Rural Finance in the Near East and North Africa
Rural Finance in the Near East and North Africa
Table of contents

I. Socio-economic situation in the region ................................................................. 5
II. Rural developments within the region ................................................................. 7
III. Developments in interventions by the main funding agencies .............................. 8
IV. IFAD's rural finance interventions in the region ............................................... 10
V. Challenges in the development of rural finance in the region ............................... 12
VI. IFAD's comparative advantages and limitations within the region ....................... 15
VII. A guiding framework for rural finance in the region ........................................ 17
VIII. A proposed approach for the application of the GF in countries ......................... 21
IX Conclusion ........................................................................................................ 24

Acronyms

CGAP Consultative Group to Assist the Poor
GF Guiding framework (for rural finance operations)
MFI Microfinance institution
NGO Non-governmental organization
RFI Rural financial institution
SOAB State-owned agricultural bank
Since its founding in 1977, the International Fund for Agricultural Development (IFAD) has supported the development of rural financial services. Over the years, the Fund’s strategies and implementation modalities have progressively evolved as greater knowledge of the subject and increased experience have resulted in a better understanding of the nature of poverty and rural finance.

The present document outlines a guiding framework (GF) for rural finance operations in the Near East and North Africa for 2008-2012. Its primary objective is to guide the operational staff of the Near East and North Africa Division of IFAD in designing, implementing and monitoring rural finance interventions and activities in the region by following international best practices in the rural and microfinance sector. The document is also useful in informing IFAD’s partners about the Fund’s medium term approach to rural finance in the region.

The proposed GF follows and complies with IFAD’s Rural Finance Policy (2000), the related Decision Tools for Rural Finance (2002), IFAD’s Updated Rural Finance Action Plan (2006), and the subsequent Evaluation of IFAD’s Rural Finance Policy (2007). The IFAD Strategic Framework 2007-2010 – Enabling the Rural Poor to Overcome Poverty – was also carefully reviewed during the development of this document. At the same time, the GF builds on the lessons learned in rural finance by IFAD and other donor agencies within and outside the region. It uses the findings of the “Self-Evaluation of the NENA and CEN Regional Strategies” completed by IFAD’s Near East and North Africa Division in 2006, as well as the accumulated experience of the Division in the region through country project supervision reports, mid term reviews, completion reports, and project or country programme evaluations. While established for the region as a whole, the GF will have primary relevance to those countries that have been traditional IFAD borrowers. These countries include: Algeria, Djibouti, Egypt, Gaza and the West Bank, Jordan, Lebanon, Morocco, Somalia, the Sudan, the Syrian Arab Republic, Tunisia, Turkey and Yemen.

The consulting firm Development Innovations Group prepared an initial draft of this document. It was subsequently revised and finalized by Mr Graham Perrett, an international expert in rural finance. The document has benefited from substantial inputs and comments from the staff of the Near East and North Africa Division, as well as from the technical advisors in rural finance of the Technical Advisory Division of IFAD. The whole exercise has been coordinated and supervised by the regional economist of the Division, Ms Mylène Kherallah, with the administrative support of Ms Sara Oliván.

It is important to recognize that the GF is a “living document”. As such, it should be reviewed and revised on a regular basis in light of developments within the field of rural and microfinance, as well as changes that arise within the operational environment of the Division and any future changes in IFAD’s financing instruments.

DR MONA BISHAY
Director
Near East and North Africa Division, IFAD

I. Socio-economic situation in the region

The socio-economic environment in the Near East and North Africa has been affected for the past 15 years by several factors, the most important of which are the following:

(i) **The global demand for oil.** The steady increase in oil prices and the increased global demand for oil have enriched the oil producers within the region so that economic growth has become increasingly differentiated. The oil producers, primarily the Gulf countries, have enjoyed rapid economic growth, while many non-oil exporters have reported continued sluggish or erratic growth. Moreover, the steady increase has encouraged many countries to subsidize the price of oil, thereby distorting the market for this and other products. It has also vastly raised liquidity in the financial systems of some countries, resulting in relatively easy availability of capital for investment, as well as increased aid provided by the rich Gulf countries.

(ii) **Ongoing conflicts within the region.** The region suffers from a number of conflicts involving several countries. These conflicts deter foreign and local investment, disrupt the delivery of financial services to rural areas, create political instability and result in a loss of human capital. Moreover, the unrest encourages a shift in focus away from long-term development to short-term humanitarian relief.

(iii) **State-led interventions in economic development.** While there has been a progressive reduction in the role of the public sector in the economies of the region, many of these economies have been dominated historically by public-sector institutions. The involvement has ranged across all economic sectors, including agriculture and banking, and has resulted in the establishment of a large public sector that generates little economic output, imposes overrestrictive regulatory requirements and creates red tape. These factors have discouraged private-sector growth and quelled the entrepreneurial instinct among much of the population. As a result, many economies have been performing at a suboptimal level for a considerable time.

