: Selected indicators on Islamic banks operating in Jordan (2014)

	Foundation	Branches	Liquidity ratio	Capital (JDm)	Assets (JDm)*	Net profit after tax (JDm)*	Capital (EURm)	Assets (EURm)	Net profit after tax (EURm)
Islamic International Arab Bank	1997	36	0.45	140	1,569	13.4	132	1,479	12.6
Jordan Islamic Bank	1979	62	0.35	150	3,555	45.1	141	3,351	42.5
Jordan Islamic Dubai Bank	2010	15	0.29	100	658	1.9	94	620	1.8
Al Rajhi Bank	2011	3	-	50	354	1.7	47	334	1.6
Total		116	-	440	6,136	62.1	415	5,783	58.5

Note*: * 1 JD=1.401 US$, fixed exchange rate.*

Source*: Amman Stock Exchange.*

The Jordanian Banking Law of 2000 also regulates in detail the modalities of operations and the establishment of Islamic financial institutions, which are considered as commercial banks and, thus, similarly under the supervision of the Central Bank of Jordan. Thus, also concerning the regulation of Islamic finance and integration into the banking system, Jordan was among the first countries.

In 2012, with the Islamic Finance Sukuk Law, Jordan has also regulated this financial instrument, which should be in full compliance with Sharia principles and should represent, for Islamic banks and Islamic financial institutions, a viable strategy for financing projects and/or investing and which should, herewith, enable banks and companies to diversify their sources of income.

Besides different types of accounts, Islamic banks offer financing and banking services. The main products offered hereby are the following:

- *Murabaha sale*, which is an interest free sale of a property between the bank and its client. The sales price includes a profit margin, pre-agreed by both parties;
- *Lease ending in ownership*, which applies to real estate and machinery. The bank purchases the entity and then leases it for a period of time to the client. After having paid the lease for the agreed amount of time (building in a profit margin), the entity becomes the property of the client.
- *Musharakah*, which is contract based on a partnership to share profits and losses on a pre-agreed basis.
- *Mudarabah* is a device to finance projects and commercial operations on the basis of an equity based contract.
- *Sukukor Islamic bonds*, which are shares in assets.

FINANCIAL DEVELOPMENT AND INCLUSION IN MOROCCO

Idriss Elabbassi, Aziz Ragbi and Said Tounsi

Morocco's financial sector is relatively large compared to other economies in the region. At the end of 2015, the size of total assets in the Moroccan financial system reached 186% of GDP. The composition of the financial system has been quite constant over the past decade. The banking sector is responsible for about two-third of assets in the financial system, but accounts for only 25 institutions, with 19 commercial banks and 6 offshore banks. The remainder of the financial system consists of (re)insurance companies (18) and other non-bank financial institutions (51), such as finance companies (34), micro-credit institutions (13), and pension funds (4).

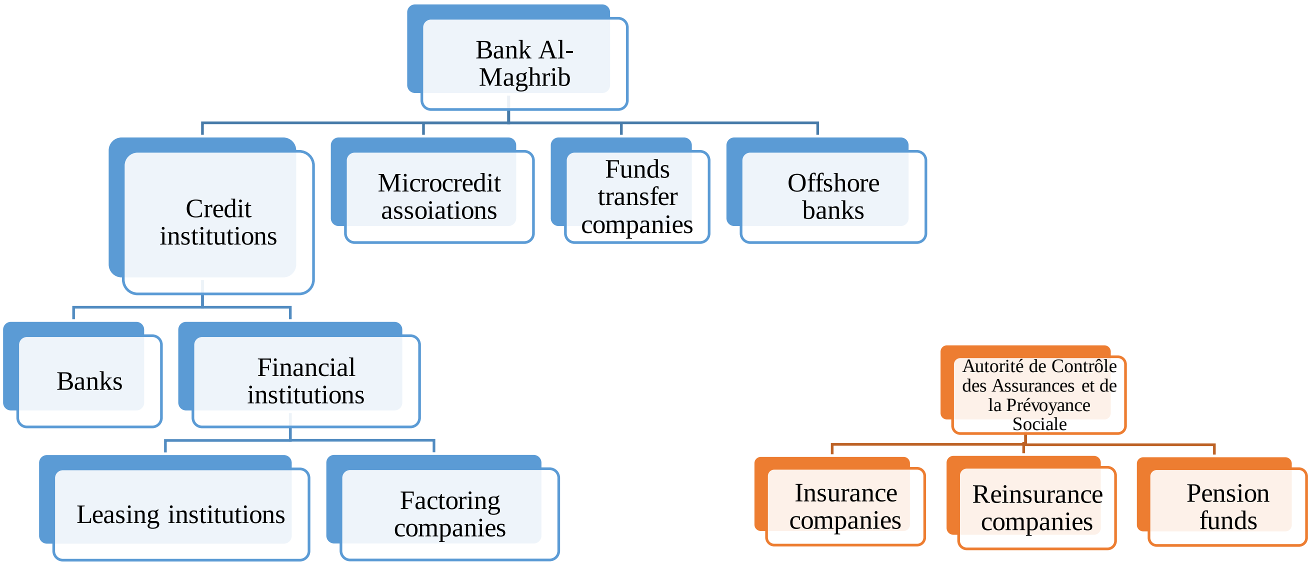
The financial system has proven resilient to the 2007-09 global financial crisis. This is primarily because the Moroccan banking sector has limited international links, i.e. limited private and public foreign assets and debt (IMF, 2016a). This is partially due to capital controls and an exchange rate peg. The local currency, dirham, is pegged to a basket of currencies consisting 60% of Euros and 40% of US dollars. In the summer of 2017, the central bank of Morocco, Bank-Al-Maghrib (BAM), announced the start of the process of convertibility of the national currency (Dirham) in the upcoming years.

FINANCIAL SECTOR STRUCTURE

The Moroccan financial sector is bank dominated. Indeed, the Moroccan banks account for about 140% of GDP. There are in total 19 banks in Morocco, but the three largest banks control more than two-thirds of banking assets.

Besides the 19 banks, there were at the end of 2015, 34 finance companies, 6 offshore banks, 13 associations of microcredit, 10 intermediate companies transferring funds, Caisse de Depot et de Gestion (CDG) and the Caisse Centrale de Garantie (CCG).

Figure 20: Moroccan financial system organisation



***Source**: Authors' elaboration.*

The Moroccan banking sector plays a central role in the Moroccan financial sector. The combined total of 19 banks had total assets equivalent to 116% of the domestic GDP at the end of 2015.

The large majority of the banks have private owners, including Moroccan private groups, insurance companies, social security bodies, and foreign banking groups. In total, seven banks are foreign owned. French banking groups control most of the foreign banks, but there are also banks from the United States, Jordan and Spain that control banks in Morocco.

