

LOAN COMMITTEE

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Minutes of the Loan Committee Meeting to consider
TUNISIA - Proposed Agricultural Sector Adjustment Loan
held on August 15, 1986, in Conference Room E-1208

A. Present

Committee:

Chairman: Mr. Stern
Finance: Mr. Qureshi
OPS: Mr. Köpp
Legal: Mr. Scott
ERS: Mr. Michalopoulos
Region: Mr. Stoutjesdijk

Others:

| | |
|---------------------|------------------|
| Messrs. Rajagopalan | Messrs. Clements |
| Asfour | Schuh |
| Erim | El Serafy |
| Seth | Bertrand |
| Bachmann | Rogers |
| Lister | Choksi |
| Mesdames Hubert | Bhatia (IMF) |
| Hadler | Dairy (IMF) |
| Engelhard | |

B. Issues

1. The meeting was called to discuss the Green Cover package on an Agricultural Sector Adjustment Loan (ASAL) to Tunisia, submitted under cover of Mr. Wapenhans' memorandum of August 11, 1986. The discussion focussed on the main issues raised in the Country Policy Department's memorandum of August 13, 1986.

DISTRIBUTION

COMMITTEE

Senior Vice President, Operations (Chairman)
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

C. Discussion

Macroeconomic Situation

2. The Region explained that the external situation had worsened in 1986 because of the sharp fall in oil prices, lower than expected revenues from tourism due to recent events in the Mediterranean, the serious drought, and a decline in workers' remittances reflecting Tunisia's political problems with Libya as well as the economic slow-down in the Gulf. Nevertheless, through a number of tough measures to reduce budget outlays, the public finance deficit is expected to decline from 5% of GDP in 1985 to nearly 4.5% in 1986.

3. The IMF representative reported that the Fund had discussed a possible CFF with the Government on the basis of the economic adjustment program agreed with the Bank, but felt that this would not provide enough support under current economic circumstances, and had recently agreed with the Government to explore also Standby and higher tranche releases. To this end, an IMF mission is planned for early September. As regards the exchange rate, the IMF representative indicated that the dinar is now 5% lower in real terms than any historical base. The Fund felt that a 15% depreciation from current levels is needed (this includes the 5% devaluation expected before Board presentation of the ASAL); this would bring the nominal devaluation in 1986 to 28%. The Government should make subsequent changes as needed to the exchange rate in light of relative price movements in Tunisia's competitor countries. The IMF representative pointed out that the Fund envisaged these adjustments in the context of a continued administered exchange rate system, and was not proposing a market-determined rate. He indicated that the Government had reacted favorably to the Fund's exchange rate proposals. Concerning consistency of the Bank and Fund proposals, the IMF representative indicated that the Fund's 15% exchange rate adjustment proposal was consistent with the Bank's tariff recommendations and the 4.5% budget deficit envisaged for 1986, but that additional budget action might be called for in 1987. In this regard, the Fund would push strongly to increase revenues and reduce subsidies, so as not to put the whole burden of adjustment on public investments. The Committee cautioned against too heavy reliance on increased revenues, in view of the already high tax rate in Tunisia. It also encouraged the Fund to pursue a more rapid pace for reducing consumer subsidies (except bread) and identifying a better system to target these subsidies.

4. The Committee welcomed the increased involvement of the IMF, which it was noted might also pave the way for an eventual SAL, and agreed that Bank and IMF staff should meet prior to the ASAL negotiations to ensure consistency of the two programs. The Committee noted that no budget objectives were shown for 1987. While the multi-year objective seemed reasonable it was essential that a specific objective for reducing the budget deficit in 1987 be agreed.

Adjustment Program

5. As regards the tariff reduction program, the Region confirmed its intention to push in 1987 for a 10-point reduction of all tariffs between 35% and 59% and a reduction to 25% of all tariffs between 25% and 35%. Concerning future reductions, the Committee felt that there was no need for an industry by industry study of effective protection, and it was agreed to delete this

proposal. As regards QR elimination, the Region confirmed that under its proposal, QRs would be lifted on all raw materials and spare parts by January 1987. QR elimination in other product categories would be spread out over several years, to provide time for Tunisian enterprises to adjust after many years of heavy protection.

