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Tunisia

Agricultural Finance Study

Main Summary Report

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CURRENCY EQUIVALENTS

(As of April 23, 2012)

Currency Unit = Tunisian Dinar (TND)

USD 1 = TD 1.530

ACRONYMS AND ABBREVIATIONS

BCT	Banque Centrale de Tunisie/ <i>Central Bank of Tunisia</i>
BFPME	Banque de Financement des Petites et Moyennes Entreprises/ <i>Bank of Financing of Small and Medium Enterprises</i>
BNA	Banque Nationale Agricole/ <i>National Agricultural Bank</i>
BTS	Banque Tunisienne de Solidarité/ <i>Tunisian Bank for Solidarity</i>
CTAMoA	Caisse Tunisienne d'Assurances Mutuelles Agricoles
CGAP	Consultative Group to Assist the Poor
FNG	Fond National de Garantie/ <i>National Guarantee Fund</i>
GDP	Gross Domestic Product
GoT	Government of Tunisia
MoA	Ministry of Agriculture
MCA	Microcredit Association
MENA	Middle East and North Africa
MFI	Micro-Finance Institution
MIS	Management Information System
NGO	Non-Governmental Organization
PO	Producer Organization
PCR	Public Credit Registry
SME	Small and Medium Enterprise
SMSA	Sociétés mutuelles de services agricoles/ <i>Agricultural Services Cooperative Society</i>
SMVDA	Sociétés de mise en valeur et de développement agricole/ <i>Agricultural Investment Company</i>
SOTUGAR	Société Tunisienne de Garantie/ <i>Tunisian Guarantee Company</i>
TND	Tunisian Dinar

Vice President:	Inger Andersen
Country Manager/Director:	Neil Simon Gray
Sector Manager:	Hoonae Kim
Task Team Leader:	William Sutton

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PREFACE

The Tunisia Agricultural Finance study was carried out in response to a request made in December 2009 by the Tunisian Ministry of Agriculture (MoA) for support for a study on the key constraints in agricultural finance. Technical and financial support was specifically requested for: (i) a comprehensive diagnostic analysis of the current mechanisms and problems of financing of the agricultural sector in Tunisia, including those by financial institutions and from budget resources, foreign direct investment, and insurance; (ii) a comparison of the Tunisian experience with successful experiences made in other comparable countries; and (iii) the formulation of concrete proposals. The diagnostic part was also requested to include the regulations pertaining to agricultural credit, other constraints impeding the development of agricultural finance, such as costs, profitability, professional organizations, extension services, research etc., and to look at the indebtedness of smallholders. It was also requested that the recommendations help to: (i) better define the objectives to be achieved in terms of financing of agriculture; (ii) increase the participation of the financial sector in financing agriculture; (iii) help identify need for support by different types of farmers; (iv) identify new instruments geared at qualitative and technological changes; (v) reduce the indebtedness of farmers; and (vi) help improve the subsidies for agricultural investment.¹

There are two main written outputs of the Tunisia Agricultural Finance Study. The experts working on the study have compiled a great deal of detailed background information diagnosing the current situation, describing practices in other countries, and providing recommendations on how to improve the situation in Tunisia. These details are provided in the accompanying Full Technical Report, which should be of interest to technicians. The present report—the main summary report—provides a summary of the main findings and recommendations for policy makers.

¹ For an extract of the main technical points of the original request see Annex 1 of the Full Technical Report.

ACKNOWLEDGMENTS

This study was a joint effort carried out by the World Bank, the Agence française de développement (AFD), and the Food and Agriculture Organization of the United Nations (FAO). The World Bank team was led by William Sutton, Senior Agricultural Economist, Sustainable Development Department, Middle East and North Africa Region (MNSSD), who took charge after the departure of Alex Kremer, Country Manager, ECCKG. The main FAO expert and technical coordinator for the study was Michael Marx (Senior Rural Finance Expert, FAO Investment Center). The World Bank team also included Loic Whitmore (Junior Professional Associate), Marie-Francoise Kin (Language Program Assistant), and Maamri Akremi (Consultant, Agricultural Economist and Rural Finance Expert) of MNSSD, under the guidance of Sector Manager Hoonae Kim. The AFD team was led by Zacharie Méchalie (Head of the agriculture, environment and water mission, AFD-Tunis); Naomi Noël and Camille Séverac (AFD-Paris); Bernard Fouquet (Consultant, Rural Finance and Banking Risk Expert); and Bel-Hassen Abdelkafi (Consultant, Agricultural Economist). Andrea Stoppa (Consultant, weather index insurance expert, FAO) contributed analysis on insurance. The team would like to thank the Peer Reviewers for the study, Renate Kloepfinger-Todd (Rural Finance Adviser, Agriculture and Rural Development Department, the World Bank) and Eustacius Betubiza (Country Program Coordinator and rural finance expert, AFCCD, the World Bank). Laurent Gonnet (Senior Financial Sector Specialist, MNSFP) also provided helpful comments. This study would not have been possible without the assistance and cooperation of the Government of Tunisia (GoT), and in particular the Ministry of Agriculture. In addition, we would like to thank all of those in the private sector, civil society and development partners who gave generously of their time and information, and in particular to the GoT Steering Committee that reviewed and provided input to earlier versions of the Full Technical Report. The team would also like to thank Eileen Murray, World Bank Country Manager, and the staff of the World Bank Tunisia Country Office for their assistance.

EXECUTIVE SUMMARY

1. Tunisia has a well-diversified and adequately regulated and supervised financial sector, which is dominated by a strong and capable banking industry. Commercial banks also dominate in the non-bank financial sector, as they own or control leasing, factoring, investment and loan recovery companies. The depth of the sector is moderate, with total deposits reaching 59% and total credit to the economy reaching 71%² of GDP, which is higher than Algeria and Egypt, but lower than Jordan and Morocco. The depth of outreach of the banking sector is satisfactory, with one branch per 8600 inhabitants. In this urbanized society, all towns have at least one branch office of a bank, and with few exceptions, the distance to the closest automated teller machine (ATM) or bank branch is reasonable.

2. However, the sector has serious problems with loan recovery, with 13% of loans outstanding classified as non-performing as of December 2010 (and probably even higher now given since the economic challenges after the revolution of January 2011). The level of coverage of non-performing loans through provisioning is around 60%, which is not adequate. Provisions for loan losses amounted to about 7% of loans outstanding. The Tunisian private banking sector in general is highly fragmented. Not a single private bank has more than a 15% market share. As a result, most banks lack the necessary scale and resources to afford significant investments in their back-office operations, which are critical to ensuring that internal controls are able to grow in proportion to bank expansion. This leads to the banks': (i) high non-performing loan ratios, (ii) their preference for guarantee schemes such as the FNG (see below) reducing their need for provisioning, and (iii) their inability to innovate and tap into new markets (for SMEs in particular).

3. Agriculture represents a significant share of Tunisia's economy. In 2008, agricultural production accounted for 12 percent of GDP, 9 percent of exports, as much as 16 percent of labor force, and 7 percent of total investment. Thus, significant attention is paid to the agricultural sector in the definition of the country's broader development strategy. Apart from the economic contribution, agriculture plays an important role as it contributes significantly to livelihoods and employment in rural areas, and a much larger than average share of the economy especially in the interior provinces where the events that led to the January 2011 revolution began.

4. Access to agricultural finance in Tunisia is limited, and this appears to be constraining agricultural sector growth. The portion of farmers benefitting from bank loans does not exceed 7 percent. Banks finance just 11 percent of total agricultural investment, while 70 percent—according to official statistics—is financed by “own resources”, which probably includes a significant volume of supplier and purchaser credit. The share of investment funded by credit has halved over the last 5 years, and seasonal credit only covers 1/14th of agricultural input use. The share of farmers reporting that their credit demand was satisfied fell from 54 percent in 1990-4 to 36 percent in 2000-4. The share of farmers investing fell from 36 percent to 26 percent over the same period. Without such investment, the ability of the sector to modernize and grow is limited.

5. In an environment where the institutions are generally risk-averse, where they do a poor job of managing credit—their riskiest activity—and where the share of agriculture in GDP has slowly declined over time (down to 10-12% of GDP), it is perhaps not surprising that the share of total lending going to agriculture has slowly declined over the years. However, a number of other factors have also needlessly contributed to this decline, among them:

² From fin stat 2009

- the low profit margins of the agricultural sector, with prices being informally capped by government directive, and declining terms of trade for the agricultural sector;
- the indebtedness of about 120,000 smallholders, who are barred from additional formal borrowing as a result of their records with the Public Credit Registry (PCR);
- frequent droughts, against which no effective protective or mitigation measures have been identified or implemented, and an insurance sector that provides protection only against fire and hail;
- a poorly designed agricultural guarantee scheme, which prevents financial institutions from debt recovery rather than assisting them;
- the absence of collateral substitutes through which loans could be secured, as an alternative to the prevailing trend to rely almost exclusively on land titles, which often cannot be foreclosed upon anyway;
- a cooperative sector that has not performed up to the expectations of either banks or its membership;
- the fragmented nature and small size of farm holdings; and
- the absence of a second-hand market for agricultural equipment, through which leasing could be developed as an alternative financing strategy.

6. Although the Government of Tunisia (GoT) provides an array of agricultural subsidies, there is scant evidence of the impacts of these subsidies in terms of contribution to the modernization and competitiveness of the sector. With respect to investment grants, beneficiaries are expected to obtain bank financing for the share of the investment not covered by the subsidy, but none of the schemes is made dependent on a link with a bank. Some schemes, such as the “supervised credit”, are in reality more an invitation to default than a strong incentive to repay a loan. The costs of administering the subsidy schemes are also becoming substantial, totaling an estimated 15-18% of the subsidy value.

7. From an institutional perspective, the National Agricultural Bank (BNA) is the primary financier of agriculture in Tunisia. Apart from this commercial bank, in which government holds a majority of shares, other commercial banks have on average only 2-4% of their loan portfolios in the agricultural sector. Other providers include informal finance through friends and relatives, trader finance for equipment and inputs, some value chain operators, and the microfinance sector. Generally, larger-scale corporate bodies have little problems with access to finance, and banks are more than ready to provide loans to this clientele perceived as less risky. In contrast, smallholders have enormous difficulties to access credit. The causes of these difficulties are specific to each type of institution.

8. Almost a quarter of all producers, and a majority of smallholders, have loans in arrears with the BNA, and the bank obviously does not want to extend fresh facilities to these borrowers unless the old ones are repaid. The bank has also strategically decided to move away from smallholders, to the extent possible, and concentrate on larger scale clients with better economic and repayment prospects. Products offered are also not tailored to the specific needs of smallholders, and appraisal is lengthy and tedious, especially for new clients. Commercial banks are prepared to serve their well-known clients, whether in agriculture or other sectors, but do not have any culture or tradition of serving smallholders, nor the tools to do so. The existence of a specialized bank serving farmers (BNA) and the large number of subsidies available for farmers contributes to their perception that they should refrain from financing agriculture, especially smallholders.

9. Input traders do not have access to the PCR, and are at times hesitant to sell equipment on a credit basis to unknown clients they cannot fully appraise. Below the threshold that the BNA is prepared to serve (TND 4000 \approx USD 2700) operate the state-owned Banque tunisienne de solidarité (BTS) and microcredit associations (MCAs). The development of a microfinance sector was tightly controlled and even suppressed under the previous government rather than supported and promoted. Despite this, given the lack of alternatives, it has become an important provider of finance to smallholders; however, its impact could have been much bigger. Both the BTS and the state-controlled MCAs suffer from insufficient loanable funds, as public resources have so far been the only source of funds. In addition, since the Tunisian revolution of January 2011 the BTS, which was closely associated with the former president, has essentially become defunct. Without the introduction of a substitute, this could leave a major gap in funding of MCAs, for which the BTS was the dominant source of funds. With regard to the private microfinance institutions (MFIs), only one—the NGO ENDA inter-arabe—was granted a license to operate under the previous government. ENDA was able to demonstrate that a private MFI could be successful—even at market interest rates—but there was a lack of competition and ENDA mostly only operated in towns and cities.