Despite these factors, the region enjoyed strong economic performance in 2006 that was fuelled by high oil prices, economic recovery in Europe and ongoing economic reforms. While there was considerable variance among the countries, most of the major economies exhibited strong growth in gross domestic product, including the Sudan (9.6 per cent growth), Morocco (7.3 per cent), Egypt (6.8 per cent), Jordan (6.2 per cent) and Tunisia (4.9 per cent) and, to a lesser extent, the Syrian Arab Republic (3.5 per cent) and Algeria (3.0 per cent). At the other end of the scale, those economies that were suffering from internal conflicts continued to regress, including West Bank and Gaza (-12 per cent) and Lebanon (-6.4 per cent). Across the region, there has been a general opening up of economies, greater transparency in government and increased access to global technologies and information exchanges. The rate of unemployment, while still high at 13 per cent, is steadily improving. But unemployment, particularly in rural and peri-urban areas, remains a major concern. This is especially so among youth because of the overall demographic profile of the region.
Despite these developments, however, poverty in general and rural poverty in particular remain widespread. Approximately 25 per cent of the total population in the region are living in poverty, and, of these, about 58 per cent are located in rural areas. Moreover, the incidence of poverty is greater in rural areas (34 per cent of the total population) relative to urban and peri urban areas, where the share is 18 per cent. In numeric terms, this amounts to approximately 50 million rural people living in poverty. These rural poor, particularly those people living in the most remote areas, remain disenfranchised; they have little say in the policies that affect them and little access to the services and markets that would help lift them out of poverty.

II. Rural developments within the region

Despite recent advances in several countries, the rural financial sector in the Near East and North Africa is still considered one of the least developed in the world. The region is still characterized by strong state involvement in the sector and by restrictive legislation and regulatory oversight. Furthermore, many established financial institutions (e.g. microfinance institutions [MFIs] and commercial banks) prefer to concentrate on the urban and peri-urban markets, possibly more so in the Near East and North Africa than elsewhere. While state-owned agricultural banks (SOABs) serve the agricultural and rural sectors, they mainly cater to more well off farmers and entrepreneurs who are able to offer collateral or some type of guarantee, which the rural poor do not have. As a result, millions of poor rural people remain without the financial services that might help lift them out of poverty.

At the same time, the number of institutions providing development finance services in the region has grown over the past decade. This may be attributed to national efforts that have supported the development and expansion of MFIs in the region. International donor funding has also helped a number of MFIs to grow, especially in countries such as Egypt, Jordan and Morocco. Despite this expansion, the level of coverage in rural areas in the region is still relatively limited, and a wide gap remains between the supply of services and the unmet demand.

Progress has been made, however. While statistics on the entire region are limited, the 11 IFAD-supported MFIs throughout the region that report to the MIX Market had about 225,000 active borrowers and about 439,000 voluntary savers as of December 2005. The gross loan portfolio outstanding as of that date was about US$522 million, and the value of voluntary savings was about US$213 million. Women borrowers totalled about 43,000.

It is estimated that there may be several hundred financial service providers operating in the rural areas of the region. Expansion throughout the region has been uneven, though, and many of the rural financial services are concentrated in a few of the larger countries. The extension of credit has been greatest in Egypt and Morocco, which represent the two largest markets in the region. In other countries, however, expansion has been limited, especially where conflicts are ongoing (e.g. in Somalia and the Sudan).

During this period of expansion, there has been some degree of experimentation and innovation, so that there is now a wider range of institutional models for the provision of services to rural areas. These include grass-roots community-based organizations, local savings and credit groups, non-governmental organizations (NGOs), rural banks and national social funds for development. This has meant that more funding is now available at both the wholesale and retail levels of the market. Furthermore, the financial methodologies being used to provide services have also begun to increase, and now a mix of village banking, rotating savings and credit associations, group lending and individual loans is being offered. Moreover, most clients may elect to avail themselves of either the Islamic banking system or regular banking services. SOABs remain predominant in many countries, however.

The range of services also has been slightly widening, although, in the case of savings mobilization, the related services are hampered in many countries by regulatory and oversight requirements. With the high level of migration both within the region and outside it, the demand for fund remittance services has increased. The range of credit products also has begun to expand, and loans of varying maturities are progressively becoming available. The demand for ancillary services, such as insurance, also will rise as the usefulness of these products becomes more well understood.
III. Developments in interventions by the main funding agencies

While it is difficult to make generalizations about trends among the diverse donors active in the region and to separate out the factors that are related exclusively to rural financial activities, certain developments that have occurred are relevant to IFAD’s own approach in the region. The most important of these are as follows:

(i) The differences in the environment for operations among countries
Donors such as the World Bank, the Islamic Development Bank, the United States Agency for International Development and the Food and Agriculture Organization of the United Nations have become increasingly aware that they need to adopt different approaches to match each country’s situation. The need for differentiated approaches at the country level are driven by variations in access to resources; the relative importance of the agriculture sector’s contribution to the overall economy and its share of the economically active population; the political, social and economic environment; and the nature of the target groups. Donor strategies and activities have also been adjusted to the significant differences among countries in the development of the rural financial services sector itself.

(ii) An increased emphasis on strengthening and reforming the financial sector
In recent years, major donors have moved upstream to the macrolevel and are focusing on sector reviews, policy dialogue and financial sector reform. Two recent examples of this are the World Bank’s Financial Sector Development Policy Loan Project in Morocco (2005) and the First Development Policy Loan for Egypt (2006). The goals of these types of programmes are to restructure the banking system, reform the contractual savings system and strengthen capital markets and mortgage finance.

(iii) A move towards demand-based financial services
Donors have also recognized that they need to move away from supply-driven credit to demand-driven financial services. This approach involves undertaking comprehensive market assessments of both existing and potential demand and may include assessing such aspects as credit culture and informal-sector competition. At times, demand-driven financial services are coupled with the provision of skills training in areas identified by financial service clients as necessary to enable them to become effective entrepreneurs.