Table 8: Key indicators Moroccan banking sector (2011-15)

	2011	**2012**	**2013**	**2014**	**2015**
Total assets (% of GDP)	118	123	122	120	116
Average yield of assets (%)	5.22	5.16	5.19	5.49	4.82
Average cost of liabilities (%)	1.93	1.95	1.98	1.94	1.59
Average operating ratio (%)	48.0	47.5	47.7	46.1	49.1
Return on assets (ROA) (%)	1.1	1.0	1.0	0.9	0.8
Return on equity (ROE) (%)	13.4	11.8	10.6	10.2	9.1
Equity ratio (%)	8.0	8.5	8.6	8.9	9.1
Loans to deposits (%)	98.7	101.0	100.6	95.3	91.6

Non-performing loans rate (NPL) (%)	4.8	5.0	5.9	6.9	7.4
NPL coverage ratio (%)	69.0	68.0	64.0	65.0	68.0

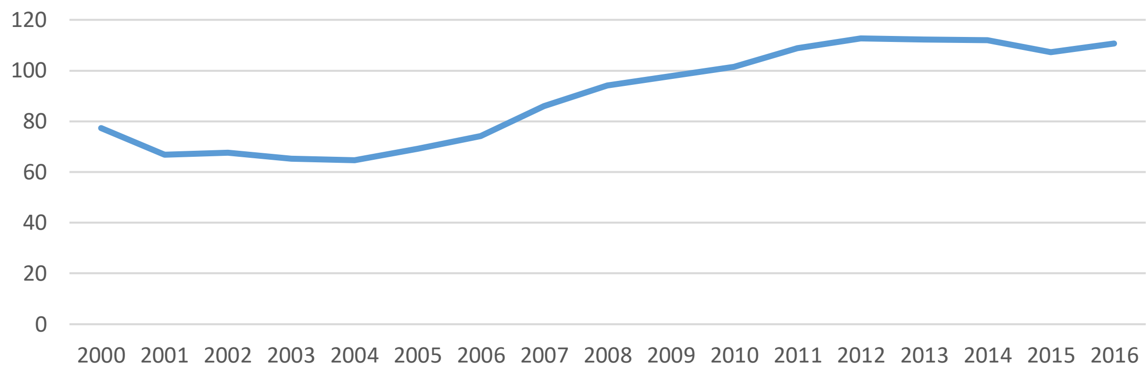
(1) Including loans to finance companies

***Source**: Bank Al-Maghrib - Banking Supervision Report.*

The Moroccan banks also have substantial activities abroad. In total they have 41 foreign subsidiaries and 18 branches, in particular in Sub-Saharan Africa. The banks have almost 1,500 banking agencies, of which the majority is located in West Africa (56%), Eastern and Southern Africa (15%) and Central Africa (7%). There are also some agencies in other North African countries (15%) and Europe (7%). In addition, there are 50 representative offices, of which the large majority are based in Europe.

The largest three banks dominate the Moroccan banking sector. Attijariwafa, GBCP, and BMCE collectively contribute around 61% of the total assets. When the top five is considered, those banks account for around 77% of total assets. The level of concentration has been fairly stable.

Figure 21: Domestic credit provided by financial sector (% of GDP)



***Source**: World Bank WDI (2017).*

The credit portfolio of Moroccan banks has been fairly stable for a few years. Domestic credit, provided by the Moroccan financial sector, grew as a share of GDP from 2004, coming to a standstill after the Arab spring in 2012. Between 2012 and 2016, domestic credit as a share of GDP has been stable, at around 110%. Non-performing loans have surged in recent years. The slowdown in the loan growth also led to a decrease in loans as a share of deposits.

Deposits remain the main funding source of the banks, providing stable and relatively cheap funding. Banks rely mainly on non-interest-bearing sight deposits (around 60% of deposits), while time deposits are less relevant and relatively short term. Nowadays, funding costs from deposits is below 2%, while alternative funding is significantly more expensive.

The performance indicators for the Moroccan banking sector look relatively sound. The margins have remained fairly constantly high, primarily due to low funding costs. The main concern is the growing stock of non-performing loans. They are largely covered with provisions, which are reducing profitability.

Turning to the capital markets, the Casablanca Stock Exchange is the only stock exchange in Morocco. It delivers only a marginal contribution to the financing of the economy. In fact, it contributed in recent years less than 10% of the total financing of the economy. Moreover, Moroccan banks are also playing a crucial role in the capital markets. In total, twelve banks are listed on the stock exchange, which represented about 40% of total market capitalisation at the end of 2015.

The Casablanca Stock Exchange remains underdeveloped. The stock market has not achieved its full potential for resource allocation, as banks continue to be the preferred source of financing for the private sector. The market capitalisation of domestic listed companies has actually decreased in recent years. Domestic listed companies still had a market value around 75% of GDP at the end of 2010, which decreased to around 50% of GDP. The market is also fairly illiquid, with trading volumes of 6% of total shares outstanding per annum.

The number of companies listed on the Casablanca Stock Exchange has remained relatively stable for years, at just over seventy companies. The market is fairly concentrated. The largest listed company by market value, Maroc Telecom (Itissalat Al-Maghrib - IAM), in 2014 accounted for 21% of market capitalisation, for instance. Moreover, the five largest listed companies represented almost 60% of total market capitalisation (IAM, AWB, BMCE, BCP and Lafarge cement).

In addition, the analysis of the concentration by economic sector highlights the importance of the banking sector (35%), the telecommunications sector (21%) and the construction industry and building materials (12%), which accounted for 68% of market capitalization in 2014.

Moreover, the total funds rose through initial public offerings (IPOs) and new issuance of capital instruments remain low. The IPOs that take place historically attract a lot of interest from investors, but after issuance, liquidity is rather limited. In particular, the small caps lack liquidity. Volumes and prices move in parallel. In fact, downturns are accompanied by very low volumes, which negatively impact liquidity. In addition, overheating affects characterise periods of rising share prices.

Although there are no restrictions to participation in the primary and secondary market for foreign investors, their presence remains rather marginal.

The onshore derivatives market is fairly active. It mostly consists of foreign exchange forwards, interest rate swaps, and forward rate agreements. Forward exchange contracts and cross-currency forwards of unlimited maturity have been available to financial operators since 2008, following liberalisation reforms, and resident brokers can contract interest rate swaps of up to two years. Foreign exchange options are limited to a maximum tenure of 12 months and the onshore market is subject to a 0.1% foreign exchange tax. The offshore market is small and limited to spot and forwards with maturities of up to two years.

The debt securities market is, like in most countries, less developed than the equity market. Public sector bond issues dominate the corporate debt securities market, while private sector corporate issues remain marginal. Both financial companies and non-financial companies issue private debt securities. Financial companies, in particular banks, had more debt securities outstanding (9.3% of GDP) than non-financial corporations (6.9% of GDP) at the end of 2015.

Mutual funds form a substantial share of Moroccan capital markets. The number of operating mutual funds reached 384 at the end of 2014, including 45 open-ended Investment Companies (SICAVs) and 339 common investment funds (FCPs). The largest share of mutual funds consists of Intermediate and long-term bonds (ILTBs), which accounted by the end of 2014 for 141 funds and 50% of net assets. The total net assets of all the mutual funds amounted to around MAD 300 billion (or €27 billion) at the end of 2014.

Morocco also has a number of non-bank financial institutions, including (re)insurance companies, leasing companies, micro-credit institutions and pension funds.

The Moroccan insurance sector is the second largest on the continent, after South Africa, and has continued to grow in recent years. The total insurance premiums stood at 3.5% of GDP in 2016 (Swiss Re, 2017). Non-life insurance is responsible for about two-thirds of premiums, whereas life insurance generates the remaining one-third of premiums. Car insurance, workers' compensation and personal insurance collectively represent about 84% of total premium volume. The Moroccan insurance sector has a comfortable solvency margin.

There are 18 insurance companies active in Morocco. The sector is quite concentrated, with the three largest insurers accounting for more than 50% of the market share. Most of the insurers are foreign owned. AXA Assurance Maroc and Zurich Assurances Maroc are two of the international insurers in this domain and Wafa Assurances and Atlanta are two of the major domestic insurers.

