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INTERNATIONAL MONETARY FUND

Minutes of Executive Board Meeting 86/177

10:00 a.m., November 4, 1986

J. de Larosière, Chairman

Executive Directors	Alternate Executive Directors
A. Abdallah	E. T. El Kogali
	Song G., Temporary
	M. K. Bush
J. de Groote	
A. Donoso	
	M. B. Chatah, Temporary
	M. Sugita
	B. Goos
	Z. b. Ismail, Temporary
	J. Hospedales, Temporary
T. P. Lankester	
	O. Isleifsson, Temporary
	D. McCormack
Mawakani Samba	
Y. A. Nimatallah	I. Al-Assaf
	E. Ayales, Temporary
H. Ploix	
G. A. Posthumus	
	C.-Y. Lim
	A. V. Romuáldez, Temporary
G. Salehkhou	R. Msadek, Temporary
	A. Vasudevan, Temporary
S. Zecchini	

L. Van Houtven, Secretary
S. L. Yeager, Assistant

Also Present

IBRD: H. Bachmann, Europe, Middle East and North Africa Regional Office. African Department: R. J. Bhatia, Deputy Director; G. E. Gondwe, Deputy Director; M. Dairi, C. A. François, P. Lenain, S. L. Rothman, E. Sacerdoti. Exchange and Trade Relations Department: M. Guitián, Deputy Director; S. Kanesa-Thasan. Fiscal Affairs Department: A. H. Mansoor. IMF Institute: R. Ben Achour, Participant. Legal Department: L. Maktouf, J. M. Ogoola. Research Department: N. M. Kaibni, E. C. Meldau-Womack, A. Muttardy. Western Hemisphere Department: S. T. Beza, Associate Director; J. P. Pujol. Personal Assistant to the Managing Director: R. M. G. Brown. Advisors to Executive Directors: P. E. Archibong, L. P. Ebrill, S. M. Hassan, J.-C. Obame, A. Ouanes, P. Péterfalvy. Assistants to Executive Directors: O. S.-M. Bethel, F. Di Mauro, W. N. Engert, R. Fox, K.-H. Kleine, M. Lundsager, T. Morita, C. Noriega, C. A. Salinas, G. Seyler, H. van der Burg, D. A. Woodward.

1. EXECUTIVE DIRECTOR

The Chairman welcomed Mr. El Kogali, Alternate Executive Director, to the Board.

2. TUNISIA - 1986 ARTICLE IV CONSULTATION; STAND-BY ARRANGEMENT; AND PURCHASE TRANSACTION - COMPENSATORY FINANCING FACILITY

The Executive Directors considered the staff report for the 1986 Article IV consultation with Tunisia (SM/86/237, 9/10/86), together with a request for a stand-by arrangement (EBS/86/236, 10/22/86) and a request for a purchase under the compensatory financing facility (EBS/86/238, 10/23/86; and Sup. 1, 11/3/86). They also had before them a background paper on recent economic developments in Tunisia (SM/86/261, 10/23/86) and an information notice on the real effective exchange rate of the Tunisian dinar (EBS/86/244, 11/3/86).

The staff representative from the Research Department stated that actual data had been received on export earnings through September 1986, which covered the first nine months of the shortfall year. The analysis in the staff paper had been based on actual data through July 1986 for merchandise exports and through August 1986 for receipts from travel and from workers' remittances; data for the remainder of the shortfall year had been estimated. The new data indicated that exports and workers' remittances had performed better than had been estimated earlier, whereas travel receipts had done worse. Consequently, the overall calculated shortfall was somewhat lower--SDR 231 million--compared with the earlier estimate of SDR 239 million. However, the aggregate shortfall, though lower, was still twice the amount of the proposed purchase.