(iv) The promotion of private-sector-led activities
Traditionally, the financial services sector in the region has been dominated by public-sector institutions, such as SOABs. Donors have increasingly recognized that the previous strategy of supporting SOABs has favoured larger farmers and the politically well connected rather than the rural poor. As a result, over the last few years, donors have moved away from support for programmes dominated by the public sector to assisting activities led by the private sector. This has taken the form of the provision of extensive capacity-building to private-sector institutions

(such as NGOs, cooperatives and community-level savings and credit groups) so that they can assume a larger and more sustainable role.

(v) The issue of sustainability
Donors are increasingly acknowledging that achieving sustainability is one of the greatest challenges facing rural financial services in the region. Many MFIs are still heavily reliant on donor funding and are unable to survive without this support. However, only those MFIs that attain financial sustainability (i.e. they have demonstrated their capacity for resource mobilization, cost coverage, profitability and dynamic growth) will become viable in the long run. Other problems that compromise the sustainability of MFIs include weak operations systems, poor management, covariance risks in rural areas and political interference. As a result, donors are increasingly paying attention to the quality of loan portfolios, establishing internal control systems, eliminating subsidized interest rates and enhancing staff capacity.
IV. IFAD’s rural finance interventions in the region

Historically, rural finance components have constituted 10 to 20 per cent of the IFAD portfolio in the region. Following the establishment of the IFAD Rural Finance Policy in 2000 and the related decision tools, the design of rural finance programmes altered significantly. The new approach involved a shift towards the development of sustainable financial systems and the support of a more diverse range of institutions. The objective was to enhance access by the rural poor to financial services. The new policy focused on four main lessons learned:

(i) **The importance of capacity-building in creating sustainable rural financial institutions** (RFIs), thereby creating greater breadth and depth of outreach to the rural working poor.

(ii) **The need to enhance stakeholder participation**, particularly among the rural working poor, as a way of building ownership in and contributing to the development of rural financial systems.

(iii) **Supporting a diversified rural financial landscape** through a variety of institutional frameworks.

(iv) **Enhancing the development of enabling environments** through the creation of conducive government policies and appropriate legal and regulatory regimes.

Based on these lessons and building on its 30 years of experience in the region, the Fund has encouraged innovation and experimentation. This approach has covered a variety of pilot programmes and included existing formal institutions that have been prepared to implement reforms, as well as facilitating access by the rural working poor to financial services. Also, where circumstances have permitted, the Fund has supported the emergence of alternative rural financial models.

Detailed below are some synthesized highlights of IFAD’s rural finance experiences in the Near East and North Africa over the past few years. All of these various approaches conform to the IFAD Rural Finance Policy of providing financial services across widely different rural areas, and markets, within the region.

**Expanding the Supply of Credit to Remote Areas**

IFAD’s traditional approach involved support for the provision of credit through SOABs and other semi-governmental agencies. When this strategy failed to meet expectations, IFAD began supporting the provision of short-term credit to rural borrowers, primarily through emerging, specialized NGOs. For example, in 2000, IFAD began working with FONDEP (Fondation pour le développement local et le partenariat), an MFI providing credit services to the poor in Morocco. Through IFAD technical assistance and financial support, FONDEP opened a branch in the IFAD project area, where no banking services had previously been provided, thereby helping to integrate

---


the local rural population into the formal financial economy. IFAD has also worked in a similar vein with social funds for development in other countries, in particular Egypt and Yemen. A wholesale funding facility has been established with these bodies, which then lends to smaller microcredit organizations and RFIs operating in outlying areas for on-lending to local residents. Using this approach, IFAD has greatly expanded the provision of financial services to the rural poor.

**Focusing on Women Entrepreneurs and Community Initiatives**

IFAD initiatives in West Bank and Gaza initially sought to help restart rural economic activities following the signing of the Oslo Peace Accords. Subsequent events, though, forced a refocus on stabilizing and strengthening local communities by establishing local women’s savings and credit associations. Since 1999, IFAD has supported women’s business centres and clubs to provide training and skill development services among rural women entrepreneurs. These groups have since initiated their own informal group savings mechanisms, which evolved into savings and credit associations that have subsequently become federated into a union. By the end of 2006, 12 associations and around 140 groups (about 12 groups per association) boasted a total of 6,000 members, with more than 3,000 borrowers and accumulated savings of US$1.8 million. The union is now the second largest MFI in West Bank and Gaza in terms of outreach. The associations are of particular relevance to local communities given the obstacles facing the formal financial sector’s lending operations due to the continued conflict in the territories.

Similarly, IFAD’s initiatives with the sanadiq (village savings and credit associations) in the Sudan, the Syrian Arab Republic and Yemen fit within the strategy of developing the community-based participatory approach. A core aspect of these projects is the integration of gender issues into project design so as to enhance women’s involvement in local financial markets.

**Engaging Commercial Banks in Rural Finance**

As part of the shift away from heavy reliance on SOABs and as a means to engage the private sector and local communities, IFAD is working to create opportunities to engage commercial banks in rural finance. IFAD partnered with ACCION International to explore the potential for engaging commercial banks in rural finance in the region by targeting banks in Algeria, Egypt, Morocco and Yemen. These efforts resulted in the establishment of a microfinance service company within the National Bank of Egypt that will be funded by a consortium of investors. A full range of financial services will be provided to target clients, leveraging off the National Bank’s network. Another initiative is the partnership with the Consultative Group to Assist the Poor (CGAP) to develop the Postal Savings Bank of Syria so that it would extend savings and credit services to microenterprises and small businesses in rural areas. These services will be provided through two windows within the bank and will support both on-farm and off-farm activities. IFAD has also worked with the Agricultural Bank of Sudan to open a rural microfinance window to serve its poor rural clients in the Kordofan area. The bank extends loans directly to individuals or to the Sanadiq that on-lend to their members. These ventures reflect the flexible approach that is now being undertaken to build partnerships to broaden and deepen the provision of financial services to the rural poor.
V. Challenges in the development of rural finance in the region

While designing rural finance projects or activities throughout the region, the Fund has encountered certain long-standing and ongoing challenges and evolving issues that will impact its sectoral approach for the foreseeable future.

