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THE WORLD BANK

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1818 H Street NW

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Loan Committee: Tunisia - Fourth Agricultural Credit



1059527

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Tunisia - Fourth Agricultural Credit Project (04) - Loan Committee Project
File - Correspondence

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Report No. P-4471-TUN

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WBG ARCHIVES

MEMORANDUM AND RECOMMENDATION
OF THE
PRESIDENT OF THE
INTERNATIONAL BANK FOR RECONSTRUCTION AND DEVELOPMENT
TO THE
EXECUTIVE DIRECTORS
ON A
PROPOSED LOAN
IN AN AMOUNT EQUIVALENT TO US\$30.0 MILLION
TO
THE NATIONAL BANK OF TUNISIA
WITH THE GUARANTEE OF
THE REPUBLIC OF TUNISIA
FOR A
FOURTH AGRICULTURAL CREDIT PROJECT

June 1, 1987

Sp-1+2
Sub. C

CURRENCY EQUIVALENTS

Currency Unit	=	Tunisian Dinar (D)
D 1.00	=	US\$ 1.15
US\$ 1.00	=	D 0.87

(as of December, 1986)

FISCAL YEAR

January 1 to December 31

ACRONYMS

ASAL	Agricultural Sector Adjustment Loan
BCT	Central Bank of Tunisia
BNDA	National Bank for Agricultural Development
BNT	National Bank of Tunisia
FOSDA	Special Fund for Agricultural Development
FOSEP	Special Fund for Fishery
FNG	National Guarantee Fund
MIS	Management Information Systems

REPUBLIC OF TUNISIA
FOURTH AGRICULTURAL CREDIT PROJECT

Loan and Project Summary

Borrower: National Bank of Tunisia (BNT)

Guarantor: Republic of Tunisia

Amount: US\$30 million equivalent

Terms: 17 years, including four years of grace, at the standard variable interest rate.

Financing Plan:

	<u>US\$ million</u>
IBRD	30.0
BNT	12.7
Government	4.3
Sub-borrowers	12.0
TOTAL	<u>59.0</u>

Staff Appraisal Report: No. 6622-TUN Date: June 1, 1987

Map No.: IBRD 14921R

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WBG ARCHIVES

MEMORANDUM AND RECOMMENDATION OF THE PRESIDENT
OF THE INTERNATIONAL BANK FOR RECONSTRUCTION AND DEVELOPMENT
TO THE EXECUTIVE DIRECTORS
ON A PROPOSED LOAN
TO THE NATIONAL BANK OF TUNISIA
WITH THE GUARANTEE OF
THE REPUBLIC OF TUNISIA
FOR A FOURTH AGRICULTURAL CREDIT PROJECT

1. The following report on a proposed investment loan to Tunisia for US\$30 million equivalent is submitted for approval. The proposed loan would have a term of 17 years, including 4 years of grace, at the standard variable interest rate. It would help finance an agricultural credit project and promote development of a financially sound rural credit system. BNT^{1/} would be the Borrower, and the Republic of Tunisia the Guarantor.
2. Background. The Sixth Development Plan in Tunisia (1982-86) called for an increase in capital investment in agriculture, which is a priority sector. The Seventh Plan (1987-91) will continue to treat agriculture as a priority sector and emphasize greater involvement of private sector financing of agriculture as part of the current adjustment program. Agricultural credit will therefore continue to be important. Issues relevant to the project are: (a) inadequacy of interest rates and spreads; (b) arrears; (c) proliferation of agricultural credit programs, with different lending conditions; (d) cost of subsidies under the FOSDA/FOSEP^{2/} program, and excessive State intervention in some credit operations. Recent measures taken include: (a) raising of interest rates by 0.75% to 2%; (b) enforcing collection of arrears; and (c) making operational the National Guarantee Fund (FNG) to cover part of the risk of default on subloans made to small and medium farmers.
3. Project Objectives and Rationale for Bank involvement. The project has been designed in the light of experience gained under earlier credit projects (in particular the third credit line), and the ASAL^{3/} discussions. The main objectives of the new project are to (a) restructure the complex institutional system by which agricultural credit is made available; (b) encourage BNT and the banking sector to increase their role in mobilizing resources and in financing agriculture through further interest rate reforms;