10. Under these circumstances, a number of institutional reform processes are required. First, there is an urgent need to develop microfinance as an independent provider of financial services, and allow MFIs to mobilize deposits and intermediate these into loans. In addition to a new law on microfinance, the transformation of the current MCAs into strong microfinance institutions requires substantial capacity building efforts. Ideally, the BNA would become the preferred institutional partner in the banking sector for the MFIs, thus replacing the BTS. These activities would need to be paralleled by efforts to improve risk management systems, namely the transformation of the redundant guarantee mechanism into a relevant and viable provider of guarantees on a demand basis, the development of drought risk mitigation mechanisms (for example, assess the feasibility of index-based weather insurance more fully, and if warranted test it on a pilot basis.), and the expansion of access to the PCR data for other types of financial service providers.

11. Given the potential role for producer organizations (POs), a package of at least four reforms would be needed: (i) a program to strengthen links between POs and MCAs, including the permission for MCAs to provide loans to POs; (ii) improving management of POs to get direct access to bank financing; (iii) new corporate legal statuses for the management of inherited farm estates, and eventually also for POs as for-profit organizations; and (iv) the establishment of Credit Management Units in POs in charge of facilitating their access to different means of finance.

12. As a situation where almost one quarter of farmers is barred from access to an essential service, there is a need to address the over-indebtedness of the farming sector. Three measures are needed as immediate point of departure: (i) the cancellation of unrecoverable debts, many of which have been granted under somewhat dubious circumstances; (ii) the creation of a new law on debt negotiations and counseling, which could provide a pathway for all over-indebted persons—not only farmers—to emerge from their debts; and (iii) the publication of an annual report on the state of indebtedness of the agricultural sector. However, these measures need to be handled with great care—especially the potential cancellation of debts—in order to avoid creating conditions of moral hazard and further undermining the already weak credit culture in Tunisia.

13. Finally, three types of measures are needed to improve the quality and efficiency of financial service delivery, of which the first two measures relate specifically to the BNA. First, until now government-sponsored loan programs that provided loans without any risk to the lender—but rather with full risk to the treasury—have failed to make any visible impact on

farmers. Instead, they have led to increased debts for the state and implicitly undermined the financial discipline of borrowers. Therefore, such facilities should be abrogated immediately. Second, the BNA should start an initiative to offer services more attuned to its farmer clientele, and improve substantially on the quality of its services. Examples of the service improvements required include improved financial products, faster processing, development of collateral substitutes, and increased customer orientation, in addition to the already mentioned linkages with the reformed microfinance sector. A third initiative is related to the financing of new technologies, which should be supported through the new guarantee mechanism, funding for proto-type feasibility studies and a dialogue with the financial sector led by the MoA.

14. A summary of the specific recommendations developed by this study—along with their expected impacts, estimates of the cost of their implementation, and their level of priority—is provided in Table 1. These recommendations imply new roles for the MoA regarding agricultural finance. The MoA may need to withdraw from some arenas, introduce more market-based mechanisms and private sector management approaches, and listen to the feedback of private sector service providers. These measures would contribute to the creation of an environment in which the private sector and the public sector work in partnership. This would require accepting that some old instruments may no longer be applicable, and that it may be necessary to adopt new ones. MoA may also have to accept that it should no longer be the only or even the main decision maker in the arena, but one player among several, and that the creation of alliances to pursue common goals would be a more effective strategy to achieve its objectives. By adopting these new roles, and becoming a strong promoter of the reforms recommended herein, it could achieve higher levels of agricultural financing and improved quality of services, while reducing the cost to the state.

15. The recommendations of this study are all important, and to have the greatest impact they are meant to be implemented in a comprehensive and coordinated manner, rather than piecemeal. Nevertheless, given the topic of the study, the recommendations concern the financial sector alone, and therefore are not sufficient themselves to address the fundamental issue that agricultural finance will never be successful unless farming is profitable, thereby providing a sufficient rate of return on investment. In reality, as alluded to in the study, Tunisian farmers are being squeezed by deteriorating terms of trade that result at least in part from the poor policy environment for agriculture more generally. Those broader issues are beyond the scope of this study, but must be addressed if financing for agriculture is to expand and support a healthy, growing agricultural sector.

Table 1: Summary of Recommendations

Recommendation	Main impact expected	Costs in TND	Priority
Recommendation 1: Approve a new law on micro finance regulating the transition of MCAs to private sector financial institutions, opening the sector for other interested players on the basis of clear conditions, and ensuring that both the law and the “decrees of application” are consistent with international good practices, as recommended by CGAP. ³	<ul style="list-style-type: none"> • Better access to deposit and credit facilities for the rural populace • Higher volumes of loans for rural investments, in particular agriculture 	0.5-.07 mn excluding donor support	Very high
Recommendation 2: Provide technical assistance and capacity building to MCAs on all dimensions of rural microfinance	<ul style="list-style-type: none"> • Transformation of all MCAs to new legal status • High compliance of MFIs with regulations • Solid financial status (portfolio at risk, capitalization) • 35% of loans for agriculture 	20-30 mn	Very high
Recommendation 3: Reform the national guarantee fund (FNG) consistent with good international practice, for example along the lines of the SOTUGAR (which manages the FNG)	<ul style="list-style-type: none"> • Sustainable operations without requiring budget support • More efficient response to collateral requests of financial institutions • Higher number and volume of agricultural loans guaranteed 	0.1-0.2 mn for feasibility study; funding requirements not known; implies a solution for covering the risks under the old FNG	Very high
Recommendation 4: Develop drought risk mitigation measures responding to farmer expectations, assess the feasibility of index-based weather insurance more fully and if warranted test it on a pilot basis, and create a natural calamity fund for non-insurable risks	<ul style="list-style-type: none"> • Reduction of vulnerability of farmers • Improved protection of lenders • Higher loan volumes for agriculture projects 	To be determined on the basis of feasibility studies	High
Recommendation 5: Expand access to the Public Credit Registry (PCR) for MFIs and input suppliers as an interim step, and eventually create a proper credit registry outside the central bank	<ul style="list-style-type: none"> • Higher loan repayment rates for agriculture projects • Lower transaction costs for financial institutions • Improved financial discipline 	Very low	High
Recommendation 6: Encourage partnerships between MCAs and POs , first on a pilot test basis	<ul style="list-style-type: none"> • Improved access of POs to credit • Improved repayment rates 	1-2 mn, but depends on access to refinance by MCAs	High
Recommendation 7: Improve access to bank financing for POs through improved management of POs	<ul style="list-style-type: none"> • Improved management of POs • Increasing number of POs obtaining bank loans • High repayment rates 	To be determined on the basis of feasibility	High

³ The interim government that came to power after the January 2011 revolution passed a law (no. 117/2011) creating a new regulatory framework for microfinance subsequent to the final mission for this study, so the new law was not reviewed. The implementation of the new legislation awaits the issuance of the related “decrees of application” (*decrets d'application*). Care should be taken to ensure that both the law and the decrees of application are consistent with international good practices, such as those recommended by the Consultative Group to Assist the Poor (CGAP).

		studies	
Recommendation 8: Develop new options for corporate legal status of inherited farm estates and for-profit POs	<ul style="list-style-type: none"> • Modernization of estate farms • Improved access to agricultural credit • Higher loan volumes for agricultural purposes 	0.1-0.2 mn	Moderate
Recommendation 9: Creation of Credit Management Units in POs	<ul style="list-style-type: none"> • Increased volume and efficiency of bank lending to agriculture • High repayment rates • Break-even of the credit management units 	0.1-0.2 mn	Moderate

Recommendation 10: Cancel unrecoverable debts of farmers	<ul style="list-style-type: none"> • Gradual return of farmers to formal economic circuits (if handled with care) • Improved access of smallholders to credit 	0.1-0.2 mn for study, unknown costs for debt waivers	Moderate
Recommendation 11: Create new legislation on debt negotiation and counseling	<ul style="list-style-type: none"> • Gradual return of over-indebted farmers to formal economic circuits • Improved access of smallholders to credit at medium term • Partial recovery of overdue loans 	0.1-0.2 mn for study, unknown costs for debt cancellation for banks	Moderate
Recommendation 12: Produce annual report on indebtedness of the agricultural sector to parliament	<ul style="list-style-type: none"> • Public discussion about causes and impacts of over-indebtedness on the basis of solid data • Better understanding about investment, credit, debts and enabling factors of success of agriculture as businesses 	Low, can be easily absorbed by BCT	Moderate
Recommendation 13: Abrogate 'supervised' loans under treasury risk	<ul style="list-style-type: none"> • Reduction of wasteful expenses of government • Higher quality of lending to agriculture 	Nil	High
Recommendation 14: Revise terms and conditions of BNA loans	<ul style="list-style-type: none"> • Faster processing of agriculture loans • Lower transaction costs for BNA • Improved perception of BNA clients by farmer-borrowers 	Low, can be absorbed by BNA internally	High
Recommendation 15: Facilitate the financing of new technologies through technical information, data and studies, establishing a dialogue with the financial sector making such loans eligible for FNG guarantee coverage	<ul style="list-style-type: none"> • Higher number and value of loans for new technologies 	0.3-0.6 mn for technical assistance	Moderate

MAIN SUMMARY REPORT

Part A: The state of agricultural finance in Tunisia

1. **Access to agricultural finance in Tunisia is limited.** The portion of farmers benefitting from bank loans does not exceed 7 percent. Banks finance just 11 percent of total agricultural investment, while 70 percent—according to official statistics—is financed by “own resources”, which probably includes a significant volume of supplier and purchaser credit.⁴ And this is despite several measures adopted by the Government of Tunisia (GoT) in recent years in support of the financing of agriculture: repeated debt cancellations and rescheduling, creation of new mechanisms for agriculture financing (Banque Tunisienne de Solidarité (BTS), Microcredit Associations, budget credit lines, etc.), investment premiums in support of mechanization, livestock farming and others. Access to agricultural credit remains difficult due primarily to inappropriate bank requirements and products and complex administrative procedures. Close to a quarter of agricultural enterprises are in arrears to the banks, of which the vast majority are small farmers. Only 7 percent of farmers are formally covered by some form of agricultural insurance, which is nearly always a condition for a bank loan, and no coverage exists against drought, which is the main natural hazard in Tunisia.

2. **The lack of access to finance appears to be constraining agricultural sector growth.** The share of investment funded by credit has halved over the last 5 years. While only 11 percent of agricultural investment is financed by bank credit, about 20 percent is financed by state “encouragements”, or investment subsidies. Seasonal credit only covers 1/14th of agricultural input use. A single bank, the state-owned BNA, is responsible for 36 percent of bank lending to agriculture. The World Bank’s 2006 agricultural sector review noted a long-term downward trend in input credit utilization, with the number of seasonal credits falling from 3,907 in 1998-99 to 1,446 in 2003-04. When surveyed, about a quarter of farmers say that they do not request credit for fear of indebtedness and another quarter because of difficulties in accessing credit. The share of farmers reporting that their credit demand was satisfied fell from 54 percent in 1990-4 to 36 percent in 2000-4. The share of farmers investing fell from 36 percent to 26 percent over the same period. Without such investment, the ability of the sector to modernize and grow is limited. This is the fundamental quandary that led the GoT to request assistance in identifying the constraints in Tunisia’s agricultural finance system.

