

LOAN COMMITTEE

LC/M/86-31
September 22, 1986

Minutes of the Loan Committee Meeting to consider
TUNISIA - Proposed Industrial and Trade Policy Adjustment Loan
held on Tuesday, September 16, 1986 in Conference Room E-1204

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A. Present

Committee:

Others:

| | | | |
|-----------|---------------|-----------------------|-----------------|
| Chairman: | Mr. Stern | Mmes/Messrs. Bachmann | Hasan |
| OPS: | Mr. Husain | Choksi | Pranish |
| Legal: | Mr. Goldberg | Clements | Roger |
| Region: | Mr. Wapenhans | Donovan | Sacerdoti (IMF) |
| | | de Vuyst | Sawaya |
| | | El Rifai | Segura |
| | | El Serafi | Stoutjesdijk |

B. Issues

1. The meeting was called to discuss the Initiating Memorandum dated September 8, 1986 from Mr. Stoutjesdijk to Mr. Stern, submitted for approval to appraise a proposed industrial and Trade Policy Adjustment Loan (ITPAL). The discussion focused on the main issues raised in the Country Policy Department's memorandum of September 12, 1986.

C. Discussion

Macroeconomic Program

2. The Committee suggested that the proposed operation focus on critical issues in industrial investment and trade incentives and that the issues relating to money supply and credit allocation be left to the IMF. The IMF representative reported in this context that a Fund mission in the field had reached agreement with the Government on far-reaching liberalization of monetary and credit controls based on "classical" instruments such as active money-market management and liberalized interest rates, with only a few preferential rates remaining controlled.

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COMMITTEE

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Senior Vice President, Finance
Vice President & General Counsel
Vice President, Operations Policy
Regional Vice President concerned*
Vice President, Energy & Industry (for lending
in these sectors and SALs)
Vice President, Economics and Research (for non-
project lending)

OTHERS

Standard (see OMS 9.25 page 7)

*Copy to all other Regional Vice Presidents

3. On exchange rate policy, the IMF representative noted the Government's intention, following the recent devaluations, to maintain the rate at its current effective level by making further periodic adjustments as appropriate. The IMF representative expected that a Standby proposal would be presented to the IMF Board around end-October.

4. The Committee noted that, as agreed during the Loan Committee meeting of August 21, 1986 on an Agricultural Sector Adjustment Loan (ASAL), the macro-economic policy program would serve as the framework for both the ASAL and the ITPAL and would be a condition of both loans.

Liberalization Program

5. The Committee sought clarification on the proposals for decontrol; a speaker commented that the control system seemed to remain essentially in place until the early 1990s. The Region recalled that a five-year program for reform of the trade system had been agreed in connection with the Agricultural Sector Adjustment Loan, with specific actions defined for removal of quantitative restrictions and tariff adjustments during 1986-88. It is proposed that a general understanding would be reached under this operation on the rate at which remaining QRs (mainly on consumer goods) would be eliminated during 1988-91; substantial action is envisaged by 1989. The trade reform program would be an integral part of the proposed loan conditionality.

6. It was envisaged by the Region that investment sanctioning procedures would be progressively liberalized, broadly in line with the removal of price controls. The Committee agreed that all licensing should be removed by the end of 1988 at the latest on proposed investments below a specified threshold level and on investments in well-established industries; the Committee also thought that the threshold should be higher than the figure of DT 200,000 (about US\$300,000) mentioned in the Initiating Memorandum. On this basis, by end-1988 at least 60% of investment would be decontrolled. A program to phase out remaining restrictions during 1989-91 should be agreed.

7. The Committee expressed reservations about the proposals for special incentives for exports, regional and technology development and employment. It noted that remaining bias against exports in the trade regime could be partially offset by tax drawback provisions and should be addressed by further adjustments of import tariffs; that special incentives for regional and technology development had generally been ineffective; and that employment could be encouraged through appropriate factor pricing as well as changes in labor regulations. Provision of any special incentives under the program would require strong justification. Moreover, they should be clear, simple, and of limited duration; available virtually automatically without requiring case-by-case government approval; and apply across the board. They should not undermine the beneficial effects of the reform package. The Region explained that where ERR tests were envisaged (e.g., for proposed projects involving regional development incentives), the analysis would be undertaken by the development banks financing the projects as part of their regular appraisal procedures, and would not involve the Government.

Business Environment

8. The Committee questioned whether sufficient action was envisaged to improve the business environment; the possible need for corporate tax reform was raised in this context. The Region explained that various aspects relating to the business environment were already being addressed through project work. The Committee requested that this subject be discussed systematically when the proposed operation was next presented to the Loan Committee for review, including necessary improvements.

Exchange Rate Risk

9. The Committee indicated that, as a general rule, exchange rate risks on foreign borrowings should be borne by final borrowers. Agreement should be sought with the Government on this general objective as well as on a program for a build-down of the existing exchange commission facility. Access to the Exchange Rate Guarantee Fund should be progressively restricted for borrowers able to protect themselves against the foreign exchange risk. The average level of the exchange guarantee commission should also be adjusted to more accurately reflect the risk involved.

Social Impact

10. The meeting discussed the social impact statement annexed to the Initiating Memorandum. The Chairman indicated that the President's Report should include a full statement on the impact of the program on the poorest segment of the population.

D. Conclusion

11. The Committee approved the Region's proposal to proceed with appraisal, subject to the comments and modifications noted above.