Long-Standing and Ongoing Challenges

While several challenges have been successfully overcome, others continue to affect progress. The most important of these challenges are the following:

(i) **Wide variations in the size and structure of target markets in rural areas.** In confronting the financing needs of its target market, IFAD faces a wide range of demands both throughout the region and within individual countries. While not new, this problem has been accentuated as each country develops at a different pace and more potential Fund clients become involved in monetized economies that have varying degrees of complexity. Furthermore, the needs of these disparate groups of clients vary considerably (in terms of products, capacity-building needs and funding), as do the population densities, accessibility and the level of financial sophistication of clients in each programme area. These factors complicate the development and application of a universal rural finance model for the region because each country or programme will have its own unique characteristics and needs.

(ii) ** Widely dispersed populations.** In many of the countries within the region, the target market populations are remote, widespread and often transient. For this reason, it is difficult and costly to serve them through a standardized network of branches that traditionally provide outreach into rural areas. As a result, specific approaches and structures need to be developed to provide services to these populations, such as the use of mobile banking technologies.

(iii) **The absence of credit culture.** Within certain societies in the region, there are cultural differences regarding the obligation to repay loans. Certain cultures consider it a matter of pride and honour to repay loans, while, in others, the sense of obligation to repay is lacking. This latter attitude may also be encouraged because lenders have not always insisted that loans be repaid. It may also result from political interference given that forgiveness programmes are sometimes announced by civic or government leaders. Considerable difficulty will be encountered if new credit systems are launched alongside existing or former programmes that have not insisted on repayment. Where these cultures or practices exist, there is likely to be a high loan default rate, which eventually will cause the collapse of rural finance programmes.

(iv) **The reliance on subsidized interest rates.** In common with other regions, many SOABs operating within the Near East and North Africa have provided loans at subsidized interest rates either as a matter of government policy or in the mistaken belief that borrowers could not afford to pay commercial rates. Over time, this strategy has had the unfortunate effect of distorting the market in terms of the access to and the cost of credit by artificially lowering the actual cost of the production of rural products and addicting borrowers to cheap credit. This has resulted in a culture of dependency on subsidized credit that may be politically difficult to overcome.
Evolving Challenges and Opportunities

In addition to the historical and ongoing challenges, certain new ones are evolving across the region. The most relevant of these are the following:

(i) Rapid population growth, changing demographics and the slow rate of rural employment creation. Population growth and the need to create employment opportunities for unemployed youth will be among the major challenges facing the region over the next 20 years. It is projected that the economies in the region will have to create about 100 million jobs over this period merely to keep pace with demand. Because approximately 60 per cent of the population of the region is living in rural areas, the need to create rural employment opportunities is particularly acute. Many of these needed opportunities will be created only if there is funding available for small and medium-sized businesses and for self-employment activities. This will require a broadening of the types of activities to be supported by IFAD to include medium-sized enterprises, as well as to cover those industries or activities that support populations in rural areas and rural migrants in peri-urban areas. These activities may or may not be tied directly to agricultural initiatives.

(ii) The lack of managerial capacity at all levels. Managing financial institutions, even small savings and credit groups, requires special skills that are often lacking in rural areas. Well-trained management is required to provide leadership, maintain confidence in institutions, keep appropriate financial records and install effective credit assessment and loan collection systems. Lending entities, whether commercial wholesale lenders, MFIs, micro-credit organizations, or grass-roots NGOs, need to be knowledgeable about the basic principles of finance, banking and accounting. Because of the expected explosion of demand for rural financial services, the provision of training in these skills will need to be a cornerstone of any future rural finance programme.

(iii) Limited availability of performance data for practitioners, lenders and supervisory agencies. The availability of timely, accurate and relevant financial and impact data is critical to the success of independent RFIs and to successful monitoring and evaluation by outside lenders and investors of the performance of these institutions. RFIs need to know their financial situation exactly (particularly the status of loan portfolios) to manage their affairs correctly. External lenders and investors also need data to undertake monitoring and evaluation of their loans. The availability of such data is often limited in the region due to a lack of training, poor data collection methodologies and limited technical infrastructure. This last shortcoming is especially relevant in rural areas. Moreover, the capacity to undertake effective monitoring and evaluation of programmes needs to be improved. Investment in these areas and the linking of national and regional financial services networks are needed to overcome this deficiency.

(iv) The limited range of financial products that are available in rural areas. In common with other geographical regions, target market clients in the Near East and North Africa complain about the limited range of financial services available to them. The range of services differ among countries, and availability may also vary considerably within countries. The provision of loan products is often limited by the amount of funding available and the types of activities undertaken. In other cases (such as insurance), financial institutions might lack the necessary in-house expertise to support these products. Savings activities are often restricted by legal and regulatory requirements limiting their provision. Emphasis needs to be placed on encouraging private-sector suppliers of specialized services to expand into rural areas and on dialoguing with supervisory and regulatory institutions to expand the range of savings services available in rural areas.
(v) Governmental preference for integrated rather than stand-alone rural finance programmes. Based on experiences within the Near East and North Africa and in other regions, rural finance programmes are increasingly being designed on a stand-alone basis rather than as a component in an integrated programme. This approach enhances the employment of specialized management skills and creates a focus on sustainability and viability. Several governments in the region, however, still request rural finance programmes to be incorporated as a component within integrated programmes. When an integrated approach is adopted, care needs to be exercised so that the financial services component is staffed by trained, specialist managers and is designed to be sustainable and viable. The component also needs to be adequately funded and supported by senior management.