Mr. Msadek made the following statement:

> Since independence Tunisia has achieved three decades of balanced and uninterrupted economic growth in an environment of low inflation and financial stability, while maintaining a low level of indebtedness. During this period the country's infrastructural base has been established and the standard of living of the population has been increased substantially. The early attention to education, which had been made available to all segments of society, has produced a pool of highly skilled labor and facilitated the diversification of the country's productive base. Furthermore, the discovery of oil has contributed to a substantial rise in export earnings, which enabled Tunisia to step up its development effort while at the same time building up its international reserves.
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> Beginning in 1982, however, unfavorable external developments, including the deterioration in the terms of trade--particularly following the fall in oil prices--the weakness in world demand, and the slowdown in remittances and tourist receipts, began to

put pressure on the balance of payments and to impose foreign exchange constraints on the country's ability to maintain the momentum of high growth and to press ahead with its development effort. The authorities recognize that these adverse developments are more structural in nature and require broad-based adjusment measures. In formulating these policy responses a number of important considerations had to be taken into account. First, given the need for employment creation and for the increase of the country's capacity to service its external debt, the adjusment policy had to be growth oriented. Second, the authorities were keen on maintaining their cautious external borrowing policy; therefore, increased reliance had to be placed on domestic savings in financing development efforts. Third, in the absence of new oil discoveries the country's reliance on energy exports to generate needed foreign exchange will have to be shifted to other exports. This required the redoubling of efforts to further diversify the economic base and improve export performance.

With these considerations in mind, the authorities have initiated in late 1985 a broad-based adjustment program aimed at reducing internal and external imbalances, while restructuring, reorienting, and liberalizing the economy in a manner consistent with a changing international economic environment.

However, the collapse of the oil market in early 1986 and adverse developments in the region, together with unfavorable weather conditions, have intensified the pressure on the balance of payments and made it necessary for the authorities to accelerate the pace of adjustment and to endeavor to offset the sharp fall in oil revenue through a more intensive export promotion drive. In this context, the authorities, while continuing to pursue cautious demand and external debt management policies, will aim at restructuring the supply side of the economy, increasing efficiency, and liberalizing prices, investment, and imports.

This adjustment program has been coordinated with the Fund within the perspectives of a stand-by arrangement. Already several measures contemplated in the program had been implemented prior to negotiations with the Fund. In a sense, Tunisia came to the Fund with an ongoing program.

Consistent with the authorities' objective of tighter demand management policy and the need for releasing resources to the rest of the economy, the budgetary deficit is programmed to be virtually eliminated by 1991. The authorities have introduced, within the context of the 1986 supplementary budget, measures aimed at strengthening revenue performance and curtailing spending, including a significant reduction in subsidies. As a result, the 1986 overall fiscal deficit is now expected to be contained below 6 percent of GNP, notwithstanding the unfavorable economic environment that prevailed during the year.

An important element of the authorities' strategy of fiscal adjustment is the rehabilitation of the public enterprise sector. With the assistance of the World Bank, the authorities have embarked on a program of study and structural reforms of the public enterprise sector with a view to improving its competitiveness, reducing, when appropriate, direct state control, and privatizing those enterprises which do not hold a monopoly position. Such a reform would make these enterprises more responsive to market forces both in terms of their cost decision and pricing policies. It would also reduce the financial burden on the budget and provide the private sector with the opportunity to further diversify its investment portfolio.

On the reform of the tax system and in the light of the recommendations of a Fund technical assistance mission, the authorities have decided to introduce a value-added tax as of January 1988. At the same time, income tax legislation will be unified and simplified, with a view to encouraging savings, production, and exports.

Regarding monetary and credit policy, the authorities have already started limiting the growth of money supply to a level compatible with the objectives of growth, low inflation, and balance of payments sustainability. The indicator of money supply (M2) is now to grow at the rate of nominal GDP in 1986 (5.7 percent) and at a rate far short of the growth of GNP at current prices in 1987. Furthermore, mew measures are being taken to liberalize interest rates, introduce a greater reliance on market mechanisms, and give commercial banks greater responsibility in credit decisions.

The innovation in the Tunisian program lies perhaps more in the breadth of the structural measures considered. In addition to the reform of the public sector enterprises and the tax reforms already mentioned, these include a major liberalization of the economy covering pricing policy, trade and import liberalization, tariff reforms, and a reorientation of investment. These supply-side measures are expected to result in a smoother and more efficient operation of the economy with less government intervention, greater participation of the private sector, and an enhanced international competitiveness.

Price liberalization, a large part of which has already been implemented during the course of 1986, will continue during the program period. It is the authorities' intention to eliminate price controls by 1991 with the exception of a limited number of essential products. Commodity subsidies will thus be gradually reduced and the Subsidy Fund is expected to be self-financing by the end of the period.