-
- 1/ BNT = National Bank of Tunisia (a major commercial bank since 1969)
 - 2/ Special Fund for Agricultural Development and Special Fund for Fishery (Government Funds administered by BNT, providing loans at subsidized rates, and grants)
 - 3/ Agricultural Sector Adjustment Loan

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(c) improve the financial viability of agricultural credit operations and harmonize credit terms and conditions; (d) assist Government in its efforts to develop private investment in the agricultural sector to meet its objective of raising investment in the sector; and (e) promote savings schemes tied to eligibility for credit. The Bank's presence will be catalytic in achieving these objectives more rapidly, and in setting the stage to bring other commercial banks into agricultural lending over the next three to five years.

4. Project Description. The project would support two major components from September 1987 to September 1990:

- (a) BNT Credit Program: (i) on-farm investments by small and medium, and large private farmers, particularly the former; (ii) investments by cooperatives; (iii) investments by agricultural and agro-industry enterprises, and selected investments (repairs) by creditworthy fishermen;
- (b) Institutional Development: (i) the MIS software, equipment and training needed to modernize and strengthen, on a decentralized basis, BNT organizational structure, planning process, management control, accounting systems, and loan monitoring systems; and (ii) the strengthening of the agricultural credit policy coordination between the Ministries of Planning and Finance, Agriculture and Agricultural production, the Central Bank (BCT), BNT and BNDA.^{1/} The Coordinating Committee would plan and monitor reforms, and coordinate the execution of the subsequent Government policy decisions.

Total project cost is estimated at US\$59 million equivalent, including US\$30 million equivalent or about 51% in foreign exchange. A breakdown of costs and the financing plan are shown in Schedule A. Retroactive financing of up to 10% of the loan amount (US\$3 million) would be made available to the Borrower to help bridge the financing gap between the Third Credit Line and this loan and ensure that the BNT institutional component is not unreasonably delayed. Amounts and methods of procurement and of disbursements, and the disbursement schedule are shown in Schedule B. A timetable of key project processing events and the status of Bank Group operations in Tunisia are given in Schedules C and D, respectively. A map is also attached. The Staff Appraisal Report, No. 6622-TUN dated June 1, 1987, is being distributed separately.

5. Actions agreed. Under the recent ASAL, the Government agreed to (a) the principle of achieving, during the Seventh Plan period, an interest rate and spread structure for agriculture which covers the financial and operating costs at reasonable efficiency and a reasonable part of the risks, with the objective of encouraging the banking sector to play its role more fully in financing development; a first interest rate adjustment, acceptable to the Bank, is a condition of second tranche release and (b) the reduction and better targetting of budgetary allocations to the credit part of FOSDA, with current, sharply reduced levels to be maintained in 1987 and a further 15% reduction for 1988. Under the Project, specific actions have been defined and agreed to achieve:

^{1/}BNDA : National Bank for Agricultural Development (a Government development bank created in 1983)

- (a) the agreed medium-term adjustment on interest rates and spreads; this includes agreement to increase interest rates by not less than 0.5% for medium-term and 0.25% for short-term rates by August 31, 1987^{1/} as a first step to bring agricultural interest rates in line with market rates, and an agreed schedule of adjustments in 1988, 1989, 1990, and 1991 so that market rates are reached by end 1991 as agreed under the ASAL.
- (b) continued action to reduce budgetary allocations to the FOSDA subsidized credit programs: this includes agreement on a 15% reduction by end 1989 and another 15% by end 1990 over the reduced level of D11 million, such level to be reached in nominal terms by end 1988 under the ASAL.