Overview of the agricultural sector

3. **Agriculture represents a significant share of Tunisia’s economy.** In 2008, agricultural production accounted for 12 percent of GDP, 9 percent of exports, as much as 16 percent of labor force, and 7 percent of total investment. Thus, significant attention is paid to the agricultural sector in the definition of the country’s broader development strategy. Apart from the economic contribution, agriculture plays an important role as it contributes significantly to livelihoods and employment in rural areas, and a much larger than average share of the economy especially in the interior provinces where the events that led to the January 2011 revolution began. Agricultural production depends to a large extent on rainfall and rainfall patterns. Under normal circumstances, growth rates of about 2-3% can be achieved. As available water resources have more or less been fully used, an expansion of irrigation over and above the current 9% of cultivated land does not seem to be possible. Few farmers hold land titles on their agricultural

⁴ Data in the Main Summary Report are rounded and refer to the most recent year for which data are available, i.e. 2009 or 2008. The exact figures are provided in the Full Technical Report. French terms are translated and their acronyms used as in the main report (see list of acronyms on p. 5).

lands, preventing their use as collateral. On the other hand, financial institutions are informally barred from enforcing repayment of debtors which have mortgaged their lands or houses.

4. **Recent policies and strategies** of the GoT aim at increasing the average growth rate of the agricultural sector from about 2.6% to about 3.5%. This is hoped to be achieved through a range of measures making agriculture more competitive and profitable, which include the consolidation of national food security as a vector of national sovereignty, export promotion, the protection of the natural resources, and efficiency improvements of the irrigation systems. The annual production of wheat should reach at least 1.5 million tons, of a total consumption of about 2.5 million tons. After the 2008 food price increases, the GoT is even more determined to achieve this minimal production level, despite the relatively high cost. Tunisia also wishes to exploit the potential of organic production, increase the use of geothermic resources for high quality vegetables, upgrade agricultural production to meet international quality and hygiene standards, and establish a quality label “Made in Tunisia” in overseas markets. Given the limitations of arable lands, and the exhausted water resources, intensification is the obvious path for development.

5. The MoA is quite aware that some of the above requires fundamental changes in orientation: from achieving quantitative targets of production towards the adaptation to demand orientation and an emphasis on quality; from implementing role models fixed by the state towards an adaptation to the objectives of the producers, and, as regards financing modes, from subsidies towards more flexible, rapid and quality oriented modes of financing.

6. **Farm characteristics.** The 2005 census revealed that there are about 516,000 farm households. Farms are very fragmented. More than half of all farm households (54%) cultivate areas not exceeding 5 ha, up from 41% forty years ago. The average farm size is 10 ha. Only 5% of farms operate on areas above 50 ha. Of these, a good number are agricultural investment societies (SMVDA) which receive long term leases of high quality state-owned arable lands in return for achieving specific production targets, mostly for wheat, barley, fodder and tree crops. Three out of ten farms are owned by absentee landlords, and four out of ten farms do not pursue any other income generating activity, often because of the lack of viable alternatives. Four out of ten farm households pursue farming as a minor activity in parallel to other (often more profitable) income generating activities. Literacy levels are high in Tunisia, most farmers know well what they are doing, but the level of education of farm workers on some aspects of modern farming may not be adequate. In a farming sector that is slowly aging and that does not attract many youths, there are also inherent limitations to modernization and adaptation to change.

7. **Prices.** The GoT keeps a heavy hand in agricultural prices. Prices for some important commodities are fixed indirectly through a system of production subsidies, e.g. in the cases of wheat, barley and milk. While prices for fruits and vegetables are said to be free, GoT controls these through a range of administrative measures, which producers and wholesale markets are to respect even in case of seasonal scarcity. Price increases for major agricultural commodities have over the past 15 years been kept below the inflation rate. The system allows providing the urban majority (two thirds of the population) with relatively cheap food. However, these policies also lead to low incentives for farmers to invest, increase production, or improve quality, which result in lower farm incomes.

8. **Cooperative sector.** Cooperatives or “producer organizations” (POs) are relatively weak, apart from a dozen older POs engaged in wine production. The majority of primary POs are engaged in the collection and storage of cereal crops and milk, and most POs offer a multitude of services (input supply, collection of commodities, storage, transport and payment of subsidies). Some sell inputs on credit, but this works only where the coops can deduct the amounts due from the proceeds paid out. Most POs have weak management, are undercapitalized, offer only

rudimentary services, operate in business sectors with narrow margins, have no or only limited access to bank financing and suffer from low levels of member patronage. Government control over their activities has been tight except in the old wine producing POs that existed before independence. Milk and cereal collecting POs suffer from high numbers of users, who outnumber the share-buying members by a factor of two. It is widely assumed that the users of cooperative services would turn to the private sector if forced to buy shares from their cooperative in order to use the services. Except the wine producers, no other POs are engaged in more profitable activities of value addition. While most people would agree in principle on the potential of the sector, they equally cite a number of constraints preventing them from becoming more important players. These include: (i) insufficient operational freedom for POs; (ii) low levels of confidence among many farmers in the potential of POs; (iii) low level of trust by banks in the administrative and financial strengths of POs; and (iv) a prohibition on borrowing from financial cooperatives or associations, such as the local microcredit associations (MCAs).

9. The 270 agricultural investment companies (SMVDA) which lease productive government lands are mostly not very efficient producers, often due to internal management and financial problems, but also due to the imposition of inappropriate crop production systems through the lease agreements. The water user associations and other farmer groups (about 3000) are believed to have a certain potential, but these are by the law governing them not permitted to make profits or borrow externally. Given the variation of interests, production modes and ownership models in Tunisia, it is evident that the current options for doing business under a corporate status are not attractive.

10. **Agribusiness.** This sector is strong and firmly established and contributes about 3% to GDP on top of the contribution from primary agricultural production. The GoT has over the years strongly supported agribusiness through a range of subsidies to enhance the competitiveness and reduce production costs, and controls much of it through the apex bodies of the supply chains, which it finances partially or totally. The agribusiness sector provides substantial amounts of finance to farmers, and a good share of this is refinanced by the banking sector, mostly BNA. This includes farm input, equipment and machinery dealers and food processors. The agribusiness sector itself has no problem with access to finance, and even has at times access to cheaper finance from abroad. While official data record a value of TND 725 million, the actual amount is certainly larger. Where needed, value chain operators provide crucial in-kind inputs to farmers and deduct debts at source from sales. The efficiency of the private sector in terms of repayment and cost of lending is higher than in the banking sector. However, the possibility for expanding this service much over current levels is limited. Annex 5 of the Full Technical Report presents details on three different value chains (cereals, red meat and irrigation equipment).

11. **Government influence** in agriculture is strong. It is part of a wider 'deal' through which farmers provide satisfactory quantities of certain commodities at predictable prices. Subsidies for production or investments are in place to keep the system going. For most commodities, farmers do not have grave problems with marketing, and prices remain within certain boundaries. The cooperative sector and the farmer unions are controlled and pursue government policies. Farmers on the other hand are ill-equipped to market their produce individually, and their POs ill-equipped to find new market destinations outside the existing ones. More advanced risk management systems do not exist or are not functional. Through an implicit "social contract", farmers have had a safe income, but this has been slowly eroding as agricultural terms of trade have been declining for farmers. The prices of key imported inputs like fertilizer and fuel have been rising while output prices have been constrained by government controls. The system helps government keep agricultural prices low and within a narrow band, which promotes cheap food prices for urban consumers and helps the tourism sector to remain competitive. However, the negative side of this system is that it results in slowly eroding real incomes for farmers, and that undermines modernization attempts (see above). It also makes agriculture less

attractive as an investment, which limits the scope for expanding access to finance. The issue is whether under such a controlled system without much individual responsibility for the producer, it will be possible for the GoT to achieve the modernization of the sector, increased competitiveness in a liberalized world and increased export earnings. And alternatively, whether it will be possible to split the sector into two segments, one along traditional commodities operating under the current system, and a modern one able to compete and generate incomes and export earnings. An additional issue is that with agricultural research and extension receiving only 2% of total public sector spending on agriculture, it will be difficult to achieve substantial changes.

Overview of the financial sector

12. . The formal financial sector is well regulated and supervised, capable and diversified, and comprises 20 universal banks, 9 specialized banks, and a host of leasing, factoring, investment and loan recovery companies, many of which with overseas equity participation. The depth of the sector is moderate, with total deposits reaching 59% and total credit to the economy reaching 63% of GDP, which is higher than Algeria and Egypt, but lower than Morocco. The sector has serious problems with loan recovery, with 16% of loans outstanding classified as non-performing. The level of coverage of non-performing loans through provisioning is around 60%, which is not adequate. Provisions for loan losses amounted to about 7% of loans outstanding to the economy. Depth of outreach of the banking sector is satisfactory, with one branch per 8600 inhabitants. In this urbanized society, all towns have at least one branch office of a bank, and except a few zones in the South, the distance to the next ATM or bank branch is not far.

13. **Regulation.** Banking regulations emphasize compliance of banks with prudential regulations and state directions. Financial institutions are in principle free to determine their own interest rates, but have to comply with a reference rate determined by the central bank (BCT). The basic reference rate is currently around 5% p.a., and banks can charge a markup of up to 5 percentage points. The law permits microcredit activities only for so-called microcredit associations (MCAs), which have been installed with government support in most districts. These do not have their own share capital, and obtain loanable funds only from the state-owned micro enterprise bank (BTS) and can onlend this only at 5% p.a. GoT has however granted an exceptional license to one private microcredit institution (ENDA inter-arabe). MFIs are not permitted to accept deposits. The MCAs are monitored by the BTS, and the one private MFI is not supervised at all by a government body. The plans of the previous government for future reforms comprised increased capitalization of banks, improved risk management systems for banks, the free convertibility of the local currency and the creation of a holding for all government investments in the financial sector, but not a microfinance law. The interim government that came to power after the January 2011 revolution passed a new law (no. 117/2011) creating a new regulatory framework for microfinance subsequent to the final mission for this study, so the new law was not reviewed. The implementation of the new legislation awaits the issuance of the related “decrees of application” (*decrets d'application*). Care should be taken to ensure that both the law and the decrees of application are consistent with international good practices, such as those recommended by the Consultative Group to Assist the Poor (CGAP).

14. **Universal banks.** Universal banks account for 80-85% of the financial services in the country, offer all standard products and services, engage in deposit collection from all clients including salary earners, are strongly involved in consumer lending but are rather restrictive as regards small enterprise lending, and require full collateral coverage of loans. Given the ceilings on interest rates, the default rates of borrowers, and the obligation to make adequate loan loss provisions to comply with prudential regulations, lending is not the most profitable activity for banks. Banks see agribusinesses as normal business operations and have no restrictions on lending to them. Their total portfolio in agriculture and related activities is in the range of 2-7%, but most of this is in food processing and agribusiness. Their expertise in appraisal of more complex

agricultural loans is limited. Most of them are convinced that with the existence of the state-owned National Agricultural Bank (BNA, see below), they should not be engaged in agricultural lending. Where they do so, most of it is for agricultural projects of a long-standing customer, whom they have served in other business sectors. While they would occasionally adopt new customers, and start with small amounts, adopting larger numbers of small producers would however not fit into their ambitions or orientations. A key concern as regards agricultural production is related to the risk management: banks see the existing insurance coverage of hail and fire as insufficient, the coverage of the state-owned guarantee mechanism (FNG) as inadequate and complain about the dysfunctional drought protection fund. Competition is usually not high in the banking sector, income levels are usually secure, and banks are not (yet) forced to look for other, non-conventional clients to generate sufficient income. The Public Credit Registry (PCR) operated by the central bank is accessible to banks, but not to MFIs and input suppliers.

15. **The National Agricultural Bank (BNA).** The BNA is one of the three largest universal banks in the country, operates one in seven bank branches in the country and is the biggest provider of loans to the agricultural sector. It was originally created by the GoT in 1959 to respond to the credit needs of the agricultural sector. 83% of its shares are owned by the GoT and some government-owned enterprises and parastatals. The BNA was for a long time a role model for development finance institutions, in particular in the Middle East and North Africa (MENA) Region, as it achieved a smooth transition from a credit-only institution to commercial and universal banking, and a diversification of its portfolio over different economic sectors. The bank finances a bit more than two thirds of all agricultural production and service loans, and a bit less than a fifth of the agribusiness sector. About one third of all loans are in the agricultural sector. The bank owns a host of subsidiaries, including one leasing and two investment companies, plus a loan recovery company to which it sells its non-performing portfolio. Over the past four years, deposits, loans, equity funds and assets have grown by about 40%, loan loss provisions by 100% and net profits by 400%. Return on assets was 1% and return on equity 8%.