Aware of the role of import liberalization in the adjustment process, the authorities have already started liberalizing imports destined to the productive sector with particular emphasis on export-oriented industries. They aim to continue the process throughout 1987 and 1988 and to complete it with the liberalization of consumer products by 1991. Through the liberalization of imports the authorities also aim at introducing greater competition with local industry, which in the final event would enable them to confront foreign products in the export markets.

Starting in 1987 the authorities intend to move ahead in the reduction of customs duties with a view to introducing a uniform rate of effective protection of 25 percent so as to reduce distortions and ensure a better allocation of resources.

The authorities' new investment strategy, which will go into effect at the beginning of next year, eliminates the need for a prior approval for investment not requiring state support and limits incentives to those projects which favor exports, regional development, and the transfer of appropriate technology. It will also extend incentives to expansion and replacement projects.

Investment spending is expected to be reduced from 28 percent of GDP, on average, during the Sixth Plan (1982-86) to 21.3 percent of GDP in the new Plan (1987-91). This reduction in the investment ratio is accompanied by a reorientation of investment outlays away from large capital-intensive projects toward small and medium-scale labor-intensive industries with high productivity and short maturity. At the same time as improving the efficiency of new investment, the authorities are keen on increasing the utilization of existing capacity. In this vein, incentives toward full capacity utilization reinforced by the recent adjusment of the exchange rate are expected to contribute further to greater competitiveness and export growth.

In addition to the reduction and rationalization of investment, the authorities envisage an improvement in the rate of domestic savings from 16 percent of GNP in 1986 to 19 percent of GNP in 1991, which should contribute to the strengthening of the external sector. This improvement in savings performance would result from firm control over private and public consumption and greater incentive to savings mobilization.

An important aspect of the program is the expected positive behavior of exports. These should grow at a rate of 6.7 percent at constant prices in 1987 and at an average rate of 5.7 percent a year for the period of the Seventh Plan. To ensure this success, the authorities have introduced a number of important measures in the areas of credit, insurance, and the exchange rate. In addition, further incentives to exports are provided through the reduction of tariff and nontariff protection of domestic industries. The authorities stand ready to maintain the competitiveness of exports through the adoption of timely and appropriate measures.

The external debt structure is expected to improve in the coming years with a smaller proportion of medium-term loans. The debt service ratio, even on the baiss on the present pessimistic scenario regarding the availability of concessional loans, is expected to reach a peak of 30 percent of current receipts in 1990 and to decline to 28 percent by 1991. However, an effort is being made at the level of the international community to obtain a greater proportion of concessional loans in support of Tunisia's adjustment program, which should further reduce the debt service ratio.

Tunisia's adjustment program falls within the Seventh Development Plan. Thus the stand-by program is framed within the medium-term context of the Development Plan. Given the required financial support from bilateral and multilateral sources and on the basis of the strategy agreed upon with the Fund and the Bank, the growth rate of GDP should move from 1 percent in 1986 to 3.6 percent in 1987 and thereafter average 3.8 percent a year for the period of the Plan. Job creation is expected to follow the growth impulse at an annual rate of 50,000 for the period of the Plan.

In conclusion, after several years of successful economic progress with high rates of growth and a strong balance of payments position, Tunisia, faced with the steep decline in oil prices in 1986, deteriorating terms of trade, unfavorable weather conditions and other adverse exogenous factors, has acted decisively and at an early stage and has shown determination supported by a national consensus in adopting bold and difficult adjustment measures to contain the deterioration of its external position. It opted for a profound, and in the long run, sure way to correct its imbalances by overhauling its entire economy and reorienting it in accordance with lower energy perspectives and a greater need for international conpetitiveness. In this effort it has cooperated closely with the World Bank and the Fund and is today seeking Fund support in the form of a stand-by arrangement and a compensatory financing purchase.

Mr. Nimatallah asked the staff to comment on the purpose of its forthcoming visit to Tunisia.

The Deputy Director of the African Department responded that during the forthcoming visit to Tunisia the staff would focus on the authorities' 1987 budget proposal. According to the authorities' general timetable, the 1987 budget proposal was expected to be finalized and approved by the Cabinet and submitted to the National Assembly toward the end of November.