The total assets of the insurance sector represented around 20% of GDP in 2009. This is comparable to the total assets of insurance sectors in other MENA countries.

Leasing companies make up a fairly small share of the financial system. They represented over MAD 40 billion in total assets (€4 billion) at the end of 2013. Equipment leasing operations, constituted almost two-thirds of the total assets, although the share of property leasing is increasing.

POLICIES FOR FINANCIAL SECTOR DEVELOPMENT

Morocco has conducted several reforms to make the financial system more competitive and public interventions more consistent in recent years. These approaches include reforming the banking sector, financial markets, as well as monetary and exchange rate policies.

Bank Al-Maghrib (BAM) is the central bank of Morocco, responsible for both monetary policy and the prudential regulation and supervision of most financial institutions in the country. Besides commercial banks, this includes offshore and Islamic banks. The monetary policy of the bank is focused on price stability. The supervisory responsibilities include, for instance, assessing whether the financial institutions fulfil the regulatory requirements.

Even though the Moroccan financial system weathered the financial crisis quite well, regulation and supervision has been strengthened in line with new international standards. Indeed, BAM has committed to enhance the resilience and robustness of the domestic banking system with more stringent regulation and supervision, including the gradual adoption of the Basel III standards for capital adequacy and liquidity[9] and improved bank resolution.

BAM follows a risk-based approach in banking supervision. Based on various criteria such as asset quality, solvency, liquidity, profitability, governance and sensitivity to market risks, BAM determines the riskiness of a particular bank. When a bank is considered riskier, it is subject to more intense supervision (e.g. on-site inspections, preventive actions). In addition, the central bank is also responsible for the recovery and resolution of distressed banks. BAM has, as the resolution authority, the powers to assign an interim administrator as well as to sell assets, bridge bank or bad bank.

[9]The Tier 1 capital to risk-weighted asset ratio requirement has been increased to 9% and the regulatory capital adequacy ratio to 12% (effective June 2013).

In total, more than eighty institutions are subject to the central bank's supervision. These include 19 banks, 35 finance companies, 6 offshore banks, 13 microcredit associations, 9 fund transfer companies, the Caisse Centrale de Garantie and the Caisse de Dépôt et de Gestion.

The Société Marocaine de Gestion des Fonds de Garantie des Dépôts Bancaires (SGFG) is the institution taking care of the execution of the deposit insurance scheme. The deposit insurance scheme is depending on both ex-ante and ex-post contributions from banks. More specifically, it manages the collective guarantee funds for deposits of conventional banks and participative banks (Islamic banks or sukuk) as well as direct bank recapitalisation to failing banks in special circumstances.

The Autorité Marocaine du Marché des Capitaux (AMMC) is the financial markets authority of Morocco. It needs to ensure the protection of savings invested in financial instruments. This is based on the principle of equal treatment, transparency, integrity of capital markets and investor protection. The AMMC is a government agency with financial autonomy. For this purpose, it controls the activities of stockbrokers, collective investment funds and financial market infrastructure.

The Autorité de Contrôle des Assurances et de la Prévoyance Sociale (ACAPS) is responsible for the supervision of insurance companies and pension funds. ACAPS is, like AMMC, one of the government agencies with financial autonomy.

In recent years, significant progress has been made in the supervision of insurance companies. Regulation is based on the EU insurance directives, including advanced provisions on corporate governance and internal controls.

All the above mentioned micro prudential supervisors are part of the Comité de Coordination et de Surveillance des Risques Systémiques (CCSRS). The committee replaced the financial sector supervision coordination committee. CCSRS is responsible for the coordination of macro prudential measures to foster the stability of the financial sector. Moreover, it is also responsible for coordination and information exchange with foreign supervisors. The BAM delivers both the chair and secretariat of the committee.

There have been several rounds of structural reforms in the financial sector in the past couple of decades. The main aim of these reforms was to create a solid and efficient financial system. The reforms covered the banking sector, financial markets, monetary authorities and exchange rate policies. The initial rounds of reforms were primarily oriented at making the markets more competitive, for example, via the privatisation of some of the previously government controlled banks. In recent years, the focus of the reforms has shifted somewhat, to aligning the Moroccan financial legislation with international standards.

Morocco follows international regulatory and supervisory standards in most fields. International standards have changed substantially in the aftermath of the 2007-09 global financial crisis. This required the Moroccan central bank to update their financial legislation as well. Given the bank dominance in the financial sector, in particular the revision of the legislative framework for banks, was important. The new banking law adopted in 2014 aligned the legislative requirements to the Basel standards. This includes, among others, supervision of systemically important banks, a resolution mechanism for distressed banks and enhanced coordination among supervisors (IMF, 2016).

The legislative requirements for Moroccan banks are, in most cases, above the minimum levels embedded in the international standards. The large exposure requirement is, for example, restricted at 20% of capital instead of 25%, and minimum capital requirement 10% instead of 8%.

The central bank has identified the three largest banks in the country as systemically important. The main determinants of systemic importance are the size, interconnectedness and cross-border activities. The legislative requirements for the systemically important banks are more stringent. They need, for instance, to prepare their own resolution plan and will be subject to a capital surcharge (IMF, 2016b). There are no provisions for the resolution of financial market infrastructures and insurance companies (IMF, 2016b).

Moreover, the new banking law that was published in 2015 also included provisions for cross-border coordination of banking supervision. The cross-border expansion of Moroccan banks presented new challenges for the supervisor. The new banking law allows BAM to close agreements with banking supervisors in other countries on the exchange of information, on-site inspections and to create supervisory colleges. In addition to the standard agreements on information exchange and participation in supervisory colleges with central banks, BAM also has a few agreements with central banks on crisis management (IMF, 2016c).

In addition, a crisis committee has been established to coordinate the actions of the authorities involved in financial crises. The committee is primarily interested in crises that might require financial injections from the government. The Minister of Finance chairs the committee that has been active since 2012 and has several other members, with the Governor of BAM, director general of AMMC and director of ACAPS (IMF, 2016).

FINANCIAL INCLUSION AND ALTERNATIVE SOURCES OF FINANCE

In recent years, the promotion of financial inclusion has become a major focus for BAM. A strategy for financial inclusion has been adopted for the development of the financial sector by 2020, which includes several measures related to the promotion of banking services for low-income populations, such as financial education and microfinance.

Raising public awareness of the importance of financial services, financial education contributes to the improvement of their living standards, allowing them to better understand these services and better manage their income and savings. In this regard, in 2012 the central bank created the Moroccan Foundation, which aims to promote the principles and best practices related to financial education and awareness of an understanding of financial services and means to prevent risks.

To further enhance access to finance for micro-businesses, Bank Al-Maghrib has undertaken several measures including the removal of barriers to access banking services, including free access to basic banking services. Moreover, it has also improved the monitoring of SME funding with an observatory. The aim of the latter is to collect and share reliable data on micro-businesses, to provide appropriate solutions to their problems.

BAM has further committed to realising strategies to improve the services and distribution of banking services for the low-income population. Indeed, commercial banks were directed to expand their branch networks and develop suitable products that respond to the needs of the low-income population. In response, commercial banks have developed partnerships with micro-credit associations, i.e. the possibility for customers of these intermediaries to carry out transactions of deposits and cash withdrawals, money transfer, the transfer and payment of bills.