In addition, Government has (i) agreed on improving bad debts policy, and FNG operating procedures; (ii) defined in April 1987 the eligibility of small- and medium-scale farmers to institutional credit in a way satisfactory to the Bank; (iii) rescheduled in March 1987 the debts due by farmers where this was justified; and (iv) agreed on promoting farmers bank savings schemes linked to eligibility for credit during project implementation. Government has also: (i) signed a policy letter to be implemented by BNT and incorporating the project proposals, in particular those on interest rates, spreads, FOSDA, recoveries, savings, risks, guarantees, provision for bad debts, and harmonization of subloan lending terms, conditions and procedures; and (ii) specifically confirmed in the policy letter that measures taken and to be taken to complete by December 31, 1989 the nationwide subloan harmonization process would lead in particular to the merger of BNT agricultural credit programs (including FOSDA) into a single fund managed by BNT (fungibility of funds). BNT's improved MIS will be put in place during the project period. Government would set up the Agricultural Credit Policy Coordinating Committee by December 31, 1987.

6. Justification. The proposed project would support the Government's medium-term adjustment effort to establish a policy and institutional framework which would promote development of a financially sound rural credit system. Through provision of investment credit to private farmers, the project would also contribute to increased agricultural production and rural employment. Bank involvement is justified because of the sectorwide improvements being introduced under the project.

7. Risks. On the basis of past experience, the risks are mainly the Government's possible lack of commitment to go ahead with the proposed reforms. Since the project has been designed to be fully consistent with the Government's medium-term program already mutually agreed by the Bank and the Government under the ASAL, this risk is considered reduced.

^{1/} In any event not later than loan effectiveness of the proposed agricultural credit project.

8. Recommendation. I am satisfied that the proposed loan would comply with the Articles of Agreement of the Bank and recommend that the Executive Directors approve the proposed loan.

Barber Conable
President

Attachments

Washington DC
June 1, 1987

Schedule A

<u>Estimated Cost</u>	<u>Local</u> -----	<u>Foreign</u> US\$ million	<u>Total</u> -----
BNT credit operations (Medium- and long-term)	27.5	27.5	55.0
Institutional Development (Software, equipment, training, consultants)	1.5	2.5	4.0
<u>Total Project Cost</u>	<u>29.0 /a</u>	<u>30.0</u>	<u>59.0 /a</u>

Financing Plan

IBRD	-	30.0	30.0
BNT	12.7	-	12.7
Government	4.3	-	4.3
Sub-borrowers	12.0	-	12.0
TOTAL	<u>29.0</u>	<u>30.0</u>	<u>59.0</u>

/a Includes US\$9.4 million of taxes and duties.

Schedule B

PROCUREMENT METHODS
(US\$ million) /a

	ICB	LCB	Other	N/A	Total Cost
1. Farm machinery, equipment, civil works, silos, livestock, fishing gear and farm development under subloans	- -	- -	55.0 (27.5)	- -	55.0 (27.5)
2. Computer equipment	2.8 (1.9)	- -	- -	- -	2.8 (1.9)
3. Consultants /b	- -	- -	0.2 (0.15)	- -	0.2 (0.15)
4. Software, Computer maintenance and Training Programs	- -	- -	1.0 (0.45)	- -	1.0 (0.45)
TOTAL	2.8 (1.9)		56.2 (28.1)		59.0 (30.0)

/a Figures in parentheses represent Bank loan financing

/b includes training specialists.

DISBURSEMENT PROCEDURES

Category	Amount of the Loan Allocated (US\$ million)	% of Expenditures to be financed
1. Subloans to small and medium farmers	8.0)	
2. Subloans to large farmers	8.0)	
3. Subloans to Cooperatives	3.5)	75% of amounts disbursed by BNT under such sub-loans
4. Subloans to agricultural and agro-industry enterprises	4.5)	
5. Subloans to fishermen	3.5)	
6. Computer equipment and maintenance, software, consultants and training	2.5 —	100% of foreign expenditures and 70% of local expenditures
TOTAL	30.0	

Estimated Disbursements:

Bank FY	1988	1989	1990	1991	1992
	(US\$ million)				
Annual	5.0	7.0	8.0	7.0	3.0
Cumulative	5.0	12.0	20.0	27.0	30.0