The authorities therefore felt it would be worthwhile to consult with the Fund staff prior to the first review to ensure that the 1987 budget proposal conformed with the intentions set forth in the stand-by arrangement.

Mr. Nimatallah made the following statement:

> Tunisia has had a long and commendable record of growth and financial stability. Per capita income has increased over threefold within the past two decades. The authorities have succeeded in avoiding external arrears, and Tunisia has not been a prolonged user of Fund resources. For these reasons, I am reassured that the authorities will be able to make repurchases on time.
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> With the present deterioration in Tunisia's economic situation, the authorities have shown willingness and determination to take decisive and difficult corrective measures. They have been able to achieve the necessary national consensus to undertake a comprehensive adjustment program aimed at restoring economic and financial balance while restructuring, reorienting, and liberalizing the economy. A number of important measures have already been implemented prior to making a request for a stand-by arrangement with the Fund. I commend the authorities for their commitment to work closely with the Fund and the World Bank in implementing such a comprehensive program.
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> As to the objectives of the stand-by arrangement, the emphasis placed by the authorities on the attainment of balance of payments viability is appropriate and consistent with the envisaged moderate economic growth, and an eventual reduction of external debt. As had been brought out during the recent seminar on the theoretical aspects of Fund-supported adjustment programs (Executive Board Seminars 86/10 and 86/11, 10/20/86; and Executive Board Seminars 86/12 and 86/13, 10/30/86), in certain instances--and Tunisia is a pertinent example--those objectives can be achieved simultaneously, though not necessarily within the program period. However, to help restore confidence, it is necessary that the authorities declare categorically that priority is being given to attaining external viability. For Tunisia, the envisaged acceleration of the growth rate from 1 percent of GDP in 1986 to 3.6 percent of GDP in 1987 seems feasible. Some 15 percent of idle capacity in Tunisia could be activated simply by adopting appropriate incentives. If that were accomplished, it should be possible to reduce investment outlays as envisaged without compromising the growth objectives. Such measures should also help strengthen public finances and contain the growth in external debt.
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> In the medium term, while growth will help attain viability in the external sector, the Tunisian authorities will need to redouble their efforts to offset the adverse impact of the expected reduction in revenues from energy exports. The need to improve

export performance is all the more urgent in view of the prospective increase in external debt payments. In this context, the recent important steps taken to strengthen the international competitiveness of the economy, and the authorities' continued cautious wage policies are commendable. However, there is still scope for improving incentives, particularly in the agricultural sector, and much can be gained by streamlining present administrative procedures that are inhibiting growth and private sector exports. Equally important is the need for Tunisia's trading partners to open their markets to Tunisia's exports.

Regarding the objective of reducing the fiscal deficit, the authorities' commitment to strengthen public finances is encouraging. I am in general agreement with the thrust of the fiscal policy envisaged in the program and with the means of achieving its objectives. The emphasis placed on restraining expenditure is appropriate, particularly with respect to limiting subsidies and restructuring the public sector enterprises.

I am also pleased to see the clear intention by the authorities to stabilize, and eventually reduce, the size of external debt. Unfortunately, the world community, which seems more concerned about debt burdens that are large in absolute terms, has paid little attention to the debt problem of countries like Tunisia, where the burden of external debt is as great in relative terms. I am encouraged that the new economic plan in Tunisia will aim at stabilizing external debt, and will eventually reduce it through reducing the ratio of investment and enhancing the ratio of savings. Those intentions are welcome and should enable Tunisia to sustain growth with reduced recourse to external borrowing.

I am impressed by the authorities' intention to enhance the efficiency of the economy in general by increasing liberalization, which should encourage the private sector to take up the possible slack created by government retrenchment and, in the process, help sustain growth over the medium term. However, to maintain and strengthen the confidence of the private sector, it is essential that this process not be interrupted; experience shows that it is necessary to sustain continuity so as to convince the private sector that these policies will be enduring.