In addition, BAM has also set up several initiatives to enhance financial inclusion. The initiatives ranged from promotion of a modern credit bureau helping prevent over-indebtedness, to specific measures for transparency in bank services. The BAM, supported by the Ministry of Finance, is keen to initiate work on a national financial capacity strategy.

The Financial Capability and Inclusion Survey in Morocco of the World Bank (2014a) provided key diagnostics to design such a strategy. The survey covered four main areas:

- *Financial inclusion:* Based on the survey, around 41% of adults use formal financial products or services. However, within Morocco there are large differences in financial inclusion across various segments of the population. There seems to be a divide across gender, income and geography. Indeed, women as well as households with a low-income and in rural areas, are the most likely to be underserved. In fact, only 28% of the adult population, 21% of women, and 10% of the population with a low-income, has a bank account. Moreover, more than two-thirds of the population is seen to be familiar with Microfinance, but this only extends to 5% of the adult population. A relatively large share of the Moroccan adult population (24%) uses insurance products, but in the large majority of the cases this is due to mandatory coverage and only voluntary in less than 10% of cases.

The high costs of financial services are considered one of the main reasons for the low penetration of bank accounts and other financial products. This would stem from a lack of competition (Demirguc-Kunt and Klapper 2012) as well as low-cost basic banking services being unknown to many. Moreover, the further development of mobile and agent banking could help to reduce the costs of financial services and serve the currently underserved better.

- *Financial capability:* Popular knowledge of basic financial concepts is fairly low in Morocco. While 90% of Moroccans can perform simple divisions, only 40% understand how inflation affects their savings, and only 20% can solve slightly more difficult numeric tasks in order to identify better bargains. International comparison shows, however, that Moroccans are becoming competent in choosing financial products, but they are still struggling with managing daily expenses and retirement savings. But financial literacy, skills, and awareness of financial products are quite unevenly distributed in society, and especially lag behind among rural Moroccans, the young, the unemployed, and those who never finished primary school. Moreover, the public education system provides little, if any, financial education opportunities.
- *Relationship between Financial Inclusion and Financial Capability:* The part of the population that saves and borrows from formal institutions is more aware of financial institutions and their offerings than the population that does not save or borrow from these institutions. The awareness about financial concepts, as well as behaviour, is nevertheless similar between both groups. This might be partially due to the fact that Moroccan financial service providers are not offering products that enhance the financial literacy of their customers.
- *Financial Consumer Protection:* There is a low confidence amongst Moroccans in financial institutions and especially banks. This might at least partially be explained by the many conflicts between financial service providers and customers. In fact, about 25% of Moroccans that participated in the survey experienced conflicts. Most of the Moroccans did not take action, but of around 40% that do, more than two-thirds ask for assistance

from relatives, friends or other people in the community. In particular, the complaints of women and the rural population often lead to exclusion from the financial service after the conflict.

Despite the initiatives of BAM and the banking sector, a large share of the population and businesses remains excluded from traditional financial systems, partially because of their low bankability – low or volatile income and no or limited collateral available. This part of the population and private sector are the main customers of the microcredit sector.

Microcredit sector is growing but the penetration rate remains low. The microcredit sector consisted of a total of 13 associations in 2014, which had 863,071 beneficiaries, 1,536 contact points and 6,000 employees. But the three largest associations grant more than 90% of the microcredit. The large majority of the microcredit was granted to micro-enterprises (89%), which were in most cases located in urban areas (67%). The ratio of outstanding microcredit represents about 0.6% of GDP.

Beyond the microcredit sector, the Caisse Centrale de Garantie (CCG) was founded in 1949 as a public sector institution fulfilling a mission of general interest. It represents the main government arm in charge of the public credit guarantee scheme. The institution covers three major activities: guarantee, joint financing and equity. It plays a central role in enabling SMEs to access finance.

The CCG has a comprehensive product portfolio that encompasses the entire life cycle of the firm, from its establishment to its transmission and restructuring. Most indicators show a steady growth in activity over the last decade. The ratio of guaranteed credit to total bank loans to MSME was around 12% in 2012 and outstanding guarantees representing around 0.7% of GDP.

Finally, Islamic finance or participatory banking has only recently been foreseen within a legislative framework, but is rapidly growing in importance. With the regulatory and supervisory framework that was adopted in 2015, BAM fulfilled the promise of the Islamic party-led coalition. In addition, within Morocco's Supreme Council of Islamic Scholars, a board was installed to oversee the conformity of financial products and services to Sharia law.

From the beginning of 2017, BAM approved five banks to provide Sharia-compliant financial services, including Attijariwafa, Banque Centrale Populaire, BMCE Bank of Africa, CIH Bank and Credit Agricole du Maroc. In addition, BAM has also granted subsidiaries of French banks permission to offer Sharia-compliant financial services, including Société Générale, BNP Paribas and Crédit Agricole. It is expected that in the upcoming period several additional banks will receive permission to provide Sharia-compliant financial services.

FINANCIAL DEVELOPMENT AND INCLUSION IN TUNISIA

Rania Makni, Soumaya Ben Khelifa, Olfa Benouda Sioud and Dorra Mezzez Hmaied

The Tunisian financial system is composed of banks, insurance companies and other financial institutions as well as financial markets institutions and, recently, microfinance institutions. The banks, however, dominate the system representing almost 90% of total assets, whereas the stock market only contributes about 9%. The financing of the private sector and, in particular SMEs that form the backbone of the Tunisian economy, continue to face difficulties in accessing finance.

Tunisia was among the first countries in the Middle East and North Africa (MENA) region to introduce financial reforms. The Tunisian financial sector was strictly controlled until the mid-1980s. Since then, it has undergone three decades of progressive reforms, however, these reforms are considered insufficient. They have not succeeded in achieving growth and development for the real economy - although the banking sector has been subject to multiple reforms, the last of which was in 2016.

The financing of the private sector and, essentially of SMEs, remains an important problem for Tunisia. SMEs are under financed and face difficulties in access to finance. The Tunisian economy is mainly composed of SMEs, which have to develop in order to create employment.

According to the African Development Bank, the poor performance of the banking sector is a major challenge for the Tunisian economy. Poor governance in the sector has contributed to inadequate risk monitoring and a low diversification of credit portfolios. The non-banking financial institutions and markets are underdeveloped. Capital and fixed-income securities markets remain quite modest.[10]

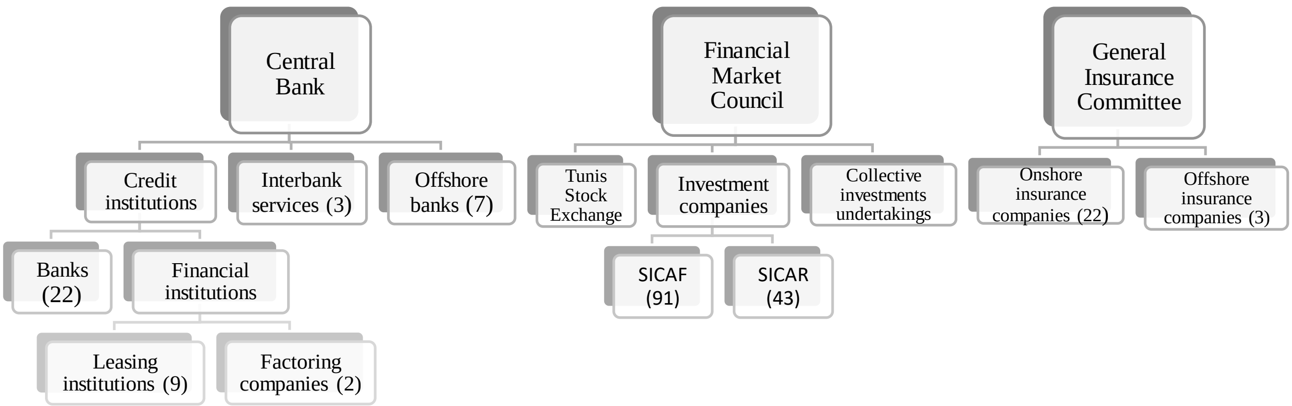
FINANCIAL SECTOR STRUCTURE

The Tunisian financial sector is relatively small and bank dominated (IMF, 2012). Lending institutions' assets were about 116.6% of total assets/GDP in 2015. The non-banking sector is, however, relatively small.