Schedule C

TUNISIA

FOURTH AGRICULTURAL CREDIT PROJECT

Timetable of Key Processing Events

- | | |
|--------------------------------------|--|
| (a) Time taken to prepare: | One year |
| (b) Prepared by: | BNT and Government with consultants' assistance |
| (c) Bank First Preparation Mission: | September 1985 |
| (d) Appraisal mission departure: | November 9, 1986 |
| (e) Negotiations: | April 13-17, 1987 |
| (f) Planned Date of Effectiveness: | November 2, 1987 |
| (g) List of relevant PCRs and PPARS: | First Agricultural Credit
(PPAR/PCR No. 2497)
Second Agricultural Credit
(PPAR/PCR No. 5401)
Third Agricultural Credit
(PCR process at final stage) |

THE STATUS OF BANK GROUP OPERATIONS IN TUNISIA 1/

A. STATEMENT OF BANK LOANS AND IDA CREDITS (As of March 31, 1987)

Loan or Credit Number	Year	Borrower	Purpose	US \$ Million Amount (Less Cancellation)		
				Bank	IDA	Undisbursed
Forty-six Loans and Credits Fully Disbursed				549.29	75.15	
1601	1978	Republic of Tunisia	Rural Roads (Third Highways)	30.00		0.40
1675	1979	Republic of Tunisia	Second Urban Sewerage	26.50		5.66
1746	1979	Republic of Tunisia	Second Fisheries	28.50		6.74
1796	1980	Republic of Tunisia	Southern Irrigation	19.50		2.16
1797	1980	Office des Ports Nationaux	Third Port	42.50		8.84
1841	1980	Republic of Tunisia	Fourth Highways	36.50		10.19
1864	1980	Société Tunisienne de l'Electricité et du Gaz	Second Natural Gas Pipeline	27.00		1.63
1961	1981	Republic of Tunisia	Fourth Education	21.00		13.33
1969	1981	Republic of Tunisia	Small-Scale Industry Development	30.00		11.40
1997	1981	Republic of Tunisia	Northwest Rural Development	24.00		12.90
2005	1981	Republic of Tunisia	Health and Population	8.50		4.86
2052	1981	Republic of Tunisia	Grain Distribution and Storage	38.00		8.89
2108	1982	Republic of Tunisia	Fifth Highway (Rural Roads)	35.50		17.05
2113	1982	BDET	Electrical and Mechanical Industries	30.50		9.88
2134	1982	SONEDE	Sixth Water Supply	30.50		2.18
2157	1982	Republic of Tunisia	Irrigation Development	17.00		9.10
2197	1982	Republic of Tunisia	Technical Assistance	4.50		2.00
2223	1983	Republic of Tunisia	Urban Development III	25.00		20.23
2230	1983	Republic of Tunisia	Education V	27.00		22.90
2234	1983	Republic of Tunisia	Central Tunisia Irrigation	16.50		10.21
2255	1983	Republic of Tunisia	Urban Sewerage III	34.00		30.31
2289	1983	Republic of Tunisia	Sfax Flood Protection	25.00		14.75
2301	1983	SOFOMECA	Industry (IV) Foundry	16.80		4.69
2346	1984	Republic of Tunisia	Mining Technical Assistance	13.40		10.10
2368	1984	Republic of Tunisia	Seventh Water Supply	50.00		39.92
2429	1984	Republic of Tunisia	Second Urban Transport	33.00		32.92
2455	1984	Société Tunisienne de l'Electricité et du Gaz	Fourth Power	21.70		19.95
2502	1985	Republic of Tunisia	North West Agricultural Production	15.00		15.00
2522	1985	Republic of Tunisia	Export Industries	50.00		50.00
2554	1985	Republic of Tunisia	Second Electrical and Mechanical Industries	54.00		53.64
2573	1985	Republic of Tunisia	Irrigation Management Improvement	22.00		22.00
2605	1985	Republic of Tunisia	Gabes Irrigation	27.70		26.50
2735	1986	Republic of Tunisia	Energy Conservation	4.00		4.00
2736	1986	Republic of Tunisia	Fourth Urban Development	30.20		-
2754	1986	Republic of Tunisia	Agricultural Sector Adjustment	150.00		103.14
2781	1987	Republic of Tunisia	Industrial & Trade Policy Adjust.	150.00 2/		-
TOTAL				1,764.59	75.15	607.47
Of which has been repaid				329.48	10.79	
Total now outstanding				1,435.11	64.36	
Amount Sold				25.53		
of which has been repaid				22.68	2.85	
Total now held by Bank and IDA				1,432.26 3/	64.36	
Total Undisbursed						607.47

- 1/ The status of the projects listed in Part A is described in a separate report on all Bank/IDA financed projects in execution, which is updated twice yearly and circulated to the Executive Directors on April 30 and October 31.
2/ Not yet effective; signed on March 6, 1987.
3/ Prior to exchange rate adjustment.