In sum, the authorities' determination to tackle the serious problems facing their economy is truly encouraging. The proposed program for restoring balance to the economy and putting it back on a sustainable growth path is comprehensive and deserves the full support of the Board and the international community. I therefore endorse the proposed decisions on the stand-by arrangement and the 1986 Article XIV consultation. Moreover, the request for a purchase under the compensatory financing facility meets all the requirements of that facility--the shortfall is attributable to factors beyond Tunisia's control--and I endorse the proposed decision.

Mr. Chatah made the following statement:

The economic program on which Tunisia is embarking is a strong one and worthy of Fund financial support, as well as the support of the international financial community. Moreover, Tunisia's request for a drawing under the compensatory financing facility is fully justified; it meets all the requirements of the facility, and we can therefore support it.

The staff papers give a thorough account of recent economic developments in Tunisia and the authorities' plan for dealing with the difficulties which have emerged in recent years. Since the staff and the authorities are in broad agreement not only on the fundamental policy questions but also on the specific issues regarding implementation of those policies, my comments will be relatively brief.

It is clear that despite the good growth performance in the period 1983-85, the underlying financial position of the country was deteriorating during this period. The relatively high rate of growth was not sustainable because it relied essentially on external and domestic bank financing to offset the decline in export revenue and workers' remittances. Indeed, the buildup of financial pressures and the rapid decline in foreign reserves led the authorities to resort to various restrictions and controls that eventually resulted in a sharp decline in economic growth. The authorities clearly recognized the problem in late 1985 and attempted to change the direction of policy in order to deal with it. But the dramatic fall in oil prices in early 1986 made it necessary to develop a more fundamental and comprehensive response to the worsening situation that could at once reduce the mounting domestic and external imbalances and create the conditions for sustainable growth over the medium term. In our view, the economic program for which Tunisia is seeking Fund support constitutes such a response.

In addition to its comprehensiveness, the program has a number of features that are particularly welcome. First, it is set in a medium-term framework not only in a broad sense, but also in terms of specific targets and policies over the next few years. Second, most of the structural measures are to be implemented according to specified timetables. Third, the structural measures are well coordinated with demand-management policies. Moreover, it is reassuring that the authorities are themselves convinced that the policy change is needed and will lead to the economic turnaround they are seeking--as is evident from Mr. Msadek's comprehensive statement; the program will thus be pursued with vigor and determination, which is always an important determinant of a program's success or failure.

A major challenge under this program will be to revive economic growth despite the continued decline in oil revenue and the necessary restraint in demand management. Indeed, the decline in oil revenue is striking. According to the staff's projections, the contribution of energy exports to total export revenue, which was about 40 percent in 1982, will decline to 22 percent in 1986 and to only 5 percent by 1991. Thus, an acceleration in the growth of nonenergy exports over the medium term is essential to achieve the program's objectives. Nonenergy export volumes are targeted to grow by 9 percent annually during this period. Although that target is ambitious, the wide range of policies designed to achieve it are likewise ambitious and should make it attainable. However, it is also crucial that Tunisia's trading partners facilitate Tunisia's efforts to increase exports by maintaining adequate access to their markets.

A number of specific elements of the program are particularly significant. On the structural side, in addition to the exchange rate reform, we welcome the careful coordination between import and price liberalization in terms of both pace and coverage; the deindexing of wages and prices, on the one hand, and the linking of wage increases to productivity, on the other; and the intention to implement public enterprise reform according to a specified timetable with the objective of maintaining only a minority of enterprises under government control.

On the fiscal side, the targeted reduction in the fiscal deficit from 6 percent of GNP in 1986 to 3.9 percent of GDP in 1987 is particularly noteworthy; this reduction will still allow for a reasonable increase in wages and a level of expenditure that is adequate for efficient government operations. Moreover, the strengthening of budget monitoring and the increased flexibility in the conduct of monetary policy should also be helpful in attaining the financial targets of the program.

The balance of payments projections indicate that in spite of the strength and comprehensiveness of the adjustment program, financing gaps will not be completely eliminated for some time. For 1987, donor support to fill the gap will be critical. I fully agree with the authorities that the availability of long-term concessional financing will be particularly helpful for Tunisia's debt profile and debt service ratios over the medium term. We are hopeful that the donors' meeting which is being planned will succeed in making adequate resources available on appropriate terms.