16. Several impediments prevent the BNA from expanding agricultural lending further. First, about 110,000 farm households are indebted to the BNA, as borrowers earlier defaulted on loan repayments. Their total debt (principal and interest) stands at TND 708 million (\approx USD 470 million). Due to records with the PCR, these farmers are prevented from further borrowing. Second, the bank has decided to reduce its engagement in the smallholder market segment and concentrate on clients requiring more than TND 4000 (\approx USD 2700), out of a combination of transaction cost and risk reasons. This is also the threshold up to which the BTS and MFIs currently serve small clients. Third, the bank's procedures and requirements are very bureaucratic, which slows down the appraisal process and discourages potential clients which have an alternative source of borrowing. No significant efforts have been made to streamline policies and procedures. Fourth, the bank does not excel in customer-orientation. Fifth, bank management has made little efforts to deepen its outreach in the smallholder and SME sectors, as it is convinced that these should be served by other institutions and that these would be too risky for the bank. Finally, the bank is engaged in a range of agricultural lending programs on behalf of and on account for the GoT, which are not sound and have very low repayment rates (below 25%), which reinforce the perception that it would be better to keep out of this sector. The losses incurred by BNA in agricultural lending are apparently higher than in loans to other sectors, and the bank needs lending to sectors other than agriculture to make a profit.

17. **National microfinance bank (BTS).** The GoT owns two banks in charge of micro, small and medium enterprise credit. The BTS (Banque tunisienne de solidarité) originated from a solidarity concept and is geared at individual micro and small enterprises, whereas the BFPME (Banque de financement des petites et moyennes entreprises) only finances corporations with a minimum loan size of TND 100,000. The business model of BTS is to borrow most of its funds from the public and poverty alleviation funds and intermediate these into small loans at an interest

rate of 5% p.a. The operating losses are kept low as the bank does not invest in the quality of its services, and because it is not obliged to make bad debt provisions for loans covered by the government guarantee mechanism (FNG; see below). Annual losses incurred are covered by a government subsidy. It should be noted that there is some public interest sensitivity in Tunisia, but that borrowers would actually be prepared to pay a higher interest rate if the service received would better meet their expectations in terms of proximity, speed of decisions and disbursements, and quality of advice. The total loan portfolio of BTS was TNS 523 million, of which TND 378 million was for direct loans to clients and TND 145 million to refinance the government-controlled MFI sector (MCAs). Of the direct loans, only TND 75 million (or about 20%) was granted for agricultural purposes, of which 80% was for livestock and 20% for small-scale irrigation and cereal production. Although the need for micro and small enterprise loans is largely unmet, the current BTS does not have a great development potential as it remains dependent on treasury funds. A transition to more sustainable and dependable operations, with a chance to expand services, would depend on a restructuring of the bank, deposit mobilization, more transparent systems of accounting and reporting, horizontal expansion and/or networking arrangements, and improved qualifications of staff. Since the Tunisian revolution of January 2011 the BTS, which was closely associated with the former president, has essentially become defunct. Without the introduction of a substitute, this could leave a major gap in funding of MCAs, for which the BTS was the dominant source of funds.

18. Given the laudable approach of the BTS to serve micro clients and to stay in this segment, there is some potential to expand its lending also for agricultural purposes. The main constraints would be: (i) insufficient loan funds, as the bank does not want at present to expand deposit mobilization and can mostly only get budgetary resources for onlending; (ii) the high number of smallholders that are blacklisted in view of their outstanding unpaid debts to other banks; (iii) the inadequacy of risk management systems covering some risks, in particular drought; (iv) the capacity of staff to expand lending activities and undertake loan appraisal in the agricultural sector; and (v) some operational issues such as the requirement to work exclusively with input providers accredited by the MoA.

19. **Micro-Credit Associations.** Two different micro-credit systems need to be distinguished in Tunisia: the micro-credit associations (MCAs) and the private micro-finance institutions (MFIs). There are 287 MCAs, which have been established in local communities by benevolent civil servants and local leaders, which operate in accordance with a rudimentary law. As associations, they do not have share capital, have no real owners, have no reserves to absorb any shocks and losses from default, depend on the good intentions and qualifications of local leaders and on the willingness of local government authorities to provide them with office space, etc. Their business model is to borrow loanable funds from the BTS at zero cost and intermediate at 5% p.a. This would compare with an estimated true market rate of 8-10% for loans by BTS to MCAs, and of 18-25% for loans of MCAs to their clients. The BTS provides light monitoring and only grants new loans if the repayment rate at MCAs level exceeds 80%. Average loan repayment levels have increased over time to 86%, but this is insufficient in view of the very low lending rate. The MCAs survive because they obtain subsidies from government to cover the costs of staff during the first years, receive loanable funds at zero cost, have benevolent committees recruited from local civil servants, and are permitted to subscribe to the government guarantee scheme (FNG), which relieves them from making loan loss provisions. Although the BTS, the parental body, publishes no details on the MCAs, it is likely that most of them make losses.

20. On the other hand, the system has permitted the provision of nearly half a million loans over 12 years, worth a cumulative amount exceeding TND 400 million (\approx USD 270 million). Throughout this period, about 40% of the number and value of all loans has been granted to agriculture, of which about half for livestock. In addition, the MCAs have been able to reach out to women, who absorbed more than 40% of the loans. The most important constraints of the

system obviously come from the very restrictive and inappropriate legislation, which prevents the system from developing. Other constraints are the absence of other sources of loanable funds, prohibition to mobilize deposits, capacity of staff and committees, inadequate MIS, absence of appropriate training facilities, absence of vertical and horizontal integration (through which learning could be enhanced at low cost), absence of a professional reporting system, and absence of competent supervision. If these could be replaced by a more appropriate system, the MCAs have an enormous potential to expand, and continue to finance smallholder agriculture.

21. **Private MFIs.** The GoT under the previous regime only granted a license to one MFI, an NGO called ENDA inter-arabe, to operate in the country and without an interest cap. This private MFI demonstrated a high level of performance in all dimensions, complies with the entire set of international 'best practices', has no problem obtaining sufficient commercial funding from international financiers to expand lending, has continuously expanded its network and services, preserved its orientation to serve women (73%), is a good example for action research and constant efforts to improve, and serves probably as many clients as the entire MCAs network together (>130,000). ENDA had reduced its lending interest rate to 29% p.a., but remained profitable, which is the condition for accessing refinancing facilities at low cost. Lending operations are well managed, with a portfolio-at-risk before the revolution of 1%. This excellent repayment rate is seen in all sectors, including agriculture. With its expansion from urban to rural areas, ENDA has also started to lend for agricultural purposes, and here mostly for fattening of small ruminants. These activities absorbed about TND 7 million or 13% of loans outstanding (TND 57 million). ENDA is in the process of designing new agricultural loan products for its rural clientele, whose terms and conditions more geared at the specific needs of agriculture. However, with the economic challenges that occurred after the January 2011 revolution, there are reports that ENDA's repayment rates have decreased significantly (though those for the government associated MCAs remain even lower).

22. The limitations of growth of the micro-finance sector come at a high invisible cost to society. The system could have served many more clients, if the MCAs would have been established as sustainable, growth-oriented MFIs, as in many other countries, and if the GoT would have granted more than one operating license to MFIs. Such an approach would have resulted in an estimated 300,000 additional loans worth at least TND 0.6-0.8 billion, thus a relatively high opportunity losses for the society. Since these loans were not made, it is assumed that either the associated investments were not undertaken at all due to lack of capital, or that the investors had to get their capital from other sources, including informal money lenders, at significantly higher interest rates. Thus the policy has led to high opportunity costs for Tunisian society.

23. **Credit guarantees.** The country runs two guarantee mechanisms: one, the FNG, covering micro and small loans including those for agricultural purposes; and the other one, the SOTUGAR, targeted at the operations of the much larger loans. The FNG management was transferred to SOTUGAR in 2010. The FNG covers 90% of short, medium and long term loans of banks to small and medium farmers and fishermen and all loans granted by the BTS and the MCAs. The guarantee fee is 1-2% of the amount outstanding per year. The guarantee covers 100% of the interest losses in case of declaration of a drought by the authorities and the subsequent rescheduling of loans, and 90% of the loan capital in case of default. However, the Fund only pays out on claims once a financial institution has exhausted all means of recovery. In case of mortgaged property, this requires the auctioning of land and buildings. As the courts only rarely approve the auctioning of landed property of farmers, and as most bank and MCA loans are covered by property collateral, the chances of banks to get pay outs on claims are virtually nil. It is not surprising that the value of claims payment accounts for less than 0.07% of the amount guaranteed, and this in a situation where the default rate of agricultural loans over the past decade was not less than 15% of the outstanding amount. The FNG guarantee fund is therefore more of a

virtual intervention, which satisfies the auditors to accept lower levels of provisioning, rather than a real mechanism with proven additionality. While banks customarily ask for FNG coverage of their agricultural loans, they do this as a means of precaution (for which the client pays), not because they have any confidence in the mechanism. With some of the loans (estimated to be worth around TND 600-900 million) presumably not being recoverable, the losses will have to be absorbed by either the banks or the government as underwriter.

24. The second guarantee fund in the country, SOTUGAR, covers 50% of medium- and large-scale loans and leasing arrangements above TND 100,000 granted to clients with corporate legal status. Most of the agricultural guarantees cover loans to the agribusiness sector (as opposed to primary production). The risk provisions of 2.4% of the amount guaranteed indicate well-managed loan and guarantee appraisal systems of the financial sector and the guarantee underwriter. The approach of the SOTUGAR to pay out 50% of the amount in default for over 180 days is appreciated by the banks and has created confidence in the mechanism.

25. **Leasing.** The ten leasing companies (all owned by universal banks) are well established and operate profitably. Their engagement in agriculture is practically zero, for four reasons. First, leasing companies are established in major towns only, and shy away from the higher operational cost of intervening in rural areas. Second, they find repossession of their goods from clients in default too cumbersome and costly. Third, for some goods, such as machinery, tractors and irrigation equipment, there is no accessible market for used and repossessed goods. Finally, farmers are not familiar with leasing operations, and few would consider a leasing company as a source of finance for machinery or equipment.

26. **Insurance.** The insurance sector is relatively well established, but insurance has low penetration rates in general. A well-established mutual insurer (CTAMoA) provides coverage of some risks related to agriculture, in particular hail and fire. Banks require that their clients have insurance coverage, in particular in areas where insurance cover can be obtained and for grain production. There is no insurance coverage against drought. There were some discussions over the past decade about the feasibility of index-based weather insurance policies, but these have been abandoned due to a perceived high probability of droughts, which were assumed to imply an estimated insurance premium of about 17-19% p.a. It was generally believed that farmers would not agree to pay this premium, and nor was the GoT prepared to pay the premium on behalf of farmers. The GoT had introduced legislation for a mutual risk fund for natural calamities about 25 years ago, but this has not been put into practice since then. Annex 4 of the Full Technical Report presents a brief overview of index-based insurance systems and approaches and a brief assessment of the feasibility in Tunisia.

27. **Estimation of demand for financial services.** There are several indicators that there is a substantial gap between demand and supply, although it is methodologically not possible to quantify this gap accurately. The most recent agricultural census revealed that about 12.5% of farmers had applied for a loan, of which about half were rejected. The rejection rate was significantly higher where the applicant cultivated a smaller plot of land. Furthermore, the analysis of some value chains shows serious signs of un- or under-funding, probably to the tune of TND 500 million. The sector of the economy usually covered by the microfinance industry shows an additional unsatisfied demand which cannot be below TND 600 million, of which a good one quarter or TND 150 million would be demanded by farmers. In addition, about 120,000 farmers are currently excluded from formal financial services due to their unpaid overdue loans. A strong indicator of a gap between demand and supply is the growing number of clients of MFIs.