[10] African Development Bank's 2016 Annual Report for North Africa - Addressing Together the Bank's High 5 for Transforming North Africa.

The financial market is relatively small and is made up of the Tunis Stock Exchange, investment companies and collective investment undertaking. The Tunisian insurance industry is comprised of onshore and offshore insurance companies. The banking sector consists of credit institutions, interbank services and offshore banks.

Figure 22: Tunisian financial system (2015)



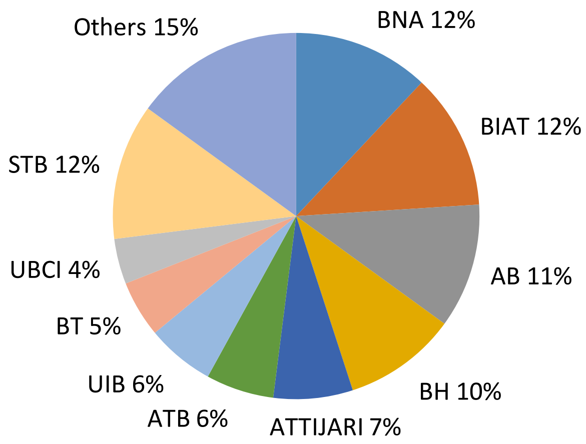
***Source**: Tunisian Central Bank (2015).*

The number of resident banks has remained stable in the past couple of years. According to the Tunisian Central Bank, there were 22 licensed resident banks at the end of2015. The total number of banks in 2015 was the same as in 2010; only one bank turned into a resident bank, from being a non-resident bank previously.

The banks have expanded their branch and agency networks in recent years. In fact, they have opened many new branches, in recent few years, and there is one bank branch per 7,400 inhabitants.[11] The network of bank branches increased by 25% in recent years, to 1,700 branches by the end of 2015.

[11]Notes et Analyses de l'ITCEQ n° 27 - mai 2015.

Figure 23: Commercial banks in Tunisia and their market share (end-2014)



***Source**: EIB.*

The banking sector is mainly composed of private and mixed ownership banks. Public banks also play an important role in financing the economy. There are three public banks, including BNA, STB and BH.[12]

Economic instability, following the revolution, has revealed the fragility and structural weaknesses of the banking system, in particular for state-owned banks. The banking sector is quite concentrated. The largest five banks represent about 57% of total market assets. The Tunisian banking sector suffers from low competition (World Bank, 2014b). This is due to the inefficient bankruptcy and collateral regimes, a weak regulatory and supervisory framework and weak governance of public banks. Furthermore, Tunisian banks are the main financing source.

Table 9: Key indicators for Tunisian lending institutions before and after the Arab spring

	2010 (ex-ante)	**2015 (ex-post)**
Structure and size		
Number	42	43
Resident banks	21	22
Non-resident banks	8	7
Leasing institutions	9	9
Factoring institutions	2	3
Merchant banks	2	2

[12]BNA: Banque Nationale Agricole; STB: Société Tunisienne de Banque; BH: Banque de l'Habitat

Total assets (in €bn)	34.0	44.4
Resident banks shares (in %)	89.9	92.3
Loans to the clients (in €bn)	21.9	29.0
Clients deposits (in €bn)	19.9	24.2
Bank branch network	1,337	1,700

Source: *Tunisian Central Bank (2015).*

The outstanding loan balance follows a positive trend during the period between 2010 and 2015. The sectoral breakdown reveals an increase in proportion of loans granted to both private and public companies. New loans were granted, particularly, to the Tunisian oil company (ETAP) and the Tunisian Electricity and Gaz Company (STEG) in order to finance their projects, as well as to the Cereal Office (OC). The Tunisian services sector receives the largest share of loans (59%) followed by the industry sector (36%), whereas the agriculture & fishing receives the lowest share (only 4.6%).

The outstanding balance of professional unpaid and disputed claims increased to TND 7.4 billion (€3.3 billion) in 2015. The sectoral breakdown shows that the services sector has the largest share of unpaid and disputed claims (59.7%) followed by the industry sector (30.7%).

The evolution of domestic credit posted a slight increase between 2010 and 2015. Thus, the banking sector continued to finance different institutions, despite the country's difficult economic situation. Domestic credits provided by the banking sector (as share of GDP) reached its highest value in 2015 (90.2%), while its lowest value was 40.6% in 1972.

Bank deposits increased in the period from 2000 to 2010 and stabilised in the aftermath of the Arab spring. Savings from individuals and private companies still increased, while institutional and non-residents withdrew deposits, according to the Tunisian Central Bank.

The Tunisian banking sector suffers from a significant proportion of non-performing loans (NPLs) and partly to inadequate capitalisation. The NPL ratio of Tunisian banks was 16% on average at the end of 2014, but there are large differences between private and public banks, with average NPLs of 9.7% and 24.9% respectively. The poor asset quality and consequential poor performance degrade the capital position of Tunisian banks. However, the central bank authorised public banks to continue operating, despite breaching the minimum capital adequacy requirement. More recently, in 2015, the parliament approved the recapitalisation of two public banks. In 2015, STB received TND 757 million (approximately €342 million) and BH received TND 110 million (approximately €50 million). More recently in March 2017, the government indicated that the three public banks may be privatised.

In terms of prudential norms, Tunisian banks have not fully implemented Basel II. The Tunisian Central Bank is currently in the process of reforming banking supervision, in cooperation with the IMF through a technical assistance programme. The banking regulation should be in line with the Basel III capital standards by 2020. The banks need to improve their IT systems sector, to allow risk-sensitive capital requirements to be calibrated (EIB, 2015).