(vi) Limited availability of wholesale credit funding. While best practices are raising their emphasis on the importance of savings-driven financial institutions, there remains a clear need for external funding in order to fuel ongoing growth and outreach. While debt and equity funding is becoming increasingly available for urban and peri-urban projects, it may be difficult to interest local commercial banks in the region in financing rural credit projects. One innovative approach might involve exploring whether international investors or fund managers can be induced to invest in rural projects in the region given the right incentives and support. IFAD can play a role in this regard because of its expertise in rural development, its reputation and its contacts with other international organizations. This role might include encouraging external investment through the grant funding of the necessary initial capital against which the private sector would extend loans, or providing loans as quasi-capital that would be repaid from external borrowings.
VI. IFAD’s comparative advantages and limitations within the region

In overcoming the current and evolving challenges in rural finance within the region, the Fund has certain advantages and limitations.

IFAD’s Comparative Advantages

Within the region, the Fund’s comparative advantages may be summarized as follows:

(i) **Long experience in the region across a broad range of countries.** IFAD has been operating in the region since the Fund’s creation in 1977 and has so far supported more than 100 agricultural and rural development programmes in 15 member countries across the region, with a total loan amount of about US$1.3 billion. Moreover, it is the only United Nations organization with a mandate to focus on the rural poor. This has enabled it to accumulate a vast amount of experience in operating in the especially challenging rural areas of the region, often in partnership with other public- and private-sector organizations. This experience and focus give IFAD a clear advantage over other institutions interested in working in the region.

(ii) **The unique focus on rural finance issues.** IFAD has a long history of providing financial services to the extreme poor, dating back to its pioneer work with the Grameen Bank. Furthermore, it has focused exclusively on the challenges of providing financial services to the rural poor, while most other agencies lack this focus because they work mainly with urban and peri-urban financial institutions. This concentration on rural finance in the region gives IFAD a unique legitimacy among practitioners, donors and governments.

(iii) **The close contacts with government, NGOs, regional and international agencies.** Due to its operations in the region and the nature of its activities, IFAD has developed close working relationships with ministries of agriculture, irrigation and planning, financial and monetary institutions and SOABs in the various countries and, to a more limited extent, national banking sectors. It has also developed extremely good working relationships with the Rome-based United Nations organizations (the Food and Agriculture Organization and the World Food Programme) and other international entities such as the World Bank, CGAP and the United Nations Development Programme. Additionally, strong contacts and partnerships have been developed with the Arab Fund for Economic and Social Development, the OPEC Fund for International Development, the Islamic Development Bank, bilateral development agencies in the Gulf countries and a broad spectrum of national, regional and international NGOs and networks such as Sanabel, ACCION International and the MIX Market. These contacts potentially enable the Fund to influence policy at the strategic level and to reach out to the private sector on behalf of the rural poor, which is difficult for other institutions in the region.

IFAD’s Limitations

These strengths and advantages are somewhat mitigated by the following limitations that need to be ameliorated.

(i) **Limited resources and instruments of engagement.** IFAD’s financial and human resources are limited. This limitation restricts the outreach of IFAD-supported RFIs among
target populations in terms of both the number of clients reached and the remote areas serviced. Moreover, the lack of a physical presence in most countries within the region reduces IFAD's ability to influence government policies towards rural development. As a result, IFAD needs to act closely in partnership with other institutions and must be innovative in order to reach its goals.

A further limitation is the restrictive nature of the funding instruments available to IFAD, namely, loans to governments and grants. Of the funding available through IFAD’s work programme, 90 per cent is extended through direct loans to host governments, while no more than 10 per cent is extended in the form of grants to governments, NGOs, or the private sector. Since many governments are reluctant to borrow to support capacity-building, especially capacity-building among NGOs or the private sector, the amount of capacity-building IFAD is able to provide is severely constrained. Grant funding from other sources must therefore be mobilized to meet this need.

(ii) **IFAD’s historical relationship with governments and SOABs.** IFAD’s charter requires that it deal with the government of the host country for programmes rather than directly with possible implementers within the country. Normally (but not always), this means that the counterpart ministry is the ministry of agriculture, planning, or finance through which all funding and decision-making must flow. Thus, while an NGO may actually implement a programme at the grass-roots level, the counterpart ministry is intimately involved in the decision-making and oversight of the programme. Furthermore, in many cases, SOABs have been charged with implementing rural finance programmes; mainly, this approach has led to unsatisfactory results in terms of rural poverty impact and outreach. These factors have not only limited the flexibility of interventions and strangled innovation, but they often have caused the Fund to be viewed as an institution that is not open to cooperation with the private sector. This has limited IFAD’s ability to develop, promote and replicate some of the more innovative approaches to rural finance and rural microfinance that have been developed by smaller institutions and practitioners.