28. **Indebtedness of farmers.** About 120,000 farmers (23% of the total) are indebted to a financial institution. As a consequence, they are listed as debtors in the credit registry and barred from further loans from formal financial institutions. In addition, they cannot sell some of their

crops to marketing organizations and POs, which deduct amounts due by the farmer to a bank and remit this to the creditor. The total value of overdue agricultural loans is about TND 750 million, of which 110,000 cases worth TND 708 million are from the BNA alone. In the case of BNA loans, 78% of the number of overdue loans involve an average amount below TND 5000 (\approx USD 3300), which adds up to TND 260 million (\approx USD 170 million). The main cases involve loans for tree crops (40%), livestock (20%), cereals (17%) and fisheries (12%). Many of these loans have been overdue for more than ten years. Few farmers have accepted the offers of debt rescheduling after the two most recent droughts, most likely because they felt they would not be able to pay off the debts even after rescheduling, and because the debt rescheduling only affected the loans for cereals, not other crops. An unknown number of farmers continue to pay the interest due without making payments on the principal. It is unknown whether some farmers prefer to face the consequences of remaining indebted, although they would be able to pay off the debts gradually from other sources of income. Tunisia does not have a legal framework governing procedures for debt negotiations, debt counseling or debt adjustment for over-indebted persons.

29. **Overview of government subsidies.** The GoT extends a number of subsidies to the agricultural sector, the most important ones including: (i) tax exemptions for reinvesting profits into the sector; (ii) faster depreciation of assets for certain categories of investors; (iii) exemption of import duties on agricultural equipment not produced locally; (iv) income tax exemption for some investments in agriculture for up to ten years; (v) tax exemptions for exporters of agricultural commodities; (vi) relaxation of importation procedures for producers of goods which are entirely exported; (vii) tax deductions for losses incurred in the agricultural sector; (viii) direct investment grants for all types of investments in agriculture up to 25% of the investment cost; (ix) direct investment grants for specific investment categories, e.g. for water rationalization, up to 60% of the investment cost; (x) low interest loans with long grace periods and repayment schedules for children acquiring agricultural lands from their parents; (xi) direct production cost subsidies for milk and cereal producers and collectors; and (xii) fuel subsidies for fishing boats and agricultural machinery (tractors, etc.). The total costs and opportunity losses of these subsidies are not known as they are covered under different GoT budgets, which are not all publicly accessible, but certainly exceed TND 100 million per year. In addition, the costs of administering these subsidy programs are quite high, estimated at 15-18% of the value of the subsidies.

30. **Subsidies for investments in agriculture.** The most important GoT support for agricultural investments is the investment grant. Over the past 15 years, 340,000 grants worth TND 1.1 billion have been disbursed in the different categories, supporting investments of TND 5.1 billion. Across all sizes of projects, 66% of total investment costs were funded by the investors themselves, 22% through the government grants program and only 13% through bank loans. This very low level of bank funding was seen across all project categories. This raises questions, including to what extent this low level of bank financing was due to conservative bank policies or client preferences, whether similar trends exist in other types of investments including those not receiving subsidies, and whether grant funding crowds out bank financing. While the proportion of bank financing has slowly increased over the past two years, this has not even been sufficient to revert to previous levels, and it would be too early to conclude that there has been a significant change of patterns. Agricultural loans granted by the BTS are a remarkable exception from the above trends. The BTS is closely linked with local government authorities in charge of grants for smallholders. Under its individual loan window, about 15% of loans have been granted for agricultural purposes since inception. These 17,426 loans involved total project costs of TND 124.6 million, of which 70% were funded by the BTS, 20% through government grants and 10% by the investor, with an average loan amount of TND 5000.

31. **Sources of farm finance.** A comparison of census data from 1994 and 2005 permits drawing a longer-term trend line regarding the shares of sources of finance for farmers. Over that

period, the use of agricultural revenues declined by four percentage points, of non-agricultural revenues by nine percentage points, of family loans/grants by two points, and of bank loans by three percentage points, while the use of government subsidies increased by two percentage points and that of supplier credit by one percentage point. The statistics further show a decline in importance of family sources with farm size, while bank and supplier credit then become more important.

32. **Seasonal lending.** For seasonal agricultural loans, banks wishing to receive a partial refinance of their loans from the central bank (BCT) are to apply ceilings for production costs per hectare. While the system may have had its usefulness in times when banks were not aware of production costs, the system has become badly outdated. The amounts are determined by the administration, not based on the actual situation on farms, but rather based on the budget available. The system, which is disregarded by private banks, distorts lending and bank-client relations and removes the responsibility of banks in the loan appraisal process.

33. **Supervised credit.** Tunisia operates a system of 'supervised credit', through which smallholders engaged in cereal production receive loans from the BNA based on standard requirements, and not on individual loan appraisal and assessment of creditworthiness. Recipients are supposed to be regularly supervised by the administrative staff in the regional administrations. While in principle, the BNA should be in charge of client identification and loan appraisal in conjunction with the local administration, in reality the local government authorities make the decisions which the BNA then implements. The BNA does this because it does not bear any risk in these operations, because the loan funds are coming from budgetary resources and because of the interest and fee income. Statistics from the Ministry of Finance over the past decade show an average repayment rate on these loans of 38%, which compares to a repayment rate of 73% for the loans to a similar clientele from BNA resources and on BNA risk. While the number and value of these supervised loans has been declining over time, they have increased over the past two seasons, serving 2300 farmers per season. The system reaches almost half of all farmers receiving direct seasonal bank loans, although with relatively small amounts (7% of the total). For the 2008/09 season, less than 5000 farmers received direct bank loans for inputs, which is less than one percent of all farmers, with an amount of nearly TND 50 million. Seasonal credit, for which the BNA is the only accessible provider for smallholders, is practically limited to cereal production. Vegetable production has not received any direct seasonal loans since 2004, tree crops not since 2001 and other crops not since 2000.

34. **Direct bank lending** to clients for agricultural purposes, for which BNA is the prime provider, has declined by 28% over the period from 2003 to 2008. The decline was faster for public enterprises (-90%) than for private enterprises (-16%). Against this, total bank lending increased by 58% over the same period, with a growth rate of 141% for public enterprises and 18% for private enterprises (which account nevertheless for 71% of total loans outstanding). The share of direct lending to agriculture in total lending therefore declined from above 9% to below 4%. Against this trend, indirect lending approaches (for example, through intermediaries such as agribusinesses and grain buyers) have gained in importance (+ 59% from 2004-2008). The main reasons are the improved efficiency of these intermediaries in cereal and olive oil production in terms of recovery rates.

35. **Conclusions.** As a result of all of the trends presented to this point, the importance of agricultural loans in total lending has declined over the years, from 8-10% at the beginning of the decade to about 4-5% at present. While some decline is normal in an economy where the importance of agriculture is gradually shrinking over time, the pace of the decline in lending to agriculture has been quite rapid. To summarize, the following causes have been identified:

- A general perception that the agricultural sector is not profitable, or at least that smallholder agriculture is not profitable
- A general perception that the agricultural sector is risky;
- The absence of effective risk management systems which could encourage banks to deepen their engagements;
- A substantial portion of farmers – almost a quarter – is indebted and thus barred from further credit;
- Smallholders do not have any important lobby that would be able to convince banks to extend loans for their businesses;
- Many farmers, especially smallholders, do not have land titles which they could pledge as collateral, and the FNG is not treated as equivalent;
- The clear preference of smallholders to use own resources for investments to avoid lengthy and at times humiliating loan appraisals, and to avoid any risks for one's family assets; farmers know best that their farming entails risks, and that in the case of loss in production due to drought, disease, hail or fire, they would not be in a position to repay their loans from the proceeds;
- Access to informal credit, be it from relatives and friends, suppliers or moneylender;
- A low propensity by smallholders to repay their loans promptly and fully, and a low preference to repay a loan when under financial stress, e.g., after harvest when prices are low or after droughts; as income levels in rural areas are often low, even farmers with a second income would not readily use such income to pay off loans;
- An ineffective guarantee scheme (FNG) that is set up in a way to encourage banks to lend for agricultural purposes but also prevents honoring of claims resulting from overdue loans;
- An artificial brake on the development of microfinance as an alternative provider of finance for smallholders;
- A subsidy system that contributes to the perpetuation of government support to agriculture, that does not appear to be too much concerned with additionality, effectiveness, efficiency, or parallel bank financing;
- The absence of visible efforts made by the agricultural bank to deal with smallholders, develop products with appropriate terms and conditions for smallholders, and facilitate the extension of financial services through value chains; in an unknown number of cases, the rigid terms and conditions, applied in the case of agriculture from classical lending, has produced low repayment rates; there is no notable dynamism to reflect on what terms and conditions would be adequate, and how to respond to these; under a regime dictated by the enforcement of prudential regulations by central banks, these – certainly valid – systems tend to crowd out agriculture from borrowing;
- The exclusion of certain financial service providers, especially input suppliers and MFIs, from accessing the PCR;
- The inertia of government as regards establishing a rigorous loan recovery system, which does not spare farmers from loan recovery because they are farmers; and
- A lack of a vision on how the decline in bank financing could be compensated through other viable forms of finance, such as microfinance, value chain finance, or in-kind supplier credit.

Additional Issues

36. A number of complex and complicated issues remain. The first issue is whether there is sufficient credible demand for loans which the financial sector does not satisfy. On the one hand, the BNA has over the past few years treated an unknown number of smallholder applications as not viable and declined funding. In some aspects, agriculture may have become less profitable than before due to changing terms of trade (see discussion above). In a few cases,

the trend towards fragmentation of landholdings may have led to profit levels considered to be inadequate by the banks, notably the BNA. On the other hand, the growth of the MCAs and private MFIs has shown that there is an enormous credible demand for microfinance that the classical providers—BNA and other banks—have not met. At least in the case of the private MFIs, farmers have been able to absorb lending interest rates of around 30% p.a., more than double the rate of BNA and more than three times the rate of the MCAs. The number of farms receiving short term seasonal loans is very low, be it from banks directly or from intermediaries, and there are sufficient indicators pointing at levels of production below what is possible, due to lower levels of input use. Finally, the agricultural censuses reveal that at least 5% of all farmers applied for bank loans without receiving them. It may thus be safely concluded that there remains a credible, unmet demand, but it is not possible to quantify such demand without deeper quantitative surveys covering representative numbers of farm households or access to bank data bases.

37. The second additional issue is related to the repayment rates. The supervised credit approaches applied by the BNA and the GoT show that repayment rates drop where creditworthiness is not assessed and appraisal becomes rather lax. Repayment rates for agriculture and other loan purposes at the level of MFIs (MCAs and the private MIF) are rather identical⁵. For the BTS, the repayment rate of agricultural loans is 9 percent points below the average rate. In the case of the BNA, the repayment rates vary considerably by type of product and loan purpose, with probably a difference of 15 percentage points between agriculture and other loan purposes.

