POST-REVOLUTION TUNISIAN FINANCIAL SYSTEM: WHAT ABOUT ISLAMIC FINANCE?

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Abstract

The revolution of January 2011 brought hope of changes and enhancement of economic and social conditions for Tunisian citizens. The financial sector would be in the centre of economic reforms susceptible to achieve such aim since its prosperity is crucial for growth and development. In this context, the democratic elections organised for the first time in the history of the country in October 2011 brought to power a tripartite coalition, with the intention to fight against corruption, reduce economic and social inequalities, introduce reforms for the financial sector by giving to the Islamic finance a central role. The aim of this paper is to depict the state of Islamic finance in the country, and its historical and recent institutional developments. It also focuses on the role of Islamic finance in promoting the financial system development relying on an important factor in finance which is trust.

Keywords: Financial Development, Islamic Finance, Political Institutions.

JEL Classification: O16, G21, E02, P33.

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1. INTRODUCTION

The financial system is of paramount importance for growth in all economies no matter their development level. This statement is largely shared and agreed among specialists, based on empirical and theoretical studies on the link between finance and growth. However, the direction of causality between the two kinds of development (real and financial), or even the channels from which, one acts on the other, do not reach that same unanimity among scholars. Based on this idea, developing countries have tried to reap the benefits of financial development to achieve growth.

Governments of MENA countries launched, two decades ago (since the end of the eighties) vast programmes of restructuring and reforms with the aim to modernize their financial systems and enhance their performances. The foremost purpose of those policies, mainly driven by the World Bank and International Monetary Fund, was to make financial systems more dynamic and active in achieving economic development. Those reforms were guided at a large scope and through different levels.

Though implementing plenty of structural reforms, the financial development in MENA countries is still considered as under-developed compared to other regions, such as Southeast Asian countries or Latin American ones. According to specialists who are interested in the financial situation in MENA region, a major factor prevents financial sectors to fully play the role of catalyst for economic growth. This factor is the quality of the institutional, political and legal environment, which is not in synergy with the progress in financial sector. (Abed and Davoodi, 2003; Creane et al, 2004; Ayadi et al, 2013; Beji, 2015)

Thereby, the popular uprising experienced by some countries in the MENA zone (Tunisia, Egypt, Libya, Yemen, Syria and Bahrain) and the political turmoil that follows were partly caused by the weakness of the political institutions. The institutional and political deficit was harmful for social and economic conditions in those countries. For long time, they were characterized by low public transparency and accountability, poor law enforcement, high unemployment especially among young and educated people, high inequality and low purchase power for domestic consumers.

Our focus in this paper will be on Tunisia, country where democratic elections were organised for the first time in October 2011. These elections brought to power a tripartite coalition[1] who declared its intention to fight against corruption, reduce economic and social inequalities, improve law enforcement and introduce reforms for the financial sector by giving a central role to Islamic finance. In this paper, we will try to show that Islamic finance could play a central role in fostering financial development and funding growth after the revolution of January 2011. That role would be bolstered by the general improvement of the political environment and the institutional development brought by the revolution of January 2011.

[1] The tripartite coalition consists of “Ennahda” an Islamist party that won the majority of seats in the Constituent Assembly elections of October 2011 (89 seats on 217), The CPR or “The Congress for the Republic” a centre-right party (29 seats) and “Ettakatol” a centre-left party (20 seats).

The rest of the paper is structured as follows: Section 2 provides an overview of the financial system and the quality of institutions in Tunisia; Section 3 offers a description of the Islamic finance state in Tunisia, a brief historical overview and the recent legal developments of this branch; Section 4 sheds light on the possible role of Islamic finance as a catalyst for financial development and growth; finally, section 5 presents the conclusion.

2. THE EVOLUTION OF THE TUNISIAN FINANCIAL SYSTEM

The Tunisian financial sector is small comparing to other sectors in North Africa and largely dominated by banks. The domestic credit provided by Tunisian banking sector to private sector is about 74% of total GDP in 2014 (70% in Jordan, 68% in Morocco, 25% in Egypt, and 18% in Algeria for the same year). Among the 22 resident banks, three are big state-owned banks that account about 37% of total banking sector assets (only one have completed its restructuring); four large foreign owned banks (from France, Morocco and Jordan) with 28% of total banking sector assets; three are large private domestic banks that account for 28% of total banking sector assets; and five small development banks enjoying universal banking licenses and mainly funded from Gulf States. More than half of total bank credit is provided to industrial, trade and tourism sectors. The remaining credits are largely provided to public sector as mentioned in the last IMF report on financial stability in Tunisia.[2]

Table 1: Evolution of the Banking System in Tunisia

	2012	**2013**	**2014**
1. Resident Credit Companies	35	35	36
Conventional Banks	20	20	20
Islamic Banks	1	1	2
Leasing Companies	9	9	9
Factoring Companies	3	3	3
Corporate Banks	2	2	2
2. Non Resident Banks	8	8	7
Total	43	43	43

Source: Banque Centrale de Tunisie (2014): "Rapport sur la supervision bancaire", p. 25.

At the end of 2014, the overall resident banks capital is around US$ 1170.4 million owned by foreign shareholders (42.6%), Tunisian private shareholders (33%), and Tunisian State (24.4%). Comparing to 2013, the share of Tunisian private shareholders has declined by 4.1 percentage points and the Tunisian State by 1.6 percentage points. Thanks to the transformation of Al Baraka Bank (Islamic bank) into a resident bank with Al Baraka Banking Group Bahrain as main shareholder, the share of foreign shareholders has increased by 5.7 percentage points comparing to 2013. As a consequence to that transformation, Al Baraka Bank raised its capital from US $ 23 million to US $ 54 million. Its five year plan predicts the creation of 10 agencies per year during that period. The 5 first agencies were already inaugurated during the 2014 first quarter. According to the Al Baraka Bank CEO

[2] IMF (2012): "Tunisia: Financial System Stability Assessment", *IMF Country Report*, N° 12/241, p. 13.

Adnan Ahmed Yousif, the goal to achieve by operating such transformation is to reach 5% of market shares by 2018.

The non-banking financial sector is considered as limited in comparison to other countries in the region (especially Morocco, Jordan and Egypt). In 2011, it accounts for about 20% of all financial assets. For the insurance sector, there are only 19 companies primarily focused on nonlife activities (85% of premiums). The total annual premium in Tunisia is about 2% as share of GDP. That ratio is lower than the global average of 6.9%.