Table 10: Key financial indicators (2011-14)

Financial Indicators	2011	2012	2013	2014
NPLs to total loans (%)	13.3	14.9	16.5	15.8
Provisions for NPLs (%)	48.6	45.7	56.7	57.6
Return on Assets (ROA) (%)	0.6	0.6	0.2	-
Return on Equity (ROE) (%)	5.9	7.2	2.9	-
Liquidity assets to total assets (%)	26.5	28.2	28.4	28.2
Loans to deposits (%)	114.4	117.7	111.6	112.6

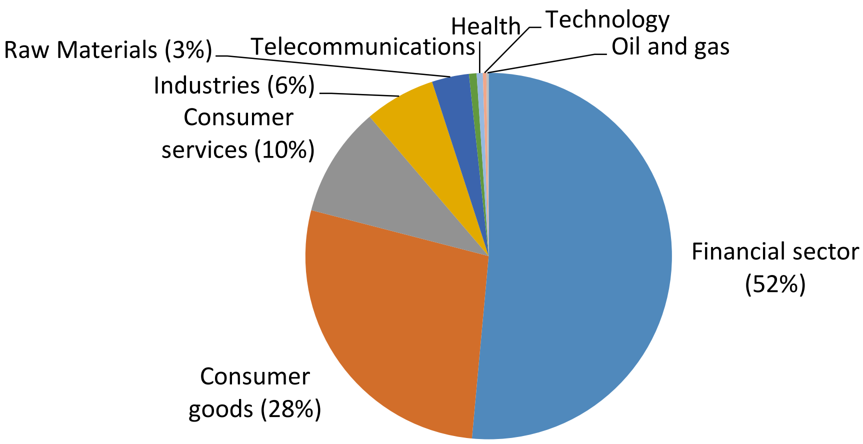
***Source**: BCT, 2014.*

The Tunisian capital markets are composed of an equity and bond market. This is the second financing source after the banking sector.

Equity markets do not contribute to the financing of the Tunisian economy as expected or needed. There are 78 companies (by the end of 2015) listed on the Tunisian stock exchange with a total market capitalisation of approximately TND 17.8 billion (approximately €8.0 billion). Funds raised on the primary market remain limited (1.7% GDP in 2015). The secondary market is illiquid and lacks depth, with market capitalisation representing on average around 20% of the GDP in the five past years.,

The alternative market to finance smaller companies, especially SMEs, was created in 2007. At the end of 2015 a total of 13 SMEs were listed on this market, benefiting from lighter admission requirements. The number of listed enterprises is, nevertheless, still limited.

Figure 24: Sectorial breakdown of market capitalisation (2015)



Looking at the types of companies, financial institutions and in particular banks, are the main category of listed companies. Banks, leasing companies and financial services account for 52% of market capitalisation. The 13 listed banks represent 42% of the total market value, followed by consumer goods and services sectors, with shares of 28% and 10% respectively.

Table 11: Main market indicators for the Tunis Stock Exchange (2010-15)

	2010	2011	2012	2013	2014	2015
Number of listed companies	56	57	59	71	77	78
Stock market capitalization (€bn)	8.0	7.5	6.7	6.3	7.6	8.0
Market capitalisation of listed domestic companies (% of GDP)	24%	21%	19%	19%	19%	21%
Foreign holding (% of total)	21%	20%	21%	22%	24%	..
Trading value (TND bn)						
Total market	2.0	1.6	1.4	1.7	1.1	1.8

***Source**: BVMT (2015).*

The Tunisian bond market is relatively underdeveloped. The bond market is open to companies and public authorities, which can issue debt securities with a maturity of more than 1 year. Corporate bonds represent 22% and government bonds represent 78% of the bond market, with a total value of TND 2.3 billion (€1.1 billion) representing 2.8% of GDP in 2015. The corporate bond market is dominated by banks and leasing companies. The secondary bond market is illiquid, showing a very low number of transactions. Government bonds are traded over-the-counter and represent approximately 96% of all bond trades.

Despite the increased number of mutual funds from 2010 to 2015, net assets of mutual funds investing in securities (OPCVM) represent 5.1% of the GDP in 2015. Bonds represent about 89% of overall operating OPCVMs' net assets (TND 3.9 billion or €1.8 billion at the end of 2015).

Table 12: Overview Tunisian mutual funds industry (2010-16)

Mutual funds (SICAV and FCP[13])	**2010**	**2011**	**2012**	**2013**	**2014**	**2015**
Number	98	106	111	115	119	125
Assets under management in (€bn)	2.7	2.7	2.4	2.0	2.0	2.0
Evolution in assets (%)	16.6	2.7	-6.0	-7.0	-0.2	-4.6
Assets of OPCVM (% of GDP)	..	8.1	7.0	6.0	5.7	5.1

Source*: BVMT (2013, 2015).*

The capital markets are composed of three bodies, namely:

- *The Financial Market Council (CMF)* is a regulatory and supervisory body that ensures the control of transactions and protection of investors.
- *The Tunis Stock Exchange (BVMT)* is responsible for the management of equity and bond markets.
- *Tunisie Clearing* is responsible of the deposit and compensation of securities. Its mission is to serve as the sole depositary for operations of delivery-settlement.

The non-bank financial sector is relatively small, including insurers and leasing institutions.

The Tunisian insurance industry is small but with huge potential for growth. In 2015, there were 25 insurance companies including three offshore insurers that operate for non-residents, twelve multi-line and ten specialised insurance companies (i.e. life [4], credit [2], Takaful [3], and re-insurance [1]).

The insurance industry is gradually recovering from the 2009 global financial crisis and 2011 Arab spring. Profits in the non-life segment fell sharply during the crises, but recovered in recent years. Insurance premiums grew at a compound annual growth rate of around 9% during the period from 2009 to 2014. In 2015, they amounted to 1.7 billion TND (€0.8 billion). Insurance penetration in Tunisia is low at just 1.9%, compared to the worldwide average of 7%.

[13]Exclusive of Venture capital mutual investment funds.

The General Insurance Committee (GIC) is the authority responsible for the regulation and the supervision of insurers.

The number of leasing companies has not changed in the last six years. In 2015, there were 9 leasing institutions in Tunisia, including 8 listed companies representing 3% of the market capitalisation. The listed leasing sector can be subdivided into two categories; six banks subsidiaries and two independent companies. They represent 12% of the capital raised by companies / private investments in 2015.

The sector was marked by a high growth rate for the period (2006-2010) of around 40% per year. Following the revolution, the growth of the leasing sector stalled. In fact, the sector index lost 27% of its value, because of the slowing economy, the rising cost of resources and defaults. More recently, for 2014 and 2015, the leasing sector quoted moderate growth rates of 14% and 9% respectively.

The outstanding balance of leasing institutions increased by 10% against 7% in 2013, reaching €1.3 billion at the end of 2014, financed up to 79% by borrowing resources, of which 42% are bank loans and 39% bond debt. The sector’s activity recovery has positively affected net proceeds, which grew 6% (against a 1.6% decrease in 2013), reaching €57 million in 2014.[14]

Tunisia was the first country in the south of the Mediterranean that showed interest in venture capital and private equity. In order to encourage new promoters, the State created in 1973 the FOPRODI which is a fund that aims to reinforce equity for SMEs. The venture capital sector was then regulated from 1985.

There are four types of private equity institutions present in Tunisia: SICAR, FCPR, Seed Funds and Fund of Funds.[15] The private equity companies are regulated and supervised by the Financial Market Council and the Ministry of Finance.

In total, there were 96 private equity structures present at the end of 2014: 56 SICAR, 35 FCPR and 5 seed funds. The different institutions contribute to the financing of the Tunisian economy, with about €52 million by the end of 2014, of which half is used in regional development areas. The investments contributed to the creation of about 200 enterprises and 5,000 jobs per year in the period 2013-14.

[14]Source: Annual report 2014.

[15]SICAR stands for Sociétés d’Investissement à Capital Risque; FCPR is a joint venture capital mutual fund and Seed funds are equity investment mutual funds, which intervene before the effective start phase.

The Caisse des dépôts et Consignations (CDC) is a fund of funds, created in 2011 as a public institution governed by the Ministry of Finance. It is a government initiative to reinforce competitive SMEs to generate employment. The CDC has created multiple funds to support SMEs in different regions of Tunisia.