38. A number of conclusions can be drawn from this:

- None of the institutions, with the exception of the private MFI and a few MCAs, has found appropriate systems and procedures to obtain satisfactory repayment rates.
- Repayment rates have dropped where government intervened in the selection or appraisal process, which is a confirmation of experience elsewhere in the world.
- Banks are informally prevented from executing their claims against debtors through a range of measures. The most valuable asset in an average Tunisian household is land and buildings, so all banks insist on land and buildings as collateral, assuming that this would make borrowers repay their loans. However, these claims cannot really be enforced through the courts, with a number of consumer and debtor protection norms in place. Borrowers not repaying their loans therefore do not worry about losing their collateral (land, buildings, etc.), but can rather count on their chances of evasion, thereby undermining financial discipline. As long as this informal protection of farmers prevails, it would be very difficult to revert to previous levels of funding of agriculture through the financial sector, unless farmers' debts could be deducted at source, as is the case with credit supplied through value chains. Only those POs able to enforce high compliance of members with decisions and obligations could be of assistance here, which does not apply to the majority of them.
- No alternative sources of finance for the microfinance sector have been developed. In most countries, where governments have actively pursued the development of microfinance through solid legislation and supervision, and encouraged actors and donors to invest, this has led to a sizable microfinance sector. In some countries, microfinance accounts for 10-15% of total deposits and loans, and serves more clients than banks. The current microfinance system that Tunisia has adopted is very rudimentary. It consists of: (i) one state-owned bank (BTS) with very rudimentary services that lends at below break-even rates, and which is constrained by

⁵ This is based on the information provided by the selected AMC visited in the field during the interviews. The BTS does not keep/provide statistics in this regard.

having access only to treasury funds for onlending; (ii) a host of decentralized, small, state-initiated MFIs that are prevented from developing rather than supported to develop; and (iii) the brake on the establishment of new private MFIs, with only one private MFI being permitted to operate. The attempt to control this sector has come at a substantial cost to the country. It is in effect holding back the development of a vibrant private MFI sector and giving many farmers no choice but to turn to informal moneylenders, instead of encouraging the development of the sector by:

- Developing a service structure below the traditional banking sector that is integrated horizontally and vertically into the financial sector, and that is capable of serving low-income groups;
 - Developing the capacity of the MF sector to obtain loanable funds come from the private sector, be it deposits or domestic or overseas bank loans;
 - Providing veritable assistance to low-income groups and keeping them focused on their economic development; and
 - Integrating people into the formal commercial and banking circuits.
- The fourth additional issue relates to insurance and its costs. The main risk that farmers in Tunisia are suffering from is drought. However, insurance currently only offers protection against hail and fire (and this is compulsory in the case of bank borrowing). Experimenting with insurance protection against drought was discussed about a decade ago, but the idea was dropped because of the lack of funding for the costs. However, there is a lack of recognition of the fact that the costs of drought to society remain the same, with or without insurance, only that formal insurance of a sector helps to redistribute cost more evenly over the years, and that a mechanism based on solidarity helps to redistribute it over many more shoulders than those immediately affected. Self-insurance of households may be cheaper than using formal insurance, but the risk for the society is that those affected by the events may be impoverished. Insufficient analysis was directed at the transaction costs of the various systems, and mechanisms to provide partial funding of a scheme from non-conventional sources. The inertia to act here is also closely linked to the inability of public and private sectors to establish solid risk management systems and approaches. The absence of an effective protection of investors, or their bankers, through insurance first and then against not insurable risks, is an effective impediment for the financial sector. The decline of agriculture has to do with the public perception that agriculture is risky, and that the state does little to assist here; even where pieces of legislation existed, such as in the case of the fund against natural calamities which was enacted in 1986, this was never put into practice. As in the case of microfinance, the lack of an appropriate and comprehensive system led to enormous costs for the society at large: the majority of farmers remaining outside the formal financial system, so that their investments are constrained, and the vast numbers of farmers who postpone cultivation of cereals until after the rains have come for fear of losing seeds and labor inputs. This leads to consistent production below Tunisia's potential, entailing large quantities of wheat imports.
 - The agricultural guarantee mechanism has failed. As farmers affected by droughts are no longer interested in rescheduling of their loans, banks are less convinced about the merits of the system. As the FNG coverage prevents banks from executing justified claims against their debtors within reasonable periods of time (and eight years is not reasonable), the system becomes fictitious or virtual, rather than real. The fund endowment came from the contributions of farmers, and smallholders paid a proportionally higher contribution than larger farmers, without substantial contributions by the government. It is no wonder that the attitude of banks is negative to the concept, and that they refrain from lending. Someone in the end has to pay the bill, be it the farmers, the banks (especially BNA and BTS) or the GoT. A system originally

thought to be “innovative” set up to produce additionality in agricultural and small enterprise lending becomes very expensive in the end: first because the bill is presented much later, and second because of the opportunity losses of investments, income and employment.

Part B: Selected cases of international experience in agricultural finance

39. **Part two of the Full Technical Report** contains descriptions and analysis of some international experiences which we believe to be relevant for developing the agricultural finance system of Tunisia. Under the section dealing with microfinance, it summarizes the experience of Morocco and Indonesia, in particular that of Bank Rakyat Indonesia, one of the leading microfinance providers through its village desks, a story that could inspire in particular the BNA to think about an expansion into rural areas through a collaborative framework with the MCAs. Judging from the experience in Morocco, which as a country shares many features with Tunisia, a further and successful expansion of microfinance in Tunisia is possible.

40. The section dealing with guarantee mechanisms for small enterprises and the agricultural sector presents a condensed summary of what is currently considered good international practice regarding guarantee mechanisms. It then provides an overview of the systems existing in Europe, specifically in Germany and in Hungary, before it draws some important structural and operational conclusions relevant in the Tunisian context. The key messages distilled here would be highly relevant for the reform, or replacement, of the Tunisian agricultural guarantee mechanism.

41. The section on index-based weather insurance is kept short – in view of recent publications on the international experience, which are easily accessible in French and English. The section dealing with consumer debt counseling and adjustment explains the approaches of France, Germany and Belgium to reduce the debt burden of over-indebted individuals, an approach which does not exist yet in Tunisia. The underlying assumption is that it would be much more appropriate to create a mechanism for individual debt counseling on a continuous basis rather than leave all cases of indebtedness, including that of farmers, for debt waivers or restructuring exercises.

42. The last section of this part deals with the legislation in France providing a very fine-tuned organizational framework for different types of smallholders, with and without limited liability. This is thought to be relevant for efforts to improve the existing legal framework for POs in Tunisia, which are not commensurate with the specific needs of producers. Over and above POs, which are structured to provide support to large numbers of members, and the not-for-profit farmer groups and water user associations (Groupement de développement de l’agriculture et de la pêche), there is a need for quick, easy and cheap registration of smaller for-profit groups of farmers, which facilitates efficiency gains, investments, profits and payment of dividends without administrative interference.

Part C: Recommendations

43. This report does not come up with a new categorization of investors and farm households, which is not within the scope of the study. It also does not look much into the impact and effects of agricultural subsidies more generally (i.e., beyond credit), and how a more suitable subsidy program for Tunisian agriculture could be established, because this would be outside the already rather wide mandate of the study, and because there are other studies by the World Bank and others on this topic. It does not propose simply asking financial institutions to increase the volume of their engagement in agriculture. It also does not propose to the government to set up new financing, refinancing or grant mechanisms, through which the administration would retain

its role in lending. Instead, it invites the administration to view the challenges from the point of view of a financial institution that must be reasonably sure that an application represents the best possible investment the bank could do, and that the applicant will repay the loan on schedule.

44. **Overview of the recommendations.** In this section we provide a range of proposals to overcome the main current constraints on agricultural finance. The recommendations are designed to complement each other, and should be implemented in a comprehensive and coordinated manner. They can be classified, in line with the above discussion and presentation, into five clusters: (i) the development of microfinance; (ii) the deepening of the risk management system; (iii) approaches to facilitate integration of producer organizations into the financial system; (iv) approaches to deal with the over-indebtedness of farmers; and (v) improvements in service delivery and orientation.

Cluster I: Reforms of the microfinance sector

45. As the capacity of the BTS and the willingness of the BNA to serve smallholders are limited, it is evident that smallholder finance will primarily have to come from the microfinance sector. The existing MFIs have clearly shown that they are interested and, within limits, able to serve smallholder farmers. It is therefore likely that both the semi-public and the private MFIs will continue to do so, as long as there is credible demand for their services. But two concrete measures are needed first: (i) the creation of a new microfinance law, and (ii) technical assistance to the MCAs. It is assumed that the emerging private sector MFIs other than the MCAs will be driven by their owners and do not need any public support other than solid regulation and supervision.

46. **Recommendation 1: Approve a new microfinance law.** The point of departure for the opening of the microfinance sector is the reform of microfinance legislation. Under the previous regime, the law was more geared at preventing and controlling microfinance, rather than creating the basis for its firm establishment and expansion. The process to develop new legislation should be participatory in nature, and involve first of all the practitioners (MCAs and private MFI) and the central bank. Technically, this could be achieved by replacing all old fragmented pieces of legislation with one single comprehensive law. An alternative would be to authorize the central bank (BCT) to create the entire regulatory framework including prudential regulation consistent with good international practice. While the new legislation needs to address two different categories of service providers, i.e. the semi-public MCAs and private MFIs, the set of rules should be the same for both types. An important issue is whether the MCAs should be limited to operate in one geographical zone (district) only or be permitted to expand beyond. This would have important consequences as regards standardization, horizontal and vertical integration, and supervision. An important change should be that MFIs must have a clear ownership structure and a corporate status that permits fast decision making and control measures, such as cooperative, company limited by shares (SARL in French), public liability company (SA in French) and the like. Good performers complying with defined minimum standards should be allowed to mobilize deposits. Apart from deposit and credit services, they should be permitted to offer also other financial services under the condition that they prove that they can reasonably provide these. Supervision should in the beginning be done through the BCT, but could over time be delegated to a special bureau or agency. As in Morocco, universal banks and other financial institutions should be permitted and encouraged to create their own MFI if their owners so decide. The previous restrictions as regards upper limits for interest rates and loan amounts and lending only to individuals, but not to corporate bodies (such as farmer groups) should be removed. The costs of this measure are comparatively low and comprise mainly technical assistance and public hearings. The interim government that came to power after the January 2011 revolution passed a law (no. 117/2011) creating a new regulatory framework for microfinance subsequent to the final mission for this study, so the new law was not reviewed. The implementation of the new

legislation awaits the issuance of the related “decrees of application” (*decrets d'application*). Care should be taken to ensure that both the law and the decrees of application are consistent with international good practices, such as those recommended by the Consultative Group to Assist the Poor (CGAP). The priority given to this measure should be very high.

47. **Recommendation 2: Provide technical assistance for MCAs.** Few of the MCAs are capable to run their businesses competently, and all of them need improved management information systems. Upon the entry into force of new regulations, they must understand these and learn how to put them into practice. Conditions for refinance, be it from the BTS as before, or from the BNA and other banks, must be developed and the process synchronized. Performance data of the MCAs must be systematically collected and analyzed. The transformation of supervision from the BTS to the BCT must be properly managed. The transition of MCAs from an association of volunteers to a corporate body of (local) investors must be achieved. It appears that these roles would be best handled under a temporary project structure, for which donor assistance should be sought. The minimum costs of a five year project may be around TND 20-30 million, or USD 13-20 million, including training, endowment with IT solutions, technical assistance and on-site coaching, etc. The priority given to this measure should be very high.

Cluster II: Improve risk management systems

48. Three types of measures are needed here: (i) the complete restructuring of the FNG; (ii) protective schemes against drought; and (iii) broadening access to the PCR, and eventually creating a proper institution to manage the PCR. Some specific recommendations to guide this restructuring are provided below.

49. **Recommendation 3: Reform the FNG.** A guarantee fund is still very important in Tunisia because of the weakness of the collateral and foreclosure system. However, the current FNG needs to be restructured along the model of the SOTUGAR. First, the new mechanism should provide collateral only for those potential borrowers that do not have sufficient collateral, and not for all borrowers. As a consequence, coverage will no longer be compulsory for all borrowers, but be contractual in nature. Borrowers with sufficient collateral thus do not need the service. Second, the guarantee comes at a cost including a risk element, for which the client will have to pay. The premium should not be fixed as one for all, but in accordance with the projected costs and risks. Third, the fund will operate in a sustainable manner by attempting to make a marginal profit from the operations. Fourth, the fund will provide coverage not exceeding 50% of the loan amount for standard clients, and not more than 70% for special risk groups the government wants to support (start ups of young professionals, biological producers, exporters, etc.). Fourth, the guarantee fund will make a first payment of 50% of the expected loss 180 days after the loan has fallen into arrears. Fifth, the eligibility criteria for accessing the guarantee should be expressed in terms of the amount of investment, and not in terms of the investment classification so far used (categories A, B and C). Sixth, both individuals and corporate bodies should be covered, in particular for-profit cooperatives and farmer organizations. And seventh, the service should be accessible to all financial institutions licensed and supervised by the BCT, including commercial/universal banks, non-bank financial institutions and MFIs/MCAs.