1061S/9 (2968Ep57)
April 17, 1987

STATEMENT OF IFC INVESTMENTS IN TUNISIA (AS OF MARCH 31, 1987)

Year	Obligator	Type of Business	Amount of US\$ Million		
			Loan	Equity	Total
1963	NPK Engrais	Fertilizers	2.0	1.5	3.5
1966/70/78	Société Nationale d'Investissement (now BDET)	Dev. Finance Co.		2.3	2.3
1969	COFIT Tourism (now BNDT)	Dev. Finance Co.	8.0	2.2	10.2
1973	Société Touristique et Hotelière RYM SA	Tourism	1.6	0.3	1.9
1974	Industries Chimiques du Fluor	Chemicals		0.6	0.6
1975	Société d'Etudes et de Développement de Sousse-Nord	Tourism	2.5	0.6	3.1
1985/86	Société Tunisienne de Leasing	Leasing Co.	3.4	0.5	3.9
1985	Société Minière de Spar Fluor et de Barytine (Fluobar)	Mining Co.		0.3	0.3
1986	SITEX	Textiles and Fibers	5.0	3.2	8.2
1987	Adwya, S.A.	Chemicals/Petrochemicals	2.3	0.3	2.6
1987	Rozzi Edilizzia Industrial- izzata - Tunisia	Prefabricated Panels	1.3	0.4	1.7
	Total Gross Commitments		26.1	12.2	38.3
	Less cancellations Terminations, Repayments and Sales		13.9	2.8	16.7
	Total Commitments now held by IFC 1/		12.2	9.4	21.6
	Total Undisbursed		11.4	1.0	12.4

1/ In addition, an investment in Comete - Engineering was approved on April 1, 1987.

International Bank for Reconstruction and Development

SecM87-318

FROM: The Deputy Secretary

March 27, 1987

NOTICE OF INVITATION TO NEGOTIATE

TUNISIA

FOURTH AGRICULTURAL CREDIT PROJECT

The Bank is inviting the Government of Tunisia, the National Bank of Tunisia (BNT), and the Central Bank of Tunisia (BCT) to send representatives to Washington, DC to negotiate a proposed loan of \$30 million to help finance the Fourth Agricultural Credit Project.

The Loan would finance the foreign exchange cost of BNT medium- and long-term agricultural credit operations and institutional development over the three-year period, September 1987 - 1990. It would also support the implementation of a policy and institutional framework which would promote development of a financially sound rural credit system.

Distribution: Executive Directors and Alternates
President
Senior Vice Presidents
Senior Management Council
Vice Presidents, IFC
Directors and Department Heads, Bank and IFC

THE WORLD BANK INTERNATIONAL FINANCE CORPORATION
OFFICE MEMORANDUM

DATE: October 27, 1986

TO: Mr. E.J. Stoutjesdijk, Acting Vice President, EMENA

FROM: Ernest Stern, Chairman, Loan Committee *ES.*

SUBJECT: TUNISIA - Proposed Fourth Agricultural Credit Project

The above proposal is approved, based on the parameters indicated in the Executive Project Summary dated October 17, 1986, with the following comments/qualifications:

(i) Retroactive financing should be limited to the normal ceiling of 10% of the loan amount. Delay in project processing, the only reason suggested in the EPS, does not constitute a basis for exception to policy;

(ii) The Region should ensure that the actions due to be completed by March 1987 (para. 5 of the EPS) are indeed completed on schedule, particularly in view of the fact that this is our fourth agricultural credit operation. It is assumed that March 1987 is the negotiating date, and that the actions listed will be completed prior to negotiations; and