The equity and fixed-income markets are still small, with a market capitalization equal to 19.2% as share of GDP in 2014. This ratio is lower than other countries in the region such as Morocco (47.9%) and Jordan (71.3%) for the same year. Private equity remains small and the nine institutions of the leasing sector, accounted for 15.5% of private gross fixed capital formation in 2010.[3]

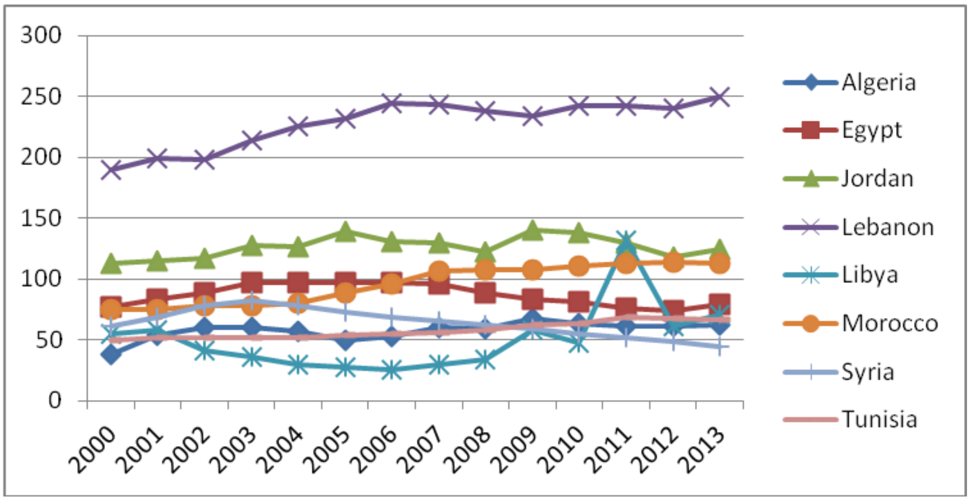
Hereafter, we will review a summary of the financial system state in the MENA region based on some key indicators. While we focus on the Tunisian case in particular, we address the evolution of those principle indicators across MENA region for comparison purposes.

2.1. Liquidity rate

According to the definition of World Development Indicators, M2 is money and quasi money: it comprises the sum of currency outside banks, demand deposits other than those of the central government, and the time, savings, and foreign currency deposits of resident sectors other than the central government. M2 as share of GDP is considered as liquidity rate since it gives an overview of the size of the financial sector. The liquidity ratio is as higher as the financial system is developed: it means that the scope of saving instruments is large and the liquidity is high in the economy. However, that ratio could decline even in presence of financial development. Indeed, when savers get more opportunities for long term investment less liquid than those proposed by the banking system, we assist to a decrease of liquidity ratio.

Graphic 1: Liquidity Ratio in Selected Countries of MENA Region

[3] IMF (2012): *Ibid*, p. 14.



Source: World Bank, World Development Indictors Database (2015)

Lebanon and Jordan have the highest ratio among the countries selected. We also see continued improvement in this ratio in Tunisia and Algeria. Morocco is experiencing a steady increase in the liquidity ratio that exceeds the level achieved by its neighbours (Algeria and Tunisia). Contrariwise, the ratio is plummeting in Syria since 2003. Regarding the liquidity indicator, the only marked effect is noticed in Libya and Jordan. In fact, the former has experienced a drastic decrease by 53% between 2011 and 2012 while the liquidity rate decreased by 5.42% between 2009 and 2012 for the later. There was not a notable change in liquidity conditions for all the other countries since the revolutions of 2011 (Tunisia, Libya, Egypt and Syria).

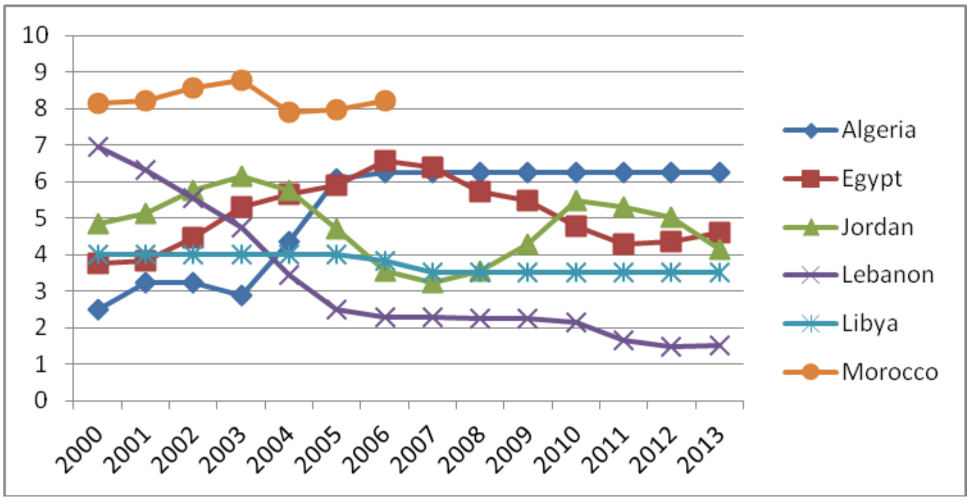
2.2. Interest Rates

An indicator of internal financial liberalization is the free fixing of interest rates by markets. Different interest rate regimes adopted by the countries in the region have resulted in different interest rate spreads.[4] During the 1980's, several countries made progress in the liberalization of interest rates process. It is the case of Algeria, Egypt, Jordan, Morocco and Tunisia. Interest rates in Syria instead remained under central bank control and directly instrumented for monetary policy purposes.

Normally, the interest rates liberalization would entail a decrease in bank spreads. The spread level is an important indicator of the competitiveness and efficiency of a given banking system. It also reflects a decline in the risk premium on loans, which means an improvement in confidence between banks (or lenders in general) and investors or borrowers. In general, the lower the spread, the higher the banking market competitiveness.

Graphic 2: Interest spread in selected countries of MENA region

[4] The banking spread is the difference between the lending and the deposit rate.