50. While the initial capitalization will have to come from the government, all financial institutions using the service will have to become shareholders and increase their shareholding slowly over time. The estimated costs for some experts and the implementation process are not significant. The SOTUGAR has sufficient expertise to implement the proposal without much assistance. The capital requirements of the new FNG may initially be around TND 150 million to enable the fund to guarantee a loan volume of TND 400-500 million. The costs of the dissolution of the old FNG can only be determined on the basis of an extensive audit. The estimated time of

preparation until the new FNG could start operating is about 20 months. The priority given for this measure should be very high.

51. **Recommendation 4: Develop drought risk mitigation mechanisms.** Farmers and banks lending to agriculture need protection against the risk of drought. A two-pronged approach comprising of insurance and state assistance is recommended. The principle should be that all risks that could be commercially insured locally should only be covered by such insurance coverage, whereas risk that could not be insured should be partially covered by an intervention mechanism against natural calamities, including drought. As regards insurance, there is a good possibility that index-based or area-yield insurance approaches would work better in Tunisia than classical insurance approaches, with their high transaction costs for damage assessment and fraud control. Although no full feasibility study on the implementation of index-based insurance cover has been carried out, some initial aspects of feasibility were assessed during the study, and the results look promising. However, due to the team's lack of access to necessary Tunisian meteorological data, even the assessment of potential was limited. It would therefore be opportune to first conduct an in-depth feasibility study—with the full cooperation of the Tunisian meteorological institute—and then design an insurance contract. In the process of contract design, the opportunities for cost reduction should be thoroughly explored, as well as options for creating a public program to reduce the premium amounts. Points of departure may be the coverage of drought during the early planting stage of cereals, and covering the costs of inputs like seeds, fertilizers, tractor services and labor. The second component of the strategy would be to implement the concept of a mutual natural calamity fund. This fund should principally cover risks that insurance would not cover, either because the risk would not be commercially insurable or because farmers would operate outside the geographic areas covered by insurance. The fund would make pay outs only for loans from financial institutions which have been affected by a defined natural calamity, and should cover a specified percentage of the principal amount. Crops in areas where they are not viable would be excluded from coverage, such as wheat production in the southern parts of Tunisia. The costs of the technical feasibility studies would not be substantial. Insurance premiums should in principle be paid by the respective beneficiary, i.e. the borrower. There may however be a need to subsidize the premiums by the government. The costs of these subsidies and of the mutual natural calamity fund could be partly funded through special levies and marginal tax increases. The estimated duration until the entry into force of prudential regulations is about 18-24 months (for details see Annex 4). The priority given for this measure should be high.

52. **Recommendation 5: Expand access to the Public Credit Registry.** Neither the MFI sector, nor input and equipment suppliers providing their goods on an in-kind credit basis have access to the PCR operated by the BCT. As these provide important services of a certain magnitude, and as the effectiveness of the PCR depends on the comprehensiveness of the data base, it does not make much sense to keep these two types of financial service providers out. The BCT should therefore open access to the PCR to these two types of providers on the basis of the same terms and conditions as for banks, i.e. mutuality, contribution to the operating costs and immediate entering of all required data into the system. The costs of this measure would be marginal, the implementation could be achieved within six months, and the importance of the measure is considered to be high. Eventually, Tunisia should work towards the creation of a proper credit registry operating outside the central bank and under civil law status.

Cluster III: Facilitating the integration of producer organizations into the financial system

53. The formation and strengthening of agricultural POs would contribute to increasing the effectiveness of governance of the agricultural sector, increasing efficiency and improving market integration and access to finance. Four concrete measures are proposed here: (i) a partnership between the MCAs and POs; (ii) improvement of access of POs to bank finance; and

(iii) new legislation permitting the corporate management of inherited farm estates and the creation of specific for-profit farmer associations; and (iv) the creation of credit management units in cooperatives and POs.

54. **Recommendation 6: Encourage partnerships between MCAs and POs.** MCAs do not have sufficient means to ensure repayment of seasonal input loans as they do not control financial flows linked with harvested produce. A recent trial experiment in Kef by the MoA aimed at establishing partnership relations between an MCA and a PO and its members. The idea was that the PO ensures the collective marketing of the produce of its members, which enables it to guarantee the repayment of the seasonal loans granted by the MCA to the PO members. The amounts realized are first used to repay the MCA loans to members. In view of these arrangements, the MCA was in a position to increase its loans significantly subject to the mutual respect of the agreement between the MCA and the PO. Given this positive experience, there could be potential to expand this further and involve a larger number of POs and MCAs in voluntary associations and carry out an analysis of their respective capacities. Assessment of the costs of this measure would require additional analysis and would depend on the requirements for technical assistance, capacity building and training. The importance of the measure is considered to be high.

55. **Recommendation 7: Improve access to bank financing for POs.** Before banks establish trust and confidence in a PO and grant a loan, it is indispensable that the management quality of the PO inspires adequate confidence for the bank to do so, and that the PO disposes of a minimum equity level that ensures its sustainability throughout the loan period, even in cases of stress. This is not often the case. It is therefore important to improve the management capacity and members' willingness to apply some of the profits to capital funds so as to ensure adequate equity levels. Such capacity could be developed through the following steps: (i) increased efforts to train managers; (ii) intensified exchanges on good practices between POs; (iii) improved systems of governance; (iv) introduction of new management information systems; (v) improved quality of services and other measures aimed at improving profitability; (vi) increased equity funds; and (vii) the elaboration of new business models. On the basis of their improved performance, POs would be assisted in learning how to negotiate for bank loans and invest bank financing efficiently and effectively. The costs of these measures over three years may be estimated at TND 2-3 million, which may be covered under the MoA budget. The importance of the measure is considered to be high.

56. **Recommendation 8: Develop a new legal status permitting the corporate management of inherited farm estates and the creation of specific for-profit farmer associations.** There are about 516 000 farm households in Tunisia. Between 1961 and 2005, the average size of a farm decreased from 16 ha to 10.2 ha, and the percentage of farms with less than 5 ha cultivated area increased from 41% to 54%. Such a situation does not favor the modernization of farm technology or improved productivity. To mitigate this tendency, it is proposed to create a new legal status that permits corporate management of inherited farm estates, in particular by members of the same family (for details on the French legislation of the "Groupement foncier agricole" and other forms see Part 2 J of the Main Technical Report). To address this problem, in-depth analysis on the fragmentation of farms is required, which will include identification of the causes and effects on Tunisian agriculture, and which will assess the different types of legal status capable of reversing the above trends on the basis of successful international experience. To the extent possible, the needs of farmers in terms of additional organizational form options should also be included in the study (for example, joint management of farms, equipment and machinery). On the basis of this, a new legal framework should be elaborated in consultation with the cooperative and financial sectors. The impact of these measures will be found in improved management and modernization of such estates, and in their better access to finance.

57. **Recommendation 9: Creation of Credit Management Units in POs.** Banks, including the BNA, have difficulties in ensuring ease of access to their services by agricultural clients. To address this, we propose creating credit management units within POs and other farmer organizations, or as independent structures, which will make the financing of agriculture more dynamic and which will reinforce POs and enhance and widen their role as professional bodies. Farmers in need of bank loans, restructuring of bank debts, or additional public services could request the support of these units to: (i) assess their seasonal or investment capital requirements in accordance with the characteristics of their own farming business and their debt capacity; (ii) compile their loan request; and (iii) arrange for the regular repayment of loans. By having detailed knowledge of their membership, the creation of PO credit management units would facilitate accurate collection of information on their self-financing and repayment capabilities, and help identify any social, financial or technical constraints that would inhibit their repayment. The knowledge of the financial situation of farmers would also permit these units to better target those who are in need of finance. The impact of this approach would be evident in an increased volume of bank loans to the agricultural sector, in higher repayment rates, and in a broader mandate and scope of technical and economic support provided by POs. The importance of this measure is moderate.

Cluster IV: Reforms geared at over-indebtedness of farmers.

58. Three different measures are needed to sort out or alleviate the problem of over-indebtedness of almost a quarter of all farm households. These are: (i) debt cancellation; (ii) creation of legislation on debt negotiation and adjustment; and (iii) an annual report on indebtedness.

59. **Recommendation 10: Cancel unrecoverable debts.** Even the limited data available on the indebtedness of farm households clearly indicate that some of the loans are not recoverable, especially those granted under projects with unclear systems and approaches, and those that have been overdue since more than a decade. Furthermore, fewer and fewer farmers are interested in the debt rescheduling exercises offered by the GoT after a drought. Debt waivers should be based on an analysis of the different categories and causes of debts, which requires a detailed statistical survey. Categories of debts that should be considered for waiving include: (i) loans of a value not exceeding TND 5000 disbursed before 2000 from budgetary resources and on account of government; and (ii) loans disbursed under within the context of development projects, which were not geared at economic benefits, and which were granted under dubious conditions and inadequate supervision systems. A thorough review process by the BNA of its overdue portfolio should reveal further options. The debt waivers should be accomplished by developing objective criteria first and only after rigorously applying these, and by imposing a ceiling for fresh borrowing (say TND 5000) for the next 5-7 years through the PCR. However, these measures need to be handled with great care—especially the potential cancellation of debts—in order to avoid creating conditions of moral hazard and further undermining the already weak credit culture in Tunisia. The measures should be accompanied by financial literacy campaigns geared at enlightening farmers about risk in borrowing and their own risk management approaches at household level, including enhanced saving. Implementation would require approximately one year. The costs for the studies would be marginal and could be covered by the MoA and BNA, the prime creditor. The effective cost of the write-offs depends on the magnitude of debt waivers, and on how realistic the chances of collection would be without waivers (in reality, very low). This measure is considered to be of moderate importance.

60. **Recommendation 11: Create new legislation on debt negotiations and adjustment.** While some people can be reached through the collective action of debt waivers, there is a need to put into place a structured process through which over-indebted individuals can get a relief of their debts to obtain a chance of starting afresh. The new measures to be introduced

should include farm households, but not be geared exclusively at them. As shown in part II of the Full Technical Report, such legislation does exist in many states of North America and Europe. In short, and following the core underlying principles of these somewhat different models and approaches, the process should start with the creation of an inventory of debts and debtors and a structured negotiation between debtor and her/his creditors that could lead to the settlement of the debts. If this would fail, an authorized government agency, probably a specialized magistrate, could then pass a settlement decision, which obliges the debtor to pay off his debts over a certain period of time (4-8 years), and through which the right to dispose of assets would be transferred to the court. In return, after complying with the payment obligations as set out, the remaining debts would at the end be waived, and the debt cancellation would be entered into the credit registry database. The costs of introducing new legislation are low, and can be absorbed within the existing budgets. Key issues are to determine which government agencies to involve in the initial debt negotiation process and which courts in the debt adjustment, and whether to involve NGOs in the process, as done in several European countries. The importance of this measure is considered to be moderate.

61. **Recommendation 12: Produce an annual report on indebtedness of the agricultural sector.** For quite some time, insiders and the affected financial institutions and the farmers are aware of the problem, and probably some civil servants and researchers, but there has been insufficient attention paid to the problem. It would thus be opportune to request the administration to produce an annual comprehensive report on indebtedness, its extent, causes and solutions. The most appropriate institution to collect the data would be the central bank (BCT), and the report itself would be elaborated by the MoA, which has the authority to convene financial institutions and request data. The first recipient of the report should be the parliament (rather than the administration alone). The costs of implementation would be comparatively low and could be absorbed by the BCT and the MoA. The importance of this measure is considered to be moderate.

Cluster V: Reforms geared at improving the quality of service delivery.