The staff papers give rise to two questions. First, no projection of the inflation rate for 1987 is given in the staff papers, although an estimate of the GDP deflator is provided. Obviously, the structural measures that are being taken, including the exchange rate adjustment and the import and price liberalization, will have an impact on consumer prices. It would be useful if the staff could make an assessment of this impact.

As to the assumption regarding oil prices that underlies the balance of payments projections in the staff papers, the staff indicates that in the paper on the stand-by request the price assumption of $13 a barrel in 1987 is the authorities' own projection, which the staff regard as conservative. Moreover, in calculating the export shortfall, the staff also assumes an oil price of $13 a barrel. That price is somewhat lower than the one assumed in the most recent world economic outlook exercise; has there been a change in that assumption? If not, should the compensatory financing projection be based on the authorities' projections even if they differ from those of the staff? I fully recognize the need for consistency in the projections presented in the staff papers, and, in this particular instance, the issue might not have any operational implication. But the issue is a more general one, and could have significant implications in other cases.

In conclusion, we can support the proposed decisions.

Mrs. Ploix made the following statement:

The staff papers are particularly interesting because of their chronological succession: the Article IV consultation report, which was issued in September, emphasizes the broad agreement reached by the Tunisian authorities and the staff on an appraisal of the present situation and on the general policies to be implemented to correct the imbalances; the paper on the request for a stand-by arrangement, issued in October, translates this agreement in principle into a detailed and comprehensive program.

At the time of the 1985 Article IV consultation (EBM/85/163, 11/12/85), it appeared that agreement on the situation and on the measures necessary to remedy it had been reached, and it was therefore disappointing that no concrete plan was presented. We thus welcome the authorities' decision to tackle the numerous difficulties they face and to implement the measures that the Fund has advocated for some time. However, the main objectives of the program might be too ambitious, taking into account the expected lag in the revival of export growth--for example, non-oil exports are forecast to grow at a rate of 11 percent to 12 percent from 1987 to 1989--and the slower than expected pace for phasing in some difficult stabilization measures.

In 1985, the economic situation worsened both externally, with a dramatic fall in external receipts, and internally, with a severe deterioration of the domestic accounts and a sudden fall in the growth rate. These developments were in part beyond the control of the authorities, who implemented welcome measures to moderate these effects, including a flexible exchange rate policy. However, these developments were harmful to an economy whose structural weaknesses were and continue to be considerable. Thus, a more comprehensive approach had to be adopted that emphasized structural policies to reduce financial imbalances and improve the effectiveness of resource allocation. This new emphasis on structural measures is welcome.

The main objective of the proposed program is to reduce the current account deficit. We are pleased to see that its framework does not embody a sharp restraint of economic activity but instead allows room for a reasonable growth assumption. In order for growth to be sustainable in the medium term, the structural components must play an essential role. I will briefly comment on some aspects of the program--the fiscal, structural, and monetary policies--and on the financing of the current account deficit.

The improvement of public financing is an essential part of the authorities' plan. On the revenue side, the elemental measures already implemented in 1986 or announced for 1987 will be rightly supplemented by a major tax reform, including the introduction of the value-added tax. Nevertheless, in the short term the adjustment burden will be largely supported by measures to restrain expenditure, which will have to be carefully put into place. In that regard, cautious wage and employment policies will have to be pursued in addition to the unavoidable curtailment of subsidies and capital transfers.

As to structural policies, both the authorities' wage and employment policies as well as reductions in subsidies will be facilitated by the various liberalization measures that the authorities are committed to pursuing and by the implementation of the proposed reform of state enterprises. These measures are far reaching: they represent a real departure from past policies and will profoundly change the general framework for Tunisian economic decision making. These measures are also necessary: the timetables for the liberalization of prices, investments, and imports must be closely adhered to in order for these measures to have an optimum effect in terms of structural reform and of strengthening public and private finance. The pace of these reforms could even be accelerated, and the authorities' readiness to consider that possibility is welcome. The shortening of delays increases confidence in the authorities' commitment and emphasizes the irreversibility of the reform process.

Credit and monetary policies are another important aspect of the program. The objective of keeping the growth of the main monetary aggregate below that of nominal GNP is welcome, because it directly supports other aspects of the program. This objective will be all the more easily attained because since 1985 interest rates have been more flexible, which should lead to improvement in the money supply and credit distribution. In this area as in others, the planned liberalization and reliance on market mechanisms should be pursued without hesitancy.