Source: World Bank, World Development Indictors Database (2015)

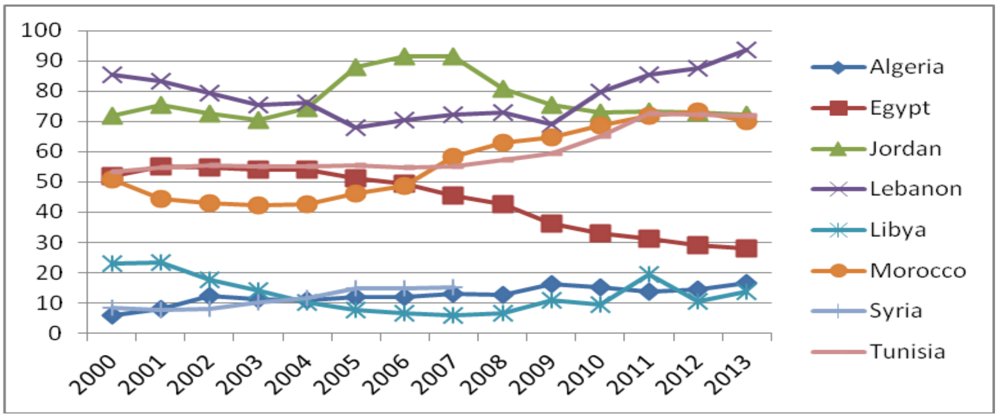
As we notice in the figure above, there is a general downward trend for all countries except for Algeria. That trend is explained by Structural Adjustment Programs (SAPs) adopted by the majority of countries since the end of the 1980s. The main aim of SAPs was to implement "free market" programs and policy even in the financial sector. Morocco recorded the highest interest spread for the last decade of about 7%-8%, while interest rate spreads in Algeria and Egypt were at 5%-6%. We also notice a clear and continued decrease of the Egyptian spread since 2007. In Tunisia, data on average spread are not available. Mainly because individual banks freely set lending rates since 1988. Banks also set deposit rates for a period of less than 3 months but without exceeding 2%. Since 2003, Lebanese financial authorities seemed to switch their policy regarding banking competition. Indeed, we notice a sharp and continued drop of interest rate spread making Lebanon the country where this indicator is the lowest. As well as with the liquidity ratio, we do not notice a dramatic change in spread interest since 2011, the revolution's year in the region.

2.3. Credits provided by Banking System

The domestic credits provided by banking sector as share of GDP is among one of the most used indicators by scholars to approximate the degree of financial development. It gives a key indication on the formal banking sector contribution in funding economic projects. It also gives an overview of the importance of the banking sector comparing to financial markets. The banking industry in North Africa underwent reforms since the eighties of last century. These reforms aimed to improve the quality of banking services and inject more competition in the banking markets. The reforms were based on privatizing state-owned banks. The restructuring wave has been slow in Algeria, and Libya, while it has been more successful in Morocco, Jordan and Lebanon. The banking sector is still dominated by state-owned banks in Algeria. They control over 90% of total banking deposits and assets. The Banque Extérieure d'Algérie (BEA) and Banque Nationale d'Algérie (BNA), the two largest state-owned banks, are holding 50% of the banking sector total assets. The fourteen private banks are holding about 10% of the assets and deposits. Mainly, those private banks are subsidiaries of international banks.[5]

[5] Franklin Allen, Isaac Otchere and Lemma W. Senbet (2011): "African Financial Systems: A Review", *Review of Development Finance*, 1, p. 91.

Graphic 3: Domestic Credits provided by Banking Sector as share of GDP



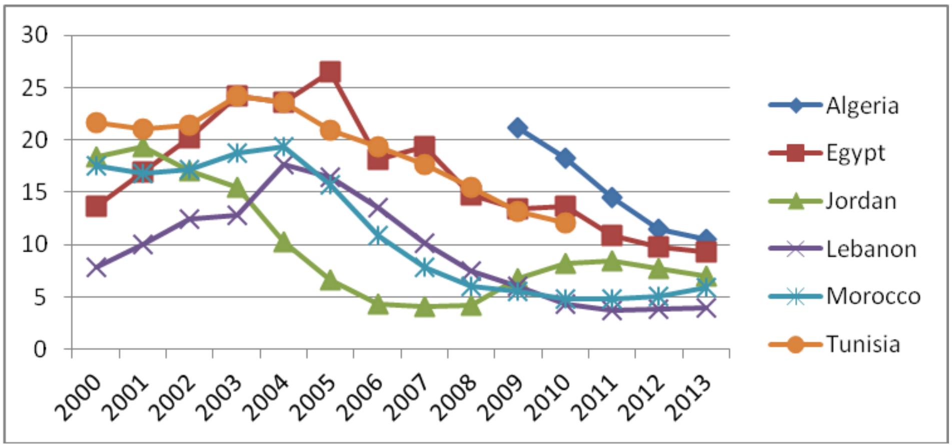
Source: World Bank, World Development Indictors Database (2015)

The sample is divided into 2 sub-groups: countries with relatively developed banking system, where the share of credits provided by banks to private sector is higher than 60% since 2009 and others where that share is plummeting or very low. The figure above corroborates the success of reforms in Lebanon, Jordan and Tunisia as stated above. Indeed, Lebanon seems to have a dynamic banking sector with the highest ratio, which is going increasingly since 2009 to reach almost 94% of GDP in 2013. As expected, Jordan also has a high level of banking financing although it is plummeting since 2007 (due to the effects of crisis) to finish at almost the same level as Morocco and Tunisia in 2013. Egypt occupies an intermediate ranking between high and low level countries. The ratio is declining since 2005 which could be an indicator of growing financial markets financing rather than banking one. As stated by Allen et al (2011), the most liberalized market in the region is the Egyptian financial market.

2.4. Non-performing Loans

The bank nonperforming loans as share of total loans is a key indicator to assess the quality of banking assets and especially banking sector efficiency. It is directly related to the institutional development and the relevance of the political environment. The study of the evolution of that ratio also gives indication about the efficiency of the banking regulation system. The banking regulation system is considered as efficient, as much as it prevents banking losses resulting from nonperforming loans.

Graphic 4: Bank Nonperforming Loans to Total Gross Loans (%)



Source: World Bank, World Development Indictors Database (2015)

The figure above shows a general downward trend for all countries. The best performances are seen in Morocco, Lebanon and Jordan as well as all the other financial indicators studied in this paper. The beginning of the last decade was marked by a high rate in Tunisia. The President Ben Ali's family and his son's in law controlled the most profitable sectors of the economy (banking, real estate, retail, automobile, etc.). They were allowed to claim credits from local banks without repaying the loans contracted (World Bank, 2014). It is true that the share of non-performing loans has declined since 2003, but remains among the highest in the region. The cronyism, high corruption and the low quality business environment explain such result.