62. Three measures are finally recommended to improve the quality and efficiency of financial services for producers. These are: (i) the abrogation of “supervised” credit where the risk is borne by treasury and not the bank; (ii) the revision of the terms and conditions of bank loans for agriculture; and (iii) the financing of new technologies.

63. **Recommendation 13: Abrogate loans under treasury risk:** Granting ‘supervised’ loans by BNA to farmers without any risks does not lead to satisfactory results in terms of repayment, as these loans are more of an invitation to default rather than to repay. Such loans also tend to perpetuate a public perception that loans do not need to be repaid, with detrimental effects on financial discipline. As a consequence, it is opportune to refrain from providing such loans, in line with the international experience that banks not bearing any risk will not be prudent lenders. Debtors should remain barred from further borrowing through the PCR unless the default was caused by events beyond their control (e.g., natural calamities). These measures do not imply any additional costs, and instead would save GoT about TND 3-4 million per year. The measures could be implemented starting immediately. The importance is considered high.

64. **Recommendation 14: Revise the terms and conditions of bank loans:** A large number of farmers is excluded from loans because they do not have the collateral required, often because of the inadequacy of the public cadastre or because they leased the land cultivated. Loan terms and conditions and loan application and processing approaches are more reminiscent of public sector administration than of private sector banking practice. Loan processing by BNA can take substantial time. The bank is far from being in a position to renew loans within 24 hours, as many banks and microfinance institutions are able to do. No systematic revision of procedures,

terms and conditions has taken place in BNA yet. It is therefore opportune for the BNA to undertake such a revision. Large-scale banks that have seriously engaged in such revision have discovered an enormous hidden waste, improved their operational efficiency and reduced their administrative costs. The revision should ideally envisage lending to smallholders (amounts below TND 5000, or USD 3300) without asking for mortgages, as practiced by so many banks in developing countries or countries in transition. This would run parallel to the recommended reform of the FNG. In addition, the bank would be well advised to establish an internal working group, probably reinforced by outside specialist consultants, to prepare and launch a customer-orientation program, paralleled by a training and orientation program for staff and regular client satisfaction surveys. The costs of implementation can be absorbed by the BNA. The importance of these measures is considered to be high.

65. **Recommendation 15: Facilitate financing of new technologies.** Apart from increasing guarantee coverage of the reformed FNG up to 70% for some innovative products and technologies, two additional measures are recommended here. The first is to elaborate standard technical and financial background material through independent agencies or consultants to help financial institutions make informed decisions about whether to lend for the new technologies. Such feasibility studies would provide solid information on the technical nature of an innovation, the costs, markets, risks and future prospects, and propose adequate terms and conditions for term financing (duration, repayment schedule based on cash flow projections). The second requires the respective promoting agency, such as the MoA or specialized agencies, to enter into a dialogue with selected financial institutions on the financing of these innovations, and adequate terms and conditions. These measures should also become a regular activity of the MoA, and an annual budget allocation for this may amount to TND 0.3-0.6 million. The importance of this activity is considered to be moderate.

Part D: Areas for additional analysis

66. Although this study looked in great detail at as many of the issues directly related to identifying constraints on expanding access to agricultural finance in Tunisia as possible, there are other issues that are indirectly related that were beyond the scope of this study, and some issues for which the team did not have adequate access to the necessary information. For example, there appears to be a class of medium-sized farmers that is not served by the microfinance institutions (BTS, MCAs, MFI) because the amount required is above TND 5000, but that does not qualify for universal bank financing, often due to lack of collateral, and that is not big enough to qualify for access to special instruments (e.g. the BFPME and SOTUGAR guarantees for loans greater than TND 100,000). Tree crop farmers for example cannot repay their loans before 5-6 years after plantation from the proceeds of their trees, and are almost excluded these days from conventional finance. Due to lack of access to accurate data, and lack of time to deepen the analysis, this issue was not analyzed further.

67. Another issue is whether investors for agriculture projects could be mobilized from the institutional sector. Tunisia has a rather elaborate system of joint venture finance, which is owned mostly by the universal banks. These institutions have minimum investment thresholds, which are much above what is conventionally required by agricultural investors. Apparently, most investors are using the legal status of SMVDA as investment vehicles, under which investors obtain land on lease basis in return for the obligation to produce specific crops following specific production patterns. It thus appears that under the current framework, there is not much scope for additional demand and supply of agricultural finance.

68. The agricultural **cooperative sector** is believed by some to provide potential solutions to many of the constraints that farmers are facing. However, POs are fraught with many constraints themselves, as discussed in the Full Technical Report (part I, chapter B 5), and their

limited operational basis is further narrowed by the cooptation done by the previous regime. It is assumed that without a larger reform of the cooperative sector, it would not make much sense to invest further in isolated segments or elements. Most POs provide cheap services to their members, and therefore forfeit making any profit as an institution. While this choice of members is certainly respected, it also means that the chances of societies to expand, invest in quality from retained profit, pay dividends, have sufficient equity capital, and be a respected economic actor capable to borrow from banks along standard/commercial terms, is highly limited. As such, investments would not result in sustainable institutions and services, unless the fundamentals are first put in place.

69. **Savings mobilization** is comparatively weak in Tunisia, and has a lot of potential to be developed and deepened. Savings are prime elements of a household strategy to provide finance for all needed expenses, including emergency requirements. They provide stability to households and reduce their vulnerability. Many Tunisians argue that farm households cannot save as their revenues are too low. While revenues are low, there is enough evidence that this does not prevent farm households from saving. However, most households keep their financial reserves in a bank other than the one from which they borrow, as a simple risk management measure to prevent the bank from debiting overdue loan installments against the deposits held. The negative side effect is that a household cannot develop its creditworthiness with the bank from which they borrow, and that their creditworthiness with the bank where they keep the savings is useless. Generally, the two relevant development banks, BNA and BTS, do not make much effort to mobilize savings from among their agricultural clients. The 'Fareh' savings plan of the BNA is geared at consumer financing, and the respective BTS product 'Toumouh' is hardly known and was launched only recently. The BTS is also operating under institutional constraints, which make it difficult for the bank to engage in massive deposit mobilization. Putting more emphasis on deposit mobilization and linking savings and loans would be easy for BNA, but difficult for BTS.

70. **Restructuring of public banks.** At the request of the government, two important issues not dealt with in this report are the reform of the BNA and the restructuring of the BTS. As regards the BNA, the bank is not entirely owned by the GoT itself, but by some parastatals and public enterprises, among other minority shareholders. The bank also has plans to raise more capital from the stock exchange. In such a situation, it would not be opportune to propose a restructuring of the bank. Ideally, reform initiatives would originate from the owners or board of directors, or at least from the CEO, and not from outside. As the government agency in charge of agricultural development, the MoA should try to convince the BNA board to start a new initiative geared at quality improvements, streamlining of operations, product development in the microfinance sector, and much higher customer-/service-orientation of staff. The latter may turn out to be the most difficult one out of these. These recommendations are in addition to the concrete recommendations made above (Recommendations 13-15). This report also does not provide guidance for any restructuring of the BTS. To become sustainable and no longer a burden on government funds, a complete overhaul of the bank would be needed, on the basis of which the BTS would either qualify for concessional or conventional financing, or be capable to fund the loans it wants to grant from deposits. The publicly accessible literature on the reform of state-owned development finance institutions is legion, and the BTS reform would not pose any structural complexities that might require new systems and approaches. For example, the presentation of the case of Bank Rakyat Indonesia in the Full Technical Report provides ample guidance on possibilities for the re-shaping of the BTS and its downstream outreach organs. However, as mentioned above, as one of the results of the Tunisian revolution the BTS currently appears to be defunct.

71. Under the current circumstances, with the apparent demise of the BTS, one possible solution for the development of both smallholder finance and the BNA would be a program to link the BNA and the reformed MCAs. Such an approach would reduce the transaction costs to

the BNA from providing smallholder finance directly through its own window, an exercise that would be complex and absorb substantial time and efforts by senior management. Once the MCAs would start mobilizing deposits, the BNA could become the treasurer of the MCAs and provide liquidity balancing to them. Reformed MCAs would benefit from a strong partner with solid knowledge in many areas of lending (in particular agriculture), sufficient liquidity, and guidance on all banking issues. Such a symbiotic linkage would depend on the commitment of the owners and managers of the BNA on the one hand, and on the transformation of MCAs into full-fledged microfinance institutions, as outlined above. But detailed implementation plans for such a program would require additional analysis.

72. **Production subsidies for agriculture.** One complex subject, agricultural production subsidies, already mentioned above, is not dealt with in this report. Tunisia has for quite some time had in place a range of subsidies for agriculture, and their impact is between weak and negligible, but sometimes with negative side effects. In line with the argument for a streamlining of bank procedures, it would make sense to conduct a comprehensive analysis of these subsidies and compare the actual impact with their stated objectives, side effects, and costs. As a general principle, where subsidies are too costly to administer (i.e., where the costs of handling are greater than 10-12% of the value handled), where no significant impact on production, value creation, incomes, tax revenues, or employment can be demonstrated, where they have detrimental side effects outweighing their benefits, or where their impacts are not sustainable, it would be advisable to phase these out. Earlier studies by the World Bank and others already dealt with the issue of agricultural subsidies in detail.

73. **Complementarity of investment grants and bank financing.** Related to the above review is the question of whether government investment grants should in the future be tied to bank finance. Some countries only pay out investment grants where a bank is in principle ready to provide co-finance for the investment, be it for seasonal or terms requirements. There are two different schools of thought. The first one reasons that government grants are geared at enhanced production outputs and productivity, which would be achieved whether the investor would finance the balance of investments from own resources or from both own and bank resources. Investors with sufficient equity willing to invest their own funds should not be punished indirectly by denying them a support that others receive. However, a disadvantage of this approach would be the higher cost of appraising a grant application, which would be the full responsibility of the government. The other school of thought reasons that leveraging of matching grants and low transaction costs for the government could be better achieved by requesting investors to show a parallel bank financing, as one could reasonably be sure that a project is feasible and viable once it has been appraised by a bank. It would also produce an additional number of loan applications and could lead to higher bank financing of agriculture, as desired by the MoA, assuming that applications are of sufficient quality. The issue is whether these are credible applications and lead to solid investments and sound bank portfolios. This second approach would also crowd out investors that do not want to borrow, for whatever reason. An answer to the question of which approach would work best could only be given after a representative analysis of grant applications/approvals done by APIA, and after doing the same with bank loan applications receiving grant funding. This was not possible within the framework of this study, so it is therefore strongly recommended to the MoA to carry out this activity.

74. The ultimate solution to the challenge of increase access to agricultural finance may not lie in doing more of the same, but doing it differently. This may ultimately require the need for the MoA to withdraw from some arenas, apply private sector views and management approaches, listen to the feedback of private sector service providers, and learn how to contribute to the creation of an environment in which the private sector and the public sector work in partnership. This would require accepting that some old instruments may no longer be applicable, and it may be necessary to adopt new ones. MoA may also have to accept that it is no longer the

only or even the main decision maker in the arena, but one player among several, and that the creation of alliances to pursue common goals would be a more effective strategy to achieve its objectives. Pursuing the approaches outlined in this report, including creating fora for stakeholder consultation and implementing the recommended actions, would provide the Government and people of Tunisia with excellent opportunities to significantly increase access to finance in the agricultural sector.

75. The recommendations of this study are all important, and to have the greatest impact they are meant to be implemented in a comprehensive and coordinated manner, rather than piecemeal. Nevertheless, given the topic of the study, the recommendations concern the financial sector alone, and therefore are not sufficient themselves to address the fundamental issue that agricultural finance will never be successful unless farming is profitable, thereby providing a sufficient rate of return on investment. In reality, as alluded to in the study, Tunisian farmers are being squeezed by deteriorating terms of trade that result at least in part from the poor policy environment for agriculture more generally. Those broader issues are beyond the scope of this study, but must be addressed if financing for agriculture is to expand and support a healthy, growing agricultural sector.