With respect to the financing of the current account deficit, the drawing under the compensatory financing facility should not give rise to any negative appreciation. Tunisia's share of the world oil market--0.3 percent of output and 0.1 percent of exports--is marginal. Furthermore, petroleum exports have never accounted for an overwhelming proportion of aggregate external earnings; for example, they represented 30.5 percent of aggregate earnings in 1984-85 and only 15 percent in 1986. Like Mr. Chatah, I would emphasize the necessity for Tunisia to develop nonenergy exports, and I welcome the cooperation between the Fund, the World Bank, and the Tunisian authorities in that area.

Aid donors must also play a role in closing the residual financing gap. The proposed informal meeting of principal aid donors should provide an opportunity for the international financial community to support Tunisia's efforts.

In sum, the program and the proposed decisions deserve the Board's commendation and support. The program is cast in a medium-term framework, and, as the staff has indicated, it "carefully blends structural measures with demand-management policies." With the help of the Fund and the World Bank, the Tunisian authorities' adherence to the policies which I have enumerated--and their careful implementation at each stage--will permit a restoration of financial balance and increase the authorities' ability to cope with external resource constraints. The implementation of the reforms outlined by the authorities would also represent a major, welcome change in the Tunisian economy. Moreover, it would open Tunisia's economy to outside competition--a situation in which Tunisia has historically done well.

Mr. Nimatallah remarked that the oil price assumption of $15 a barrel used in the world economic outlook exercise represented an indicative price, whereas actual unit prices varied from country to country, depending on such factors as the grade of petroleum and the location of the country. The Tunisian authorities' price assumption--at $13 a barrel--was probably realistic. Whether it was conservative was a matter of judgment; in any event, he would prefer to err on the conservative side.

The staff representative from the Research Department explained that the staff's price projections were based on the unit value that a country received for an export product. In addition to other factors, marketing arrangements influenced the unit value of Tunisia's oil exports; for example, exports to Italy were subject to a fixed price under a long-term contract. In addition to examining the factors relevant to a particular country, the staff also considered forecasts made within and outside the Fund in order to fully capture market trends for that country.

The calculation of export shortfalls was based on the staff's own projections as a matter of principle, the staff representative from the Research Department remarked. For Tunisia, the staff's projection of the unit price for petroleum happened to coincide with that of the authorities.

Mr. Chatah said that the staff representative had fully answered his question; the coincidence of the authorities' and the staff's price projections for petroleum exports was reassuring.

Mr. Goos commented that he welcomed Tunisia's decision to request a stand-by arrangement with the Fund. He was particularly pleased to note that the authorities had chosen to do so in a timely manner that allowed for an orderly adjustment of existing imbalances. That the authorities had come to the Fund with an ongoing program was also most welcome.

The program in support of the stand-by arrangement deserved the Fund's support, including the level of financing proposed by the staff, Mr. Goos continued. He fully agreed with the staff's recommendations; however, there was a clear need for firm implementation of the policy measures agreed under the arrangement. Moreover, an accelerated pace of liberalization might have been desirable. The comprehensiveness and breadth of the liberalization effort left little to criticize, but it also reflected the widespread recourse to regulation and control in recent years. Although important steps had already been taken or were intended in the immediate future, in the circumstances--particularly in view of the serious external financial constraint and the scale of the remaining structural rigidities--a bold and unambiguous liberalization effort was needed to mobilize the private sector potential for higher savings, exports, and growth. He was therefore somewhat concerned about the extended schedules that were envisaged for tariff reform, the reduction in agricultural subsidies, and import liberalization. The considerable degree of selectivity in import liberalization could undermine the purpose of the reform. In particular, limiting new import opportunities to already existing exporters and so-called integrated industries as well as to investment projects that had met with official approval might hamper both the necessary shift of resources toward the export sector and improved export diversification. The authorities should therefore adopt a general, more rapid approach to import liberalization and seek protection against the risk of an undue increase in imports by pursuing appropriate exchange rate and demand-management policies.