(iii) **Insufficient learning from programmes and the need to build on IFAD’s knowledge base.** While IFAD has accumulated a considerable body of knowledge in rural finance and rural microfinance, there have been gaps in collecting and disseminating this knowledge at the field level and within IFAD itself. This has often meant that the lessons learned through successful programmes within the region or in other regions have not been built upon, a tendency for mistakes to be repeated and the inadequate collection and analysis of data to ensure effective monitoring and evaluation. Future medium-term strategies will be needed to rectify this weakness.
VII. A guiding framework for rural finance in the region

Overall Goal
The overall goal of the GF for rural finance in the region is to increase the access of the rural poor to sustainable and diversified financial services. Given the diversity in operations within the region, the achievement of this goal will involve building on several guiding principles on which the GF objectives are based.

Guiding Principles
These principles are as follows:
(i) Differentiate the strategic approach to suit the country conditions so that the policies, operating procedures and financial products will be more relevant to the countries.
(ii) Strengthen management capacities in rural finance and rural microfinance.
(iii) Leverage IFAD’s assets to introduce more private-sector capital and support services in rural finance in the region.
(iv) Improve the knowledge base, monitoring, reporting and impact assessments as a way to enhance the performance of the sector at all levels.

In order to bring these principles to fruition, certain objectives have been set to identify the steps that will need to be taken.

Objectives
Objective I: Develop a strategically differentiated approach at the country level (through the country strategic opportunities programme) that complies with the IFAD Rural Finance Policy in both design and application.

This will involve the adaptation of the approach to the specific circumstances of the country. It will also involve support for capacity-building and knowledge dissemination at the local level and will strengthen the Fund’s contribution to rural finance policy.

The compelling reason for a differentiated country approach towards rural finance revolves around the considerable differences in the levels of development within and among countries in the region. Different strategies towards agricultural development have been adopted; there are varying levels of outreach and complexity in rural financial services; and there is a wide range of financial service providers. Furthermore, the necessary infrastructure, the size and profile of IFAD’s target market (the entrepreneurial poor) and the commitment and capacity of the various stakeholders to implement successful programmes vary widely. This means that, for rural finance programmes to succeed there must be a devolution of the strategic approach down to the country and programme level. If this is done, the specific sectors of the rural economy that need to be strengthened will be recognized. This approach will enable the Fund to address more effectively the issues involved in the variations in country conditions and in the size, structures and population densities of the rural target markets in the region, while staying in compliance with IFAD’s institution-wide policy. The successful achievement of this objective will require the following:
(i) The adaptation of the IFAD Rural Finance Policy to each country situation within the region and the reflection of this situation in the relevant country strategic opportunities programmes.
(ii) The development of partnerships with local, national and regional entities so as to strengthen the design and implementation of programmes at the micro-, meso- and macrolevels.

(iii) For each new rural finance initiative that is under consideration, undertaking a market survey during programme design or early implementation to assess the demand for and the availability of rural financial services for the proposed programme area; based on the results of this survey, the various points of entry for intervention and the appropriate financial products to be offered will be identified.

(iv) The development of a nucleus of rural finance expertise at the country level to encourage better programme design and implementation.

Objective II: All RFIs supported by IFAD are to be sustainable and viable.

Rural finance best practices (as indicated in IFAD’s “Decision Tools for Rural Finance”) will be adhered to, and financial products will be responsive to market demand.

The IFAD Rural Finance Policy emphasizes the need for the sustainable provision of financial services. This requires that the institutions IFAD supports must be viable and sustainable over the long term and must be in full compliance with best practices in rural finance, particularly in terms of the quality of loan portfolios and responsiveness to client needs. The IFAD approach in the region will reinforce these concepts, and assistance will be focused only on those institutions that are or will become sustainable and viable and that operate in accordance with best practices.

Objective III: Continue the shift away from extending direct, long-term credit lines towards the provision of support for capacity-building and funding to cover the initial capital requirements of partner institutions.

The amount of resources available to IFAD for the development of rural finance is limited. Moreover, there are a range of financial institutions that have better access to capital and more expertise in extending credit. These financial institutions are reluctant, however, to invest in or lend to RFIs that have a very small equity base, few existing lines of credit, or unproven management. Consequently, IFAD may, with great advantage, focus its resources and utilize its comparative advantages in identifying and remedying these weaknesses. Since governments are reluctant to borrow for capacity-building and technical assistance, IFAD will provide the appropriate financial packages to support these capacity-building efforts (e.g. through supplementary funding resources or grants). This will encourage investment in RFIs by other lenders and investors.

Strengthening management at both the strategic and operational level is critical to the success of individual partner RFIs and of national sectors in general. As a result, capacity-building needs to be provided at the micro-, meso- and macrolevels within and among countries in the region. This assistance should be broad-based and might range from technical support and training at the grassroots level to support for regional initiatives. The activities to be supported by the Fund may be wide-ranging, including the provision of local and expatriate experts, market studies and new technical assistance. Support for networking with partners within and outside the NENA region should be emphasized. Capacity-building will be needs based, with no set formula for any country or programme.

Where a limited equity base is identified as the critical weakness of the partner RFI, IFAD may, on a very selective basis, provide seed capital. This would be funded as a grant and be supplied only in circumstances in which local lending and investment practices require that the RFI meet a minimum capital threshold in order to attract external investors. Furthermore, other potential investors will have been identified already during the inception or formulation stage of the programme cycle.