In light of analysis presented above, we can set a classification of MENA countries according to the quality of their financial systems. We will discover the importance of such classification when we will have to discuss the finance-institutions nexus.

Table 2: Classification of MENA Countries according to their Level of Financial Development

Developed	Intermediate	Underdeveloped
Jordan Lebanon Morocco	Morocco Tunisia Egypt Algeria	Libya Syria

2.5. Rule of Law

We followed the work of Weill (2012) who summarized the poor quality of institutions in MENA countries by the analysis of the "Rule of Law" indicator of the World Bank. The index is between -2.5 and 2.5. The higher the indicator, the better is the "Rule of Law" in a country.

Table 3: Rule of Law by Country (2013)

Country	Rule of Law
Algeria	-0,68
Egypt	-0,6
Jordan	0,39
Lebanon	0,39
Libya	-1,36
Morocco	-0,25
Syria	-1,48
Tunisia	-0,2
France	1,4
Germany	1,62
United Kingdom	1,67
USA	1,54

Source: The World Wide Governance Indicators (2014)

The four OECD countries were taken as benchmarks. Comparing to the rest of the world, especially the OECD countries, the quality of institutions in MENA countries appears to be relatively poor. We also notice that we can apply the same ranking of Table: 1 to institutions quality. Indeed, Jordan holds the highest levels in the region, followed by Tunisia, Morocco Egypt and Algeria. Syria and Libya have the lowest institutions quality in the region. This coincidence corroborates the theoretical linkages between finance and institutions: The quality of institutions seems to have a direct and positive effect on financial development. The law and finance theory gives more than an explanation about this question. In fact, it clarifies the active role of the quality of institutions in explaining the differences between financial development levels.

In general, the economic systems in which the legal and judicial framework do not guarantee property rights or neglect the enforcement of financial contracts, suffer from a lack in incentives to lending activities and the settlement of financial transactions. Among the factors that determine a financial sector performance, legal rights of lenders and borrowers as well as the level of credibility and transparency of laws are the most important. They do give or not incentives to use financial system services. According to this, Claessens et al (2002) and Caprio et al (2007) state that the more the lenders are protected by an efficient legal system, the deeper the financial sector is.

In a highly influential paper, La Porta et al (1998) points out the contribution of legal and judicial system in the expansion of capital markets. It is what they called "the law and finance theory". The absence of that legal framework would not allow investor to access to private financing and so hinders financial development. This theory highlights the characteristics that encourage the use of financial products and services by savers and investors. These features are: strong legal and judicial system, rigorous respect of property rights, protection of investor rights and contracts between individuals.

The other branch of the law and finance theory argues that the different legal traditions born in Europe during last centuries (expanded after to all over the world by conquests, different colonization waves and herding phenomena) are determinants in explaining differences between financial and economic performances. Those differences in financial development levels seen nowadays are mainly the outcome of divergences in investor protection laws and financial contracts enforcement.

La Porta et al (1998) treated laws governing the investor protection, the enforcement of those laws and property concentration in 49 countries. Their analyses led to three main results. First, laws are different although they give a set of adequate rights to investors. In particular, the legal tradition of "Common law" is more likely to effectively protect investors rather than "French Civil Law". German civil law and Scandinavian one, take a middle rank between them. In addition, they did not find evidences confirming the existence of privileged category of investors. Evidences show that Common law legal tradition protects all kinds of investors. Second, law enforcement is dependent on legal tradition. Indeed, law enforcement is more rigorous in German civil law and Scandinavian countries. Law enforcement is also accurate in Common law countries, but less rigorous in French civil ones. The quality of law enforcement, on the contrary to laws themselves, is as high as the income level. Third, evidence supports the hypothesis that countries develop substitutes to bad investor protection systems. La Porta et al (1998) give the examples of mandatory dividends or legal reserve requirements as statutory mechanisms especially in civil law countries. The ownership concentration is another adaptive response to poor investor protection. The authors find that ownership concentration is high around the world because laws protect weakly minor shareholders: "*Furthermore, good accounting standards and shareholder protection* *measures are associated with lower concentration of ownership, indicating that concentration is indeed a response to poor investor protection*"[6]

In addition to legal environment quality which is crucial to achieve financial development, we notice in the economic literature the emergence of another important factor, considered as the natural complement of a good institutional structure. It is about the concept of social capital estimated by the level of trust and cooperation among individuals. We will deal with that point later in this paper to show its importance in fashioning the new financial architecture in the Tunisian Post-revolution context by including the concept of Islamic finance.

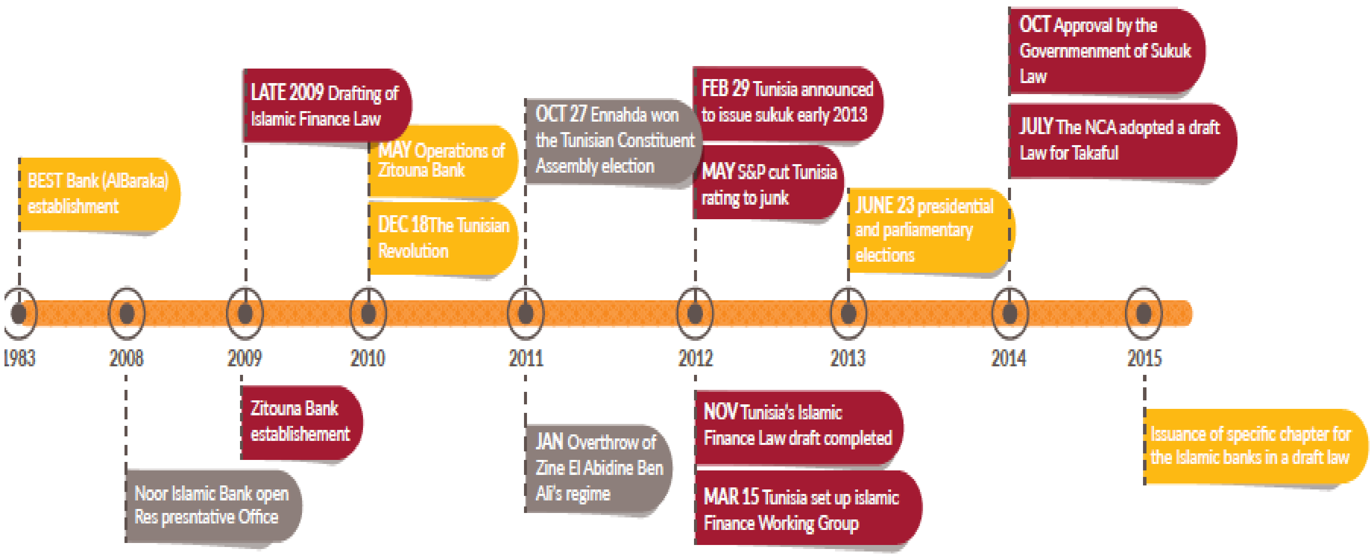
Weill (2012) argues that recent changes in the Arab countries can contribute to enhance the quality of institutions. Particularly in Tunisia were two free and democratic elections were held after the revolution (October 2011 and November 2014). He stipulates that these institutional changes are likely to have more favourable economic consequences.