POLICIES FOR FINANCIAL SECTOR DEVELOPMENT

The Tunisian Central Bank is the regulatory and supervising authority for banks and financial institutions, namely leasing and factoring companies. Its mission consists in defending the dinar's value and ensuring its stability. It controls the credit supply and the monetary policy and ensures the good management of the financial system. Furthermore, it supports economic policy. In fact, it suggests to the government all measures likely to have positive effects on the promotion of the national economy.

The Financial Market Council is the authority for control and regulation of financial market institutions, including the Tunis Stock exchange (BVMT) and the investment companies. It has a general mission which consists in organising and ensuring the proper functioning of securities markets. It exercises a permanent control and is vested with a disciplinary power.

The General Insurance Committee is the regulatory and supervising authority of insurance companies and aims to protect policy-holders' rights, and safeguards the capacity of insurance and reinsurance companies to meet their commitments towards their customers.

Tunisia has made important efforts in the past couple of decades to liberate the government-controlled financial system. The essential first step was raising administrated interest rates to the level of positive real interest rates. Following the liberalisation of credit and interest rates, there was the suppression of rediscounting in 1996 and a boosting of the money market. An important goal of these reforms was to facilitate the flow of short-term liquidity. Therefore, the monetary markets were developed, by granting access to insurance companies, investment banks and social security organisations. Then, new financial products were created like treasury bills, treasury bonds and deposit certificates. The globalisation of the Tunisian financial system was implemented gradually. There was a gradual liberalisation of capital account transactions, designed especially to enhance allocation of foreign exchange resources. In addition, an effort was made to tap the international equity and bond markets. The implantation of an interbank foreign exchange market in 1994 represented a great step toward in the management decentralisation of foreign exchange markets. In October 2015, the World Bank extended a €460 million loan to Tunisia, strengthening the financial sector, enhancing the inclusiveness and accountability of social services, ensuring the transparency and accountability of social services and developing a competitive environment.

The Tunisian Central Bank (BCT) has, since 2011, implemented several measures that shape monetary policy. These reforms concern the reduction in the reserve requirements, the variation in the BCT key rate and the raising of the minimum savings remuneration rate to stimulate small savings. In this context, in 2015, the BCT conducted an inter-institutional project with the Banque de France in order to modernise the Tunisian monetary policy.

The Tunisian Central Bank has a reform plan for the period until 2020, with the aim to ameliorate and modernise banking supervision. This plan concerns the implementation of an efficient and risk-based supervision, meeting the Basel II and Basel III requirements and developing supervision methods.

Moreover, given that the resolution of non-performing loans (NPLs) is crucial for bank restructuring, authorities agree that individual banks must improve the management of NPLs, through the adoption of the new bankruptcy law strengthening creditor rights and an effective resolution framework. In this context, the new banking law of 2016 (2016-48) has been adopted to reinforce all reforms between 2011 and 2016.

FINANCIAL INCLUSION AND ALTERNATIVE SOURCES OF FINANCE

This section discusses the level of financial inclusion, as well as initiatives to enhance financial inclusion in Tunisia.

The Tunisian government has undertaken several efforts to stimulate access to banking products; in particular, providing affordable basic savings services through the postal network, as well as a regulation encouraging microcredit. Despite these efforts, the offer of inclusive financial services remains insufficiently accessible, fragmented and incomplete. About 64% of the Tunisian population over the age of 15 has no access, or has made very limited use of formal financial services (World Bank, 2015)[16].

Payment facilities are limited and/or rarely used, financing options remain too limited and often complicated for companies (i.e. required guarantees, administrative procedures) and insurance is virtually non-existent. Moreover, the supply of these services is more geographically concentrated in the capital and the coastal region.

[16]In 2015, the World Bank

There is a large potential for microfinance in Tunisia. The World Bank (2015)[17] estimated that approximately between 2.5 and 3.5 million or 30% to 40% of adults, and between 245,000 and 425,000 or half of the micro and small enterprises could be interested in microfinance.

The microfinance sector is composed of specialised microcredit banks and accredited microfinance institutions. There are three specialised banks:

- *Banque Tunisienne de Solidarité (BTS)* offers since 1997 financing to microcredit associations and allocates direct loans up to the equivalent of €66,000 for university graduates, to finance the creation and extension of their businesses. It encourages and supports entrepreneurship, as well as contributes to more financial inclusion. According to BTS, the average loan for 2014 was €4,400 and the average default rate about 30%. In 2014, it had about 112,000 active customers with total outstanding loans amounting €273 million.
- *Banque de Financement des Petites et Moyennes Entreprises (BFPME)* was created in 2005, to offer SMEs more possibilities to access bank financing. The BFPME aims to do this by offering SMEs favourable terms to access finance. The scope of the activities is, however, limited and the quality of the debt portfolio is very low, with more than 30% of credit defaulted.
- *Banque Nationale Agricole (BNA)* is not a specialised bank for microcredit. It finances nearly 20% of the food and agriculture sector in Tunisia. The numbers of microcredit granted by the BNA is around 110,000 but due to the large number of defaults, the bank decided to concentrate on funding amounts above €1,600.

Microfinance institutions can be legally created as limited liability companies or as associations. The microfinance sector was reorganised in 2011. There are four limited liability companies (i.e. Taysir Microfinance, Microcred Tunisie, Advans Tunisie and Centre Financier aux entrepreneurs), one Islamic microfinance institution (Zitouna Tamkeen), and two associations (Association de Soutien à l'Auto-Développement - ASAD, l'Association Kairouan pour le Développementintégré - AKDI).

There were 289 **microcredit associations** operating in Tunisia by 2011, which initially had to halt their activities because they were unable to comply with the new legal framework established by the government. An extension of the transition period has allowed many of the

[17] The World Bank study "Etats des lieux de l'inclusion financière en Tunisie" and the study of Findex 2014 (made on a representative sample of the population).

associations to resume their activities. The microcredit associations also suffered from high default rates.[18]

In 2011, the government also approved the implementation of a regulatory and supervisory framework to encourage the development of the microfinance sector. Since then, many reforms have been implemented to organise the activities of microfinance institutions. This framework covers the creation of the microfinance control authority, setting up the conditions of operations and fixing the maximum amount of microcredit and the creation of a microfinance risk direction, in order to control over-indebtedness and risks related to cross-borrowing within the microfinance sector.

The law of 2011 allows limited companies to grant microcredit. These companies must have a minimum capital of €1.55 million. For microcredit associations (AMCs), the minimum allocation is €103,000, which was lowered to €22,000 in a new decree published in July 2014. In August 2016, the Ministry of Finance took some measures to enhance the protection of micro credit borrowers, which are likely to reduce the default rates. The microfinance institutions must analyse the economic situation of their clients before any microfinance is granted. More specifically, they must assess the repayment capacity, based on the level of indebtedness, future commitments, credit history, etc.

Enda is the first microfinance operator in Tunisia. It is a non-governmental organisation that covers all regions in Tunisia with 78 agencies. Compared to the other microfinance initiatives, the default rates for Enda are below 2% - much lower than for other initiatives. The European Investment Bank (EIB) and the Government of Luxembourg in 2011 launched the **MicroMed-Tunisia** project. The programme, with a budget of about €4 million, had the objective of supporting the development of the microcredit sector in Tunisia. Over a period of five years, the programme aimed to improve the regulatory environment and the ability of microfinance institutions to grow. More specifically, the programme aimed to strengthen the expertise of microfinance institutions, improve transparency in the sector and facilitate the emergence of adequate inclusive financial products - particularly for the benefit of young entrepreneurs.