(iii) Existing and future agricultural credit programs of BNT are to be consolidated under a single fund to be managed by BNT under harmonized lending terms, conditions and procedures. Are there agricultural credit programs other than those of BNT, and if so, what will happen to them and how and when will their terms and conditions be harmonized with those of BNT?

cc: Loan Committee
Mr. W.A. Wapenhans (o/r)

ROUTING SLIP		DATE: October 20, 1986	
NAME		ROOM NO.	
Mr. E. Stern, Chairman, L.C.			
APPROPRIATE DISPOSITION		NOTE AND RETURN	
APPROVAL		NOTE AND SEND ON	
CLEARANCE		PER OUR CONVERSATION	
COMMENT		PER YOUR REQUEST	
FOR ACTION		PREPARE REPLY	
INFORMATION		RECOMMENDATION	
INITIAL		SIGNATURE	
NOTE AND FILE		URGENT	
REMARKS:			
<p style="text-align: center;"><u>Tunisia</u> <u>Fourth Agricultural Credit Project</u> for \$30 million</p> <p><u>Proposed Board Date:</u> May 26, 1987</p> <p>Attached herewith please find six copies of the EPS for Loan Committee review.</p>			
FROM: A. Stoutjesdijk Acting RVP		ROOM NO.: H8065	EXTENSION: 3-2400

ES

THE WORLD BANK/INTERNATIONAL FINANCE CORPORATION

OFFICE MEMORANDUM

Received:

10/21/86

Comments by c.o.b.:

10/24/86

DATE: October 17, 1986

TO: Mr. E. Stern, SVPOP

FROM: A. Stoutjesdijk, Acting EMNVP *ds*

EXTENSION: 3-2400

SUBJECT: TUNISIA - Fourth Agricultural Credit Project
Loan Committee Review

Please find attached the Executive Project Summary (EPS) of this project for review by the Loan Committee.

The project is scheduled for Bank appraisal in November, 1986. A pre-appraisal review meeting was held on October 14 and the views of the participants at the meeting were included in the EPS.

cc: Mr. Moeen A. Qureshi, SVPFI, Member, Loan Committee
Mr. S. Shahid Husain, OPSVP, Member, Loan Committee
Mr. Ibrahim F. I. Shihata, LEGVP, Member, Loan Committee.

B. Dussert/mp
2419Ep36

EXECUTIVE PROJECT SUMMARY - APPRAISAL STAGETUNISIA : FOURTH AGRICULTURAL CREDIT PROJECT

Planned Appraisal Departure : November 9, 1986

Planned Board Date : May 26, 1987

1. Tentative Financing Plan. Total project cost is estimated at US\$59 million. IBRD would finance US\$30 million, BNT^{1/} US\$16 million, and subborrowers US\$13 million. BNT would be the Borrower.
2. Background. The Sixth Development Plan in Tunisia (1982-86) called for an increase in capital investment in agriculture, which is a priority sector. The Seventh Plan (1987-91) will continue to treat agriculture as a priority sector and emphasize greater involvement of private sector financing of agriculture as part of the current adjustment program. Agricultural credit will therefore continue to be important. Issues relevant to the project are: (a) inadequacy of interest rates and spreads; (b) arrears; (c) proliferation of agricultural credit programs, with different lending conditions; (d) cost of subsidies under the FOSDA/FOSEP^{2/} program, and excessive State intervention in some credit operations. Recent measures taken include: (a) raising of interest rates by 0.75% to 2%; (b) enforcing collection of arrears; and (c) making operational the National Guarantee Fund (FNG) to cover part of the risk of default on subloans made to small and medium farmers.
3. Project Objectives and Rationale for Bank involvement. The project has been designed in the light of experience gained under earlier credit projects (in particular the third credit line), and the ASAL discussions. The main objectives of the new project are to (a) encourage BNT and the banking sector to increase their role in mobilizing resources and in financing agriculture through further interest rate reforms; (b) restructure the complex institutional system by which agricultural credit is made; (c) improve the financial viability of agricultural credit operations and harmonize credit terms and conditions; (d) assist Government in its efforts to develop private investment in the agricultural sector to meet its objective of raising investment in the sector; and (e) promote savings schemes tied to eligibility for credit. The Bank's presence will be catalytic in achieving these objectives more rapidly, and in setting the stage to bring other commercial banks into agricultural lending over the next three to five years.
4. Project Description. The project would support two major components from Sept. 87 to Sept. 90:
 - (a) BNT Credit Program: (i) on-farm investments by small and medium, and large private farmers, particularly the former; (ii) cooperatives, and (iii) agro-industry investments;
 - (b) Institutional Component: (i) the MIS software, equipment and training needed to modernize and strengthen, on a decentralized basis, BNT organizational structure, planning process, management control, accounting systems, and loan monitoring system; and (ii) the strengthening of the agricultural credit policy coordination between the Ministries of Planning and Finance, and Agriculture, the Central Bank (BCT), and BNT. The Coordinating Committee would plan and monitor reforms, and coordinate the execution of the subsequent Government policy decisions.