3. ISLAMIC FINANCE IN TUNISIA

The involvement of Tunisia in the development of Islamic finance is nothing new. Tunisia was eager to develop the Islamic finance industry since its early stages. Indeed, since 1976 Tunisia was among the first countries in the MENA region to implement financial reforms in order to meet off-shore banks.

We present a chronology of Islamic finance development in Tunisia since the establishment of Al Baraka Bank in 1983.

Graphic 5: Chronology of Islamic Finance Development in Tunisia



Source: CIBAFI, ICD, IRTI, Thomson Reuters and Zawya (2013), p. 42.

Hereafter, we will show the historical evolution and the current state of the different components of the Islamic finance landscape in Tunisia.

[6] Rafael La Porta, Florencio Lopez-de-Silanes, Andrei Shleifer and Robert W. Vishny (1998): "Law and Finance", *Journal of Political Economy*, 106, p. 1152.

3.1. Legal and Regulatory Framework

In its quest to diversify its sources of financing and to overpass the economic consequences of the political upheaval of 2011, the Tunisian government tried to build up an adequate regulatory and legal framework to steer the Islamic finance activities.

Despite the potential and the strong internal demand, the successive governments before January 2011 did not try to neither push forward nor promote the Islamic finance products among the population. For pure ideological reasons, the political authorities saw Islamic banking with suspicion before January 2011, because of its possible association with banned political parties.

The situation radically changed after January 2011, and a complete Islamic finance regulatory system which covers *Sukuk* issuance, insurance, banking, leasing and even *Zakat* and *Wakf* was discussed to be adopted by the Parliament by the end of 2012.[7]

Islamic banking, as we will explain further, was established for the first time in Tunisia in 1983. It was operating under the civil law framework since the country did not yet implement a specific Islamic finance regulatory framework. In January 2012, in the project of “Finance Act 2012”, a specific Tax framework was predicted for Islamic financial products and services including Islamic banking activities. The government also approved a *Sukuk* law in October 2014 to diversify the government’s financing sources and to have an access to Islamic capital markets.

In July 2014, the National Constituent Assembly (equivalent to Parliament since it holds the legislative power) adopted a draft law regulating the insurance activities which facilitate the creation of *Takaful* legislative framework.[8]

During 2015, a common draft law for both Islamic and conventional banks and financial institutions was issued. Though both of them are continuing to operate under the same regulation, the first contracts with operations of Islamic finance have been defined. Furthermore, issues on banking establishment, operations, guarantee mechanism and depositor assets were discussed for the first time in a specific chapter within the mentioned draft law.

3.2. Banking

Tunisia had three Islamic banks until 2012: Al Baraka Bank Tunisia, Noor Bank and Zitouna Bank. Nowadays, there are only two fully-fledged Islamic banks since Noor Bank, an Emirati bank which opened its first overseas office in Tunisia in 2008, and is present in the country only via a representative office.

In 2013, The Central Bank of Tunisia declared that licences for Islamic windows would be allowed to conventional banks in the country. In that sense, “Amen Bank” asked in November 2015 Central Bank of Tunisia to have a licence to create an Islamic bank as a subsidiary or at least an Islamic products window.

Al Baraka Bank

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[7] CIBAFI, ICD, IRTI, Thomson Reuters and Zawya (2013): “Tunisia: Cautiously Optimistic”, *Islamic Finance Country Report*, p. 41.

[8] Islamic Finance News-Tunisia (2015): “Tunisia: Slow and Steady”, *IFN Country Analysis-Tunisia*, 12(12).

Since the mid-1970s, several banks from the Middle-East were established: “The Investment and Development Saudi Tunisian Company” (STUSID) in May 30 1981, “The Tunisian Qatari Bank” in March 1982, “The North Africa International Bank” in November 1984 and the “Tunisian Kuwaiti Development Bank” (BTKD) in July 1984.

Among the new established Middle Eastern banks, only one was based on Islamic finance precepts: “Bayt Al Tamweel Al Saoudi Al Tounsi” known as “BEST Bank”. Established in 1983 with an offshore banking licence, “BEST Bank” was allowed to conduct onshore banking activities in 1985 thank to an amendment to offshore legislation. Although, the bank should not hold deposits more than 1% of the total banking deposits. In 1999, “Bayt Al Tamwil El Saoudi Al Tounsi for Lease” was created as the first Islamic leasing company known as “BEST Lease”. In January 1st 2010, the bank was renamed “Al Baraka Bank Tunisia” and in 2011, it submitted its application to become a resident bank in order to provide services to local customers. In 2013, “Al Baraka Bank Tunisia” became the 22nd resident bank forming the Tunisian banking system. “Al Baraka Bank Tunisia” is a subsidiary of “Al Baraka Banking Group” based in Bahrain which owns 80% of its capital. The remaining 20% are owned by the Tunisian State. In the mid-1980s, “Al Baraka Bank” played a key role in financing, via *Musharaka* technique, one of the most important real estate projects in Tunisia: “The Planning of Lac de Tunis”.[9]

Since 2014, the bank has launched a set of new financing and deposit products including student financing and study accounts. In the same year, the bank opened five new branches including three exchange bureaux. Nowadays, the bank operates through a network of 13 branches and plans to reach 41 branches by 2019. In 2013, the year of its conversion to a resident bank, “Al Baraka Bank” increased its financings and investment portfolios by 7% to reach US$ 599 million. This result is achieved thank to a rise by 24% to its *Murabaha* sales to reach US$ 287 million. The bank total assets stood at US$ 643 million at the end of 2014.[10]

Zitouna Bank

With a paid capital of US$ 30 million, “Zitouna Bank” was founded by the President’s Ben Ali son in law in May 2009 and opened to public in May 2010. The second Islamic bank “Zitouna” is a domestic retail bank targeting the local market. Mobilizing the classic Islamic finance techniques such as *Murabaha*, *Mudaraba*, *Musharaka*, *Ijara* and *Istisna*, the bank provides funding to real estate, equipment and tourist facilities.[11] It provides a scope of financial products relating to deposit accounts, investment accounts, equity investments, and electronic banking. “Zitouna” also provides financial planning advice as well as services related to foreign trade.[12]

In 2012 and after the Revolution of January 2011, the current Tunisian government took the control and the direction of the bank. Currently “Zitouna” has a network of 85 agencies across the country and planning to reach 100 branches by 2018. In order to facilitate exchange of expertises and to improve the microfinancing techniques and know-how, the bank signed in April 2014 an agreement with Sub-Saharan Islamic banks (Guinea, Mauritania, Niger, Senegal and Sudan).