If a lack of debt capital or wholesale credit funding is identified as the key weakness, IFAD may, on a selective basis, provide a revolving line of credit to a partner RFI. The credit will be extended
for a relatively short period of time, must not undercut the local market and must have a clearly identified source of repayment. Alternatively, wholesale funding may be extended to apex organizations (such as social funds for development) that will act as wholesalers for grass-roots RFIs operating in remote areas. This funding, to the extent possible, should be provided on commercial terms at both the wholesale and retail levels, have a clearly identified source of repayment, and be set for a limited time frame. All extensions of credit funds must be accompanied by the appropriate technical assistance to ensure that the funds are used in a prudent and sustainable manner.

A further innovation would be the provision of a loan guarantee fund, against which commercial lenders would extend credit in local currencies. As with the other types of credit extensions, though, this funding should be offered on a relatively short-term basis, be competitively priced, not undermine the local credit market and include a clear exit strategy.

Objective IV: Adopt a flexible approach towards methodologies and partnerships by identifying and using those that are most appropriate for the particular operating environment.

IFAD’s ability to be innovative in rural finance in countries and in the field is limited by the Fund’s mandate to work through the host government, mainly with the ministry of agriculture. But there is an increasing need for IFAD to switch to a more flexible approach in the design and implementation of rural finance programmes. This is due to the rapid growth of microfinance, the varying levels of development and sophistication within and between countries and the increased numbers and types of clients and service providers.

In this environment and given its limited field presence, human resources and financial capital, the Fund can most effectively maximize its outreach and impact and enhance innovation by acting with other partners in rural finance. By building on its experience and substantially widening the spectrum of its partnerships, IFAD will be able to leverage its comparative advantages and utilize the strengths of the other partners for the benefit of its target market in the region. These partners include community-based organizations, rural banks, NGOs and social funds for development. Commercial banks that are already providing rural services or are committed to working in rural areas should be considered among the primary partners rather than as secondary options. IFAD should coordinate with other major multilateral organizations working in the region (e.g. CGAP) to discuss with host governments on the regulatory and oversight regimes most appropriate to encouraging the growth of the rural finance sector, especially the provision of savings services. Partnerships also need to be established with local entities for the provision of capacity-building services and in the field-level management of rural finance programmes.

At the local level, IFAD should support locally based initiatives, such as rotating savings and credit associations and sanadiq, particularly in capacity-building and the eventual creation of links to commercial banks or apex institutions as a source of wholesale funding. In circumstances where state banks are prepared to service IFAD’s target market and comply with best practices, they might be considered potential partners. A fruitful way of cooperating with state banks might involve using their network of branches to deliver financial services (savings for example) in collaboration with other entities (such as community-based organizations). The experiences with the Agricultural Bank of the Sudan and the Postal Savings Bank of Syria should be monitored and assessed closely so that they might be replicated if found suitable for other countries.

IFAD should also investigate the possibility of forming partnerships with emerging regional Arabic and Islamic microcredit and financial services institutions once their operational modalities have been fully developed. These include the initiative of the Arab Gulf Programme for United Nations Development Organizations to establish Banks for the Poor in the Arab world (for example, in Yemen).
Objective V: Strengthen monitoring and evaluation through linkages with international, regional and national entities, such as the MIX Market and Sanabel, and deepen the knowledge of rural finance and rural microfinance within the Near East and North Africa Division.

The collection and analysis of data and the interpretation of data for meaningful monitoring and evaluation have long been the Achilles heel of rural finance and rural microfinance. IFAD will work with its partners and other institutions to strengthen the collection, evaluation and sharing of data and to enhance the monitoring of the performance of programmes and programme components. This will be accomplished by (i) agreeing on a standard template for data collection from all rural finance components in IFAD-supported projects and programmes in the region, following the guidelines of the IFAD Rural Finance Policy and the MIX Market; (ii) providing support for capacity-building to upgrade the institutional ability to collect, interpret and transmit data (through investments in hardware, software and training); (iii) providing support through IFAD programmes for membership in the MIX Market, Sanabel and local national microfinance networks; (iv) building IFAD’s knowledge base and sharing this knowledge with stakeholders; and (v) supplying financing for training in the principles of microfinance and in financial analysis to the staff of RFIs and IFAD.
VIII. A proposed approach for the application of the GF in countries

The ideal entry point for the application of the GF will be the country strategic opportunities programme and the outset of the project or programme cycle. During the preparation of the country strategic opportunities programme, the status of rural finance in a country should be included as part of the assessment of the rural poverty profile, rural institutions and national policies in rural finance. At the project or programme level, in circumstances where a rural finance programme or component is being considered, a survey should be undertaken to assess the level of development of rural finance in the proposed programme area. This should be carried out during the inception mission (or no later than the formulation stage) and should quantify demand and supply for rural financial services. The survey should also evaluate the market in terms of level of development, outreach and sophistication. Based on the results of this survey, the status of rural finance might be classified according to the following categories.

**Stages of Development**

(i) **Introductory/basic stage: no services-basic services.** At this stage, the services provided vary from no rural financial services, except through family, friends and moneylenders, to small savings and credit groups operating informally and offering very simple savings services and, possibly, loan services. Countries that might be classified at this level are Djibouti, Somalia, and the Sudan.

(ii) **Intermediate stage: basic services-intermediate services.** At this stage, financial services would range from basic services to large groups and institutions providing savings and credit services. Rural finance services would be operated by professionals utilizing management information systems and standard operating procedures. Countries that might be classified at this intermediate stage are Algeria, the Syrian Arab Republic, Tunisia and Yemen.