The overview of the microfinance sector is the responsibility of the Autorité de Contrôle de la Microfinance (ACM), which started its activities in 2013. The ACM intervenes throughout the life cycle of microfinance institutions. It plays an important role in controlling the process for granting accreditations through the examination of the application. Moreover, it has the power to ensure compliance with regulations of those microfinance institutions subject to its supervision.

[18] Vision concertée pour le développement de la microfinance en Tunisie, 2011-2014

There are not many business angels in Tunisia. Carthage Business Angels (CBA), created in 2010, is the only network of angel investors in Tunisia. It helps to identify potential innovative projects looking for funding and it ensures communication between business angel members and project leaders. An incubator, called Wiki Startup and a Capital Ease seed fund, were launched in 2011 with CBA. In 2013, only four projects with a total value of €56,000 were financed.

Carthage Business Angels are also responsible for the launch of the first Tunisian start-up accelerator; Start'Act Business Accelerator. The business accelerator was sponsored by the French development agency (AFD). This accelerator was established to support Tunisian entrepreneurs who want to transform their ideas into a sustainable and successful business for graduate students.

Crowdfunding is a relatively new phenomenon in Tunisia. It is a financial innovation offering new sources of funding for social projects in the form of a charitable offering. There are two crowdfunding platforms offering financing sources for Tunisian initiatives. The first platform created in Tunisia is CoFundy and the second, serving enterprises with equity investments, is AFRIKWITY. These platforms are based in Europe, in the absence of an appropriate legal framework in Tunisia. The amounts raised via crowdfunding are still very small, but increasing rapidly.

The Tunisian credit guarantee company SOTUGAR was created in 2003 as a credit guarantee system for loans granted to SMEs. It is placed under the supervision of the Ministry of Finance and is financially autonomous, with 37% of the share capital held by the State and 63% by banks.

SOTUGAR is a public interest company to promote the development of SMEs during the most decisive phases of their life (i.e. creation, development, innovation, and restructuring). It intervenes in the granting of the credit guarantee system for SMEs and the participation of SICARs in the capital, as well as any funds or mechanisms for guaranteeing credit, participation and other financing.

Islamic finance is little developed in Tunisia but, according to some experts, it has a high potential for development in the future. Islamic bank assets represented 2.2% of bank assets in 2010 and 5% in 2015. Actually, Islamic banks account for 7% of the Tunisian banking sector. For Islamic insurance, the sector is small but growing rapidly. It represented 2% of insurance sector at the end of 2014.

Islamic finance has been present in Tunisia since 1983, with the Al Baraka Bank (previously named BEST Bank). It was, however, only with the creation of Zitouna Bank in 2009 that Islamic finance became popular and products became effectively accessible to all individuals and companies. In 2017, a third Islamic bank Wifack International Bank, was introduced. The UAE's Noor Bank is also present in Tunisia with a representative office. In addition to the banks, there are also three insurance companies and, recently, an Islamic microfinance company that are active in Tunisia.

The Islamic finance sector is developing, despite a lack of specific regulation. There has not been a specific regulatory framework set up for Islamic finance in Tunisia. But Islamic banks are governed under the civil law framework. The banking law 2016-48 reinforced Islamic banking and allowed conventional banks to create windows for Islamic products.

There have been several attempts to set up laws for the Islamic financial sector, such as laws for Sukuk and Shariah funds, outlined in the financial law of 2014. The parliament has endorsed a Sukuk law, but until 2016, the decrees have not been promulgated preventing implementation.

Recently, particular attention was paid to Islamic microfinance. In fact, Zitouna bank signed an agreement for the creation of an Islamic microfinance company, in partnership with the Islamic Development Bank (IDB). Zitouna Bank, Zitouna Takaful, IDB, World Bank International Finance Corporation, and Tunisian Post are the shareholders of this microfinance company, called Zitouna Tamkeen. The company promotes microfinance services and financial inclusion of young graduates and others underserved.

CONCLUSIONS AND RESEARCH AGENDA

Financial institutions and markets need to be well developed in order to contribute to sustainable and inclusive economic growth. This is in line with the predominant view of the existing academic literature that states that financial system development only up to a certain level and specific conditions contributes to sustainable economic growth (long-term, stable and inclusive). These conditions include, for example, that there is a stable macroeconomic and monetary stability, an appropriate legal and regulatory framework for financial institutions and markets, as well as political stability. In addition, financial depth, access and efficiency are important factors determining whether financial development benefits sustainable and inclusive economic growth.

In this study, the financial development of four Mediterranean countries has been assessed, which show that there is still ample room for development in Egypt, Jordan, Morocco and Tunisia. The financial development in all these countries has increased in the past couple of decades, but has come to a standstill or even decreased in the years after the Arab spring, despite reforms in recent years based on various measures of financial depth, access and efficiency. They are also still clearly lagging behind, particularly compared to other northern Mediterranean countries.

The four countries largely depend on banks for financial intermediation. Indeed, the non-bank financial institutions are underdeveloped in most of the four countries under study. The insurers, mortgage financers, the currency exchange sector, venture capitalists and Islamic financers are active in several countries and delivering services complementary to the traditional banking services such as liability insurance, equity financing, foreign exchange, etc., but in most cases they are relatively small to be meaningful.

The countries under study have committed to the international standards for supervision and regulation of banks and some of the other financial institutions, but are only partially reaping the benefits from it. This is partly because legislation is not fully implemented, but there are also other factors, such as the lending to governments, deteriorating economic conditions and limited competition.

Turning to the financial markets, these are underdeveloped in all the four countries. Indeed, equity markets and public bond markets exist in all countries, but the size of the markets and liquidity is fairly low. Both the corporate bond markets and mutual funds are small in all countries. The derivative markets are very small or non-existent in all countries. Although the development of financial markets has some clear benefits, such as financial diversification and direct intermediation, currently the countries don't seem to meet the conditions to create the appropriate institutional, regulatory and market infrastructure in order to create deep and efficient financial markets.

The underdevelopment of the financial system is the main reason for the limited access to financial services, particularly of small - and medium-sized enterprises (SMEs), women and people in rural areas. The main reason for this exclusion is the high costs of financial services, which is partially due to a lack of competition in most banking sectors and the crowding out effect led by the incentives of banks to lend to their governments rather than contributing to the real economy. The financially excluded are, in most cases, dependent upon family, friends and other unorganised networks. Despite measures to promote basic banking services, credit guarantee schemes and microcredit financing, many private individuals and SMEs seem to remain excluded.

Based on the findings in this study, there is a need for further research in various domains of the four countries. The main pressing issues across the four Mediterranean countries are to explore the avenues to enhance lending to the private sector and financial inclusion and to understand the relationship between financial development and job creation. Indeed, there could be a study conducted, for example, to assess the specific financing needs and bankability of the private sector, in order to formulate targeted policy measures to enhance the financing position. Moreover, there is also room to assess the possibility of substantially improving financial inclusion via digitalisation. This could potentially substantially reduce the costs of financial services, which would potentially make the services much more accessible for many that are currently excluded from financial services. Finally, there is a need for a more comprehensive roadmap to improve the financial sector development and inclusion in order to unlock the potential benefits for the economies concerned.

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