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[9] Majdi Chaabouni and Naïm Ghanoudi (2013): “La finance islamique en Tunisie, état des lieux et perspectives d’évolution”, *Les Cahiers de la Finance Islamique*, Special Number 2013, p. 75.

[10] Islamic Finance News-Tunisia (2015): *Ibid.*

[11] African Development Bank (2011): “Islamic Banking and Finance in North Africa: Past Development and Future Potential”, *AFDB Working Paper*, p. 25.

[12] CIBAFI, ICD, IRTI, Thomson Reuters and Zawya (2013): *Ibid*, p. 42.

Table 4: Total Assets of "Al Baraka Bank" and "Zitouna Bank" in US $ Million

	Al Baraka Bank	Zitouna Bank
2003	184.5	
2004	198.4	
2005	202.36	
2006	254	
2007	310	
2008	329	
2009	495	
2010	553	362.74
2011	545	362.47
2012	569	275.32
2013	658	610.36
2014	643	711

Source: Al Baraka Bank and Zitouna Bank, Annual Reports

Noor Bank

The representative office of "Noor Bank", which is established in 2007 and based in Dubai with branches in Abu Dhabi and Sharjah, was opened in 2008 in Tunisia but managed from Dubai. The bank would cope with difficulties to raise capital since it was launched just before the financial crisis of 2008. The intention of the Emirati managers is to invest in the Tunisian tourism sector and leisure industry. In that sense, Tunisia has already benefited of a US $ 2.2 billion investment from UAE, but future investments would depend on the evolution of tourism sector in the country.[13]

3.3. Takaful

Despite the absence of a regulatory framework, *Takaful* was available in Tunisia since 1982 with the establishment of re-Takaful operator BEST Re. Nowadays, there are four *Takaful* providers in the country along with BEST Re which was the first to be opened: "Zitouna Takaful", "El Amana Takaful", "At-Takafulia" and "Nigeria's Continental Reinsurance".

BEST Re

In 1985, the first offshore Retakaful company "BEST Re" was created one year after launching BEST Bank. The largest and oldest Takaful group in the world "Islamic Arab Insurance Co. SALAMA P.S.C" is the only owner of "BEST Re" after the acquisition of the

[13] African Development Bank (2011): *Ibid*, p. 48.

“DALLAH Al Baraka” shares in 2007. The Dubai-based company is planning to provide *Takaful* services at a regional level (Algeria, Libya, and Morocco along with Tunisia).

Zitouna Takaful

It is an insurance and reinsurance company that offers a large scope of General Takaful and Family Takaful products for individuals, professionals and businesses. The company was launched in 2011 with a capital of US$ 10 million with the aim to satisfy a growing demand for Insurance products conform to Islamic finance principles. Indeed, “Zitouna Takaful” is the first Tunisian Islamic insurance company that resorts to a Sharia Committee for the validation of its products and investments.[14]

El Amana Takaful

The second Islamic insurance company was created in June 2013 with a capital of US$ 6 million. “Al Baraka Bank Tunisia” and “BEST Lease” detain 34% of its capital. Those two institutions are directly or indirectly owned by the groups “Dellah El Baraka” and “El Baraka Bank Bahrain” detained by the Saudi businessman Sheikh Salah Abdallah El Kamel. A set of Tunisian insurance and reinsurance companies (Map, Comar, Astree and Tunis Re) owns 60% of the shares and the remainder (6%) is the propriety of Mzabi Group.

Al Takafulia

This company was created in June 2013 but started officially its activity in January 2014 with a capital of US$ 6.5 million. As well as “El Amana Takaful”, the larger part of its shares (96%) is owned by other financial institutions (A bank and 7 insurance and reinsurance companies). It offers the classic insurance products for individuals and businesses.[15]

Continental Reinsurance

In April 2014, “Continental Reinsurance” a Nigerian’s based company opened a regional office in Tunis. It offers Sharia compliant *Takaful* products.

Tunis Retakaful

The creation of the window “Tunis Retakaful” in 2011 was aimed to satisfy the domestic demand after launching “Zitouna Takaful”. It was also a reply to the growing demand emanating from Takaful insurance companies to cover needs in *Retakaful* in MENA Region and Africa.

3.4. Sukuk

[14] Rihab Grassa (2015): “Prospects for the Growth of Islamic Finance in Tunisia”, *Islamic Finance News*, mimeo, p. 3.

[15] Neila B. Taktak and Sarra Ben Slama Zouari (2014): “Tunisia Islamic Finance: Overview and Future Prospects”, *Journal of Islamic Accounting and Business Research*, 5(1), p. 9.

In 2012, Tunisian government announced for the first time its intention to issue sovereign *Sukuk* to raise between US$ 99 million and US$ 166 million. The *Sukuk* issuance was expected in 2013 with the guarantee of Islamic Development Bank (IDB). The issuance of those Sukuk was postponed to 2014.

In 2014, the Central Bank of Tunisia announced that the Government would issue *Sukuk* for US$ 630 million. The main goal followed by that issuance at both domestic and foreign market level, except balancing the budget deficit, was to pave the way for the rest of local companies to issue *Sukuk* overseas. The major part of the subscription (66%) was made by foreign investors and the rest by local market investors.[16]

In January 2015, Tunisia announced that it would issue $1.75 billion of dollar denominated bonds and Islamic *Sukuk* in 2015 as it needed funds to embark on infrastructural development.[17]

Finally, first issuance of *Sukuk* which was expected by the beginning of 2016 was postponed for the third time after being postponed for two times since 2013. The amount of the issuance is US$ 500 million aiming to attract a new class of investors due to the political instability in Tunisia.