^{1/} National Bank of Tunisia. ^{2/} Special Fund for Agricultural Development and Special Fund for Fishery (Government Funds administered by BNT, providing loans at subsidized rates, and grants).

Retroactive financing of up to 20% of the loan amount (US\$6 million) has been requested by the Borrower to help bridge the financing gap between the Third Credit Line and this loan and ensure that the BNT institutional component is not unreasonably delayed. It is recommended that this is accepted.

5. Actions agreed, and to be agreed on. Under the recent ASAL, the Government agreed to (a) the principle of achieving, during the Seventh Plan period, an interest rate and spread structure for agriculture which covers the financial and operating costs at reasonable efficiency and a reasonable part of the risks, with the objective of encouraging the banking sector to play its role more fully in financing development; a first interest rate increase, acceptable to the Bank, is a condition of second tranche release (June 1987) and (b) the reduction and better targetting of budgetary allocations to the credit part of FOSDA, with current, sharply reduced levels to be maintained in 1987 and a further 15% reduction for 1988. During appraisal, specific actions would be defined and incorporated into the Loan Documents to achieve:

- (a) the agreed medium-term adjustment on interest rates and spreads; this would include agreement to increase interest rates by not less than 1% by ASAL Second Tranche release (April/June 1987) as a first step to bring agricultural interest rates in line with market rates, and an agreed schedule of increases in 1988, 1989, 1990, so that market rates are reached by end 1991 as agreed under ASAL. BNT and other banks would then be free to determine the spreads on subloans which are most appropriate to their operations.
- (b) continued action to reduce budgetary allocations to the FOSDA subsidized credit programs: we aim at 20% by end 1989 and another 20% by end 1990 over the reduced level of D11 million, such level to be reached in nominal terms by end 1988 under the ASAL.

In addition, commitment will be sought from Government, BCT and BNT on (i) improving bad debts policy, and FNG operating so that it is satisfactory to the Bank; (ii) defining, by March 1987, the eligibility of small- and medium-scale farmers to institutional credit in a way satisfactory to the Bank; (iii) writing off old arrears without, however, dropping recovery procedures, and rescheduling certain debts (drought) by March 1987; and (iv) offering farmers bank savings schemes linked to eligibility for credit as soon as project activities start. Government, as a condition of presentation of the project to the Board, would need to: (i) sign a revised agreement with BNT incorporating the new project proposals on interest rates, spreads, recoveries, risks, guarantees, and provision for bad debts; and (ii) agree (e.g. BCT circular) to regroup existing and future agricultural credit programs of BNT under a single fund managed by BNT (fungibility of funds) so that subloan lending terms, conditions and procedures (including FOSDA) can be harmonized within one year after loan effectiveness. BNT's improved MIS will be put in place during the project period.

6. Justification. The proposed project would support the Government's medium-term adjustment effort to establish a policy and institutional framework which would promote development of a financially sound rural credit system. Through provision of investment credit to private farmers, the project would also contribute to increased agricultural production and rural employment. Bank involvement is justified because of the sectorwide improvements being introduced under the project.

7. Risks. On the basis of past experience, the risks are mainly the Government's possible lack of commitment to go ahead with the proposed reforms. Since the project has been designed to be fully consistent with the Government's medium-term program already mutually agreed by the Bank and the Government under the ASAL, this risk is now greatly reduced.