6. The Committee accepted the Region's program, which would serve as the basis for both the ASAL and the upcoming Industrial and Trade Policy Adjustment Loan (ITPAL). It indicated, however, that the adjustment operations after ASAL and ITPAL should seek to define a firmer program for the elimination of QRs (on consumer goods) during 1988-91.

Foodgrain Protection

7. The Committee, noting that Tunisia is already a large foodgrain importer, questioned the slow pace of the proposed reform of the foodgrain pricing system. The Region explained that its cereal price objective was to change from a system of setting prices on a cost-of-production basis to one linked to border prices, and that this would be phased over four years to allow time to pass consequent price increases on to consumers and to allow macro-economic distortions to be reduced. The immediate effect of the ASAL would be that domestic producer prices for bread and durum wheat would start to reflect the relationships on international markets. The formula for setting the official domestic producer prices for cereals would be based on the world market price plus 15% included as the minimum tariff on all imports proposed under the macro program. Through such an approach, incentives for efficient production would be maintained to reduce balance of payments burdens without raising the overall protection to the sector, while the relative underprotection for the sector would be corrected through the macro-economic actions on industrial tariffs and the exchange rate. The Region emphasized that this would not preclude Tunisia from continuing to take advantage of dumped cereals. While the Committee confirmed the appropriateness of the Region's formula for setting domestic cereal producer prices, it urged consideration of a shorter adjustment period.

Agricultural Sector Adjustments

8. The Committee questioned the speed of irrigation O&M cost recovery. The Region explained that the pace was agreed in the context of the recent Irrigation Management Improvement Project, based on a detailed analysis of each Irrigation Office's finances and farmers' ability to pay and taking into account the current low efficiency and reliability of water delivery; this latter issue will be addressed under the Irrigation Project. Furthermore, the Region felt that the 9% p.a. increase in water charges in real terms was not slow and pointed out that, at about 95%, payment of water charges in Tunisia is exemplary. Finally, unrecovered irrigation water costs (capital and recurrent) only amount to about 1% of Government revenues, so an accelerated pace of water charge increases would not greatly improve Government finances.

9. The Committee noted several areas in which it felt the Government's commitment to the objectives of liberalization and privatization could be

strengthened or the pace of reform speeded up. Specifically, it suggested that:

- a) commitments be obtained to introduce capital cost recovery for irrigation works once O&M charges are fully recovered, and to turn over all input marketing functions to the private sector as soon as user subsidies are eliminated (in the latter case, the Committee questioned the need for a pilot program);
- b) fertilizer margins be liberalized as a condition for second tranche release at the latest;
- c) the elimination of credit subsidies and reform of the agricultural credit system be accelerated;
- d) the budget allocations for subsidies (in particular for food grains and fertilizers) be reduced more expeditiously and foodgrain subsidies targetted more effectively;
- e) the government equipment rental services be terminated and this objective be agreed to explicitly;
- f) in several areas the immediate steps to be taken were satisfactory but a clear statement of medium-term objectives should be added.

Size of Loan

10. The Committee indicated that the Bank's agreement to the increase in the loan amount from \$100 to \$125 million proposed would be contingent on the overall strength of the reform package, including progress in the areas noted in para. 9 above. The IMF representative indicated that the Fund had calculated Tunisia's gap for 1986-87 at SDR 800 million, after taking into consideration existing commitments, and that total Fund support could be about SDR 225-240 million. He felt that the Bank's ability to support increased loan amounts for ASAL and ITPAL would be important, since it would help obtain commercial or bilateral fast-disbursing support to fill the remaining gap. The Committee reiterated that the ultimate size of the loans will depend on the strength of the packages.

D. Conclusion

11. The Committee authorized the Region to negotiate the proposed ASAL along the lines set out in the package, subject to the modifications outlined above.