3.5. Mutual Funds

The Tunisian financial system identifies 4 Islamic mutual funds. The first fund was established in 2009.

Arab Tunisian for Investment and Development Fund

The "Arab Tunisian for Investment and Development Company (A.T.ID Co)" is the manager company of the first Tunisian Islamic mutual fund launched in March 2009 while "Al Baraka Bank Tunisia" is the custodian bank. The investment portfolio of "ATID" should be composed by 20% of total assets at maximum in retail sector, 15% at maximum in real estate sector and the residue (65% at least) in miscellaneous sectors since their activities are not prohibited by Sharia.[18]

Al Kaouther Fund

The fund was established in March 2010 with a capital of US$ 49 thousand. "Al Kaouther Fund" was created by "Amen Bank" (also custodian bank) and "Tunisie Valeurs" which is the manager company.

Theemar Investment Fund

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[16] Rihab Grassa (2015): *Ibid*, p. 4.
[17] http://www.ventures-africa.com/2015/01/tunisia-joins-the-bond-train-to-issue-1-75bn-bonds-sukuks-in 2015/
[18] Neila B. Taktak and Sarra Ben Slama Zouari (2014): *Ibid*, p. 8.

United Gulf Financial Services-North Africa, which is a branch of United Gulf Bank based in Bahrain, launched in February 2013 the largest Tunisian Islamic mutual fund “Theemar Investment Fund” with a capital of US$ 32 million. The fund targets small and medium Tunisian institutions in different business sectors seeking finance to support the Tunisian economy.

Al Hikma Fund

The Fund was opened to public in January 19th 2016 with a capital of US$ 487 thousand. “Al Hikma Fund” was founded by STB Manager (Manager Company) and “Société Tunisienne de Banque” (custodian bank).

The path was not as easy to draw for the Islamic finance in Tunisia due to the political opposition for ideological reasons expressed by the successive governments before January 2011. Nowadays the Tunisian financial system contains two large Islamic banks providing 100% Sharia compliant products and services, four *Takaful* companies, two *Re Takaful* institutions, and four Islamic mutual funds. Since 2011, the Tunisian financial system has experienced numerous changes regarding Islamic finance organisation and legislation. Indeed, an Islamic finance regulatory system was set up in November 2012 which organised banking, insurance, and leasing activities. It also covers *Sukuk* issuance, and even *Zakat* and *Wakf* laws. Besides, a specific Tax framework was included in the “Finance Act 2012” to organise the Islamic banking activities. About the later, the Central Bank of Tunisia allowed in 2013 conventional banks to open Islamic windows. Though all these achievements, the Tunisian government is still waiting for the first issuance of *Sukuk*. It was initially predicted in 2013 but postponed two times since that year.

4. HOW ISLAMIC FINANCE COULD BE A SOLUTION IN A POST-REVOLUTION CONTEXT

Islamic finance assets in Tunisia are considered as small comparing to conventional ones. They are only representing 2% of total financing assets. The anterior political regime which reigned in Tunisia from the Independence to January 2011 did not provide a deep support to the implementation of Islamic finance. As we saw above, except “BEST Bank” which was an offshore institution and “Zitouna Bank” the propriety of the President’s Ben Ali son in law, the Tunisian financial system was lagging behind in respect to Islamic finance development. At the same time and as stated by The Islamic Finance Country Report (2013), there is a big proportion of population inclined toward Sharia compliance in Tunisia. The potential demand and the expectations are important among the population. According to a survey conducted by CIBAFI, ICD, IRTI, Thomson Reuters and Zawya in 2013, there is a proportion of 46% of population interested in Islamic banking and 89% that never make any banking operation with an Islamic bank. A more eloquent statistic shows that 54% of interviewees are ready to switch to an Islamic bank even if the conventional one offers better rate of return. The main motivation that would encourage people to deal with Islamic bank is adhering to Islamic rules according to 56% of people interviewed. In another survey conducted in 2012 by Gallup World Poll, there is a proportion of 57% of adults in Tunisia that has already heard about Islamic banks but only 2% has currently uses an Islamic banking service. The proportion of adults that already heard about Islamic banks is the highest in Tunisia comparing to other North African countries (Egypt, 49%; Morocco 41% and Algeria 35%) and Yemen (53%) according to the same survey.

The situation has dramatically changed after the revolution of January 2011. Indeed, the rise of Islamic parties marked a growing interest in the diffusion and use of Islamic financial Sharia compatible products. In that sense, the major Tunisian Islamic political party "Ennahda" which won the legislative elections of 2011 aimed to build up a special legislative and regulatory framework for Islamic finance in its Finance Act in 2012. Successive Tunisian post-revolution governments are hoping to make Tunisia an Islamic finance hub in North Africa. To do so, Islamic finance, more than conventional finance, needs a developed institutional framework to spread.

4.1. Islamic Finance needs Good institutions to thrive

The Islamic finance could play the escalator role in bolstering financial development conditions in Arab Spring countries and especially in Tunisia. The Tunisian case represents an exception in the region since it is the only country that experienced two democratic elections after the revolution of January 2011: The Constituent Assembly elections of October 2011 and the parliamentary and presidential elections of November 2014. The conditions of freedom of speech, freedom of press and human rights have significantly improved while much remains to be done in that field.[19] These major advances in quality of institutions could lead to better law enforcement, lower corruption and better protection of investors. As Weill (2012) notice, they can also exert a major impact on the expansion of Islamic finance. Indeed, Islamic financial instruments are more dependent on quality of institutions than conventional financial products and services. Their implementation requests more legal arrangements. Hence, Islamic financial contracts entail more legal costs than conventional ones. It is the main reason explaining the sensitivity of Islamic finance industry to weak institutional quality.[20] Weill (2012) stipulates that if Arab countries would increase the quality of institutions, Islamic banks will stop suffering from a disadvantage in efficiency comparing to conventional banks. He concludes that Arab Spring countries have much to win in giving a central role to Islamic finance by improving the quality of institutions.

The contribution of Islamic finance is not just perceived in its "traditional" benefits known in the literature such as: limiting financial turbulences and disruptions, avoiding speculation behaviour, attracting those unwilling to use conventional banks, promoting transparency, linking finance to real economy, etc. Islamic finance would have a direct and positive effect on financial development by playing a complementary role rather than being dependent of the quality of institutions as recommended by Weill (2012). Islamic finance could even play a role of substitute to poor-quality institutions.