(iii) **Advanced stage: intermediate services-advanced services.** This classification includes intermediate rural finance providers and large MFIs such as registered entities, commercial banks and cooperatives. These providers would offer a wide range of financial services, be professionally managed with effective management information systems and monitoring and reporting systems and would be able to influence government policy. Countries at this level might include Egypt, Jordan, Lebanon and Morocco.

**Applying the GF**

How the GF is applied will vary with each individual rural finance programme and with each component of an integrated programme. Detailed below are steps that may be followed to identify and carry out the appropriate approach and select the most suitable partners.

**Introductory/basic stage**

**Microlevel.** The primary focus should be on building grass-roots savings-driven institutions, such as rotating savings and credit associations and the sanadiq. Emphasis should be placed on working with local institutions and national NGOs and relying on strong input from the client base. There should be a strong focus on capacity-building in management at the grass-roots and local levels and on establishing sound monitoring and evaluation systems. The most appropriate partners at
this stage are community-based organizations and NGOs, as well as state banks willing to expand into rural microfinance.

**Macrolevel.** The major thrust should be on increasing the host government’s knowledge of and commitment to the building of a viable, sustainable rural and microfinance sector. The creation of an enabling environment should be encouraged and developed. The ideal partners at this stage are CGAP, the World Bank and the United Nations Development Programme, and the most appropriate methods for building capacity and support are the holding of workshops and the provision of technical support.

**Intermediate stage**

**Microlevel.** The outreach of the programme or component should continue to be deepened and broadened. There should be a sharp focus on the sustainability and viability of rural financial service providers. The management skills of these providers should be strengthened in business planning and strategies. Support for capacity-building should be supplied to introduce marketing techniques and additional financial products. The preferred partners at this stage are established RFIs and providers of technical assistance.

**Mesolevel.** IFAD should develop and strengthen microfinance network within countries. The strengthening and upgrading of monitoring and evaluation among programme or component activities are a priority. Local providers of technical assistance and training should be identified and supported. Where possible and appropriate, apex institutions should be developed and strengthened. Potential funding contributors, particularly locally based entities, should be identified and brought in as partners. The Fund should play an active role on existing donor coordination committees with regard to rural financial services and create partnerships with other donors, including Arabic and Islamic banks and funds, Sanabel, international investors and social development funds. In addition, links could be forged with state banks as a platform for providing outreach into rural areas.

**Macrolevel.** The Fund, in conjunction with its partners, should focus on reinforcing within local governments the need for a continued enabling environment. The need to recognize creditor rights within the legal system and the importance of the linkage between rural finance and access to markets should be encouraged. Work with other stakeholders on the appropriate level of regulation and oversight at this stage of rural financial services should be continued. The most appropriate partners at this stage are Sanabel, CGAP, the World Bank, the Islamic Development Bank, the Arab Fund for Economic and Social Development, the OPEC Fund for International Development, the bilateral development assistance agencies of the Gulf countries, and other emerging Arab and Islamic regional banks for microcredit and rural finance such as the Banks for the Poor of the Arab Gulf Programme for United Nations Development.

**Advanced stage**

**Microlevel.** Outreach to the Fund’s target market should be developed and deepened, and the introduction of advanced and more complex financial services should be encouraged. Capacity-building should be made available as a means to require full compliance with best practices. The introduction of advanced technology into operational procedures and reporting (e.g. wireless banking and monitoring) should be buttressed. The Fund should support potential consolidation among rural finance providers by helping to create linkages with rural, peri-urban and urban entities. Useful partners at this point would include larger MFIs, cooperatives, commercial banks, Sanabel and other donors.

**Mesolevel.** The Fund should assist in creating linkages between RFIs and both donors and local providers of support service. The development of apex institutions among rural finance providers should be supported, and membership in Sanabel should be encouraged. Help should be provided in initiating and formalizing linkages between international investing entities and rural finance
providers. Networking arrangements with international databases, such as the MIX Market, should be encouraged so as to share information on activities. At this level and stage of development, the most appropriate partner could be the MIX Market, CGAP, training institutions, private-sector social investors, and technical service suppliers.

**Macrolevel.** At this stage of development, IFAD should work closely with lead agencies on national and governmental policies, as well as large international and regional financial institutions and other development assistance agencies, to ensure that legal, regulatory, fiscal and monetary policies enhance the development of rural finance and rural microfinance.
CHAPTER IX. Conclusion

The proposed GF is formulated on several core principles, as follows: the strategically differentiated approach and the devolution of responsibility and decision making to the programme level, leveraging IFAD’s assets in the region, strengthening management capacity at the field level, and improving the knowledge base and impact assessments within the sector. This will be accomplished through a series of interwoven objectives. These objectives focus on the need for the early involvement of grass-roots stakeholders in the design and implementation of programmes, the importance of viability and sustainability, the requirement for capacity-building, and the key role of knowledge management, monitoring and evaluation.

The GF and the suggested approach for applying it are based on the IFAD Rural Finance Policy, the lessons learned through the field experience of the Near East and North Africa Division of IFAD over the past 30 years and a number of corporate-level evaluations and project evaluations undertaken by IFAD recently. The GF seeks to capitalize on IFAD’s comparative advantages and to reduce the potential impact of known limitations. Progress already has been made in many of these areas, and partnerships have been forged at all levels.

In applying this GF, the demand for services is not perceived as a constraining factor since the client base for rural financial services far exceeds the provision of these services. It is important, however, that at the project inception stage a solid demand analysis be undertaken to assess the feasibility of the project or component and to identify the needs of the target clients before proceeding.

Finally, this GF is a “living” document and, as such, should be reviewed and revised as circumstances dictate.