4.2. Islamic Finance as a Complement to Good Institutions

We have discussed above the role of formal institutions in fashioning financial contracts and promoting financial development. There is another strand of literature stipulating that certain norms and patterns of social interaction are determinant in the development of financial transactions. These particular patterns are called "informal institutions" measured by what sociologists call "Social Capital". Fukuyama (1997) considers that: "*Social capital can be defined simply as the existence of a certain set of informal rules or norms shared among*

[19] According to *Reporters without Borders*, Tunisia occupied the 133th rank in 2014 in terms of press freedom index while it had the 164th rank in 2010.
[20] Laurent Weill (2012): "How Quality of Institutions Shape the Expansion of Islamic Finance", *LARGE Working Paper*, N°8, p. 5.

members of a group that permits cooperation among them".[21] For Bowles and Gintis (2002): "*Social capital generally refers to trust, concern for one's associates, a willingness to live by the norms of one's community and to punish those who do not*".[22] The social capital is a concept borrowed from sociology, related to the benefits taken by individuals via their adhesion to communities and associations (Bourdieu, 1985). It is also the quality of human relationships in a society and its potential to be enhanced (Coleman, 1990). In this context, a high level of social capital leads to the exclusion and the punishment of all who deviate from a set of social conventional standards.

Guiso, Sapienza and Zingales (2000); Hong, Kubik and Stein (2004); Calderon, Chong and Galindo (2001) are among few economists that clearly analyze the link between trust and financial development, via empirical studies connecting indicators of social capital to those of financial development. The authors argue that trust is the natural complement of formal institutions because, complex as they may be, financial contracts simply cannot foresee all contingencies and the use of courts to arbitrate every possible discrepancy would be extremely costly system to run.[23] Trust is requested for the success and fulfillment of financial transactions because even in case of a strict application of laws, financial contracts are intrinsically incomplete. It implies that no contract can fully guarantee a loan repayment. It also entails that trust will have an important role to play in defining the financial market development even in presence of strong rule of law.

The role of Islamic finance as natural complement to formal institutions appears when we assume that elaborating financial contracts in a high-quality institutional environment is not a sufficient condition to achieve financial development. Stulz and Williamson (2003) confirm that idea by assuming that religion is an important determinant of creditor protection besides formal institutions. In the same vein, AFDB (2011) stated that the variety of Islamic financial contracts is very large covering multiple purposes and assuring that all parties (investors and beneficiaries) are well covered. The aim of the lender is to be sure that the borrower will not use the funds for immoral projects: "*Islamic financial contracts are designed to ensure that a high level of trust is maintained between the parties thus reducing long term transactions costs and more than offsetting the additional set up expenses associated with ensuring Sharia'ah compliance*"[24]

5. CONCLUSION

Everything suggests that the integration of Islamic finance products and practices in the Tunisian post-revolution economic landscape will continue the momentum that has already been launched. As stated by Grassa (2015): "*we will witness in 2016 the rise of Tunisia as the intellectual capital of the Islamic financial world, supported by new Shariah compliant banks and new companies in the sub-financial sectors like Takaful, asset management and Islamic funds*".[25] Despite the efforts made by Tunisian governments to implement the foundations of a relevant Islamic finance network and to ease Sharia-compliant transactions like Sukuk, Sharia-compliant funds and several Sharia-compliant products, much remains to be done. The

[21] Francis Fukuyama (1997): "Social Capital" Tanner Lecture on Human Values, p. 378-379 cited in Steven N. Durlauf and Marcel Fafchamps (2004): "Social Capital", *NBER Working Paper Series*, N° 10485, p. 4.

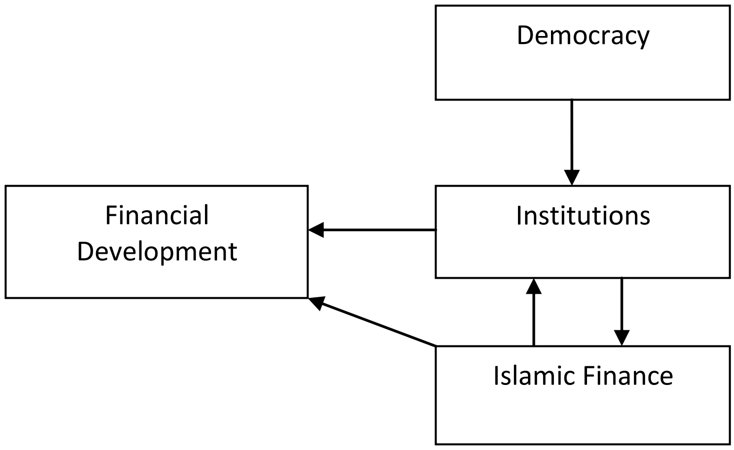
[22] Samuel Bowles and Herbert Gintis (2002): "Social Capital and Community Governance", *Economic Journal*, 112, p. 422 cited in Steven N. Durlauf and Marcel Fafchamps (2004): *Ibid*, p. 5.

[23] Andrés Fernandez and César Tamayo (2015): "From Institutions to Financial Development and Growth", *Inter-American Development Bank Working Paper Series*, N°565, p. 20.

[24] African Development Bank (2011): *Ibid*. p. 13.

[25] Rihab Grassa (2015): « Islamic Finance in Tunisia: What's next? », *Islamic Finance News*, mimeo, p. 1.

promotion of new products is requested and a more suitable legal and regulatory framework should be developed. But above all, it would be relevant if Tunisia avails the democracy climate brought by the revolution of January 2011 to enhance the institutions quality which is of paramount importance for the development of Islamic finance.



In fact, the recent political changes in the Arab countries, especially in Tunisia, can contribute to enhance the quality of institutions. Indeed, these changes have been notably motivated by the willingness for greater transparency and lower corruption. They can then contribute to better enforcement of laws with lower corruption as asserted by Weill (2012). As we saw, the literature has shown that there seems to be a bidirectional relationship between institutions and Islamic finance. Actually, Islamic financial instruments are more dependent on quality of institutions than conventional financial products and services. Their implementation requests more legal arrangements. That need is explained by the intrinsically incomplete nature of financial contracts as explained by Fernandez and Tamayo (2015). Even in presence of strong and relevant laws, trust will have an important role to play in defining the financial market deepness, given the fact that a financial contract is basically incomplete. Hence, Islamic finance has two ways to act on financial development: direct way such as limiting financial turbulences and disruptions, avoiding speculation behaviour, etc. and indirect way via the quality of institutions.

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