As to the liberalization of the financial system, while the intended reform of interest rate and central bank policies was highly commendable, about 25 percent of credit to the economy remained subject to preferential lending rates, Mr. Goos noted. In view of their potentially distorting effects on resource allocation and efficiency, preferential lending rates should be phased out. The authorities should also aim at an early elimination of the existing, though apparently reduced, requirement of central bank approval for loans granted by commercial banks.

He had no difficulties with the monetary targets or the sizable reduction in the fiscal deficit envisaged for 1987, Mr. Goos remarked. However, it was worrisome that the projected decline in the fiscal revenue ratio would have to be compensated by substantial cuts in public investment in order to reach the deficit targets. Moreover, the current budgetary savings ratio was projected to decline by more than 2 percentage points from 1985 to the end of the program. While welcoming the intention to introduce a value-added tax by January 1988, he agreed with the staff that it would be advisable either to accelerate the introduction of that tax or to take other, more timely supplementary measures to strengthen fiscal revenues.

In sum, he supported the request for a stand-by arrangement, Mr. Goos commented. The proposed program was a comprehensive and far-reaching adjustment effort, and he was particularly impressed by the structural measures that had been agreed. However, there were some potential weaknesses in the design of the program. Nonetheless, he was confident that if the program was implemented with appropriate flexibility, it should succeed. In that regard, the authorities' declared "readiness to consider an accelerated implementation" of the liberalization measures was reassuring, and it appeared advisable to follow such a course also in the conduct of financial policies. He could also support the proposed decision for a compensatory financing purchase.

Mr. Abdallah made the following statement:

> Tunisia represents a good example of a country that has strong determination, backed by appropriate measures, to cope with its economic problems. Unfortunately, the realization of its economic policy objectives has generally been thwarted primarily by destabilizing exogenous developments. It is, nevertheless, remarkable that economic activity as broadly reflected in the real growth of gross domestic product has been satisfactory, at least for the period 1983-85, when it averaged 5 percent annually. It is unfortunate that unexpected adverse circumstances forestalled the authorities' implementation of contingency policy measures formulated at the end of 1985 to deal effectively with fiscal and external deficits as well as exchange rate developments. The result, of course, was a less than satisfactory rate of growth for 1986. Management of the

economy remains difficult, owing largely to a slowdown in world demand for Tunisia's exports, the substantial decline in oil prices, and adverse weather.

The authorities' continued recognition of and readiness to address their financial and economic problems is welcome. The decision to reduce subsidies on a number of goods, including an increase in domestic petroleum prices, will boost sagging government receipts. The authorities have also depreciated the Tunisian dinar by 20 percent between December 1985 and August 1986. Thus, strong prior actions have already been taken, which is a good omen for the stand-by arrangement. Moreover, the staff recommendations regarding measures to secure financial balance are realistic, and I feel fairly confident that they will be implemented with full vigor.

The broad elements of the adjustment strategy clearly conform with the main recommendations contained in the staff report for the 1986 Article IV consultation. I welcome the careful blending of demand-management policies with the structural measures that have been incorporated in the program. Given satisfactory growth over the medium term, prospects are good that with timely and appropriate funding, the program will be effectively implemented and will lead to the desired balance of payments viability.

On the request for the use of Fund resources under the compensatory financing facility, there is abundant evidence of Tunisia's cooperation with the Fund in an effort to find appropriate solutions to its balance of payments difficulties. Finally, I support the proposed decisions.

Ms. Bush made the following statement:

Following a further deterioration in the external position in 1986, evidenced by a virtual depletion of foreign exchange reserves, the Tunisian authorities have embarked upon an adjustment effort aimed at reducing the current account deficit, rebuilding reserves, and eventually improving the external debt profile. To accomplish those goals in the context of increasing real economic growth at a rate exceeding that expected for 1986 will entail a fundamental reorientation of economic policy formulation to emphasize deregulation of both foreign and domestic trade, as well as other structural and fiscal reforms aimed at increasing the productive potential of the economy, while at the same time containing the financial imbalances that have emerged over the past several years.

The authorities appear to be making a good beginning under their adjustment program, with a clear commitment to fiscal consolidation, price deregulation, tariff and trade reform, public enterprise reform, and other measures. I welcome the overall framework of the program, which combines a variety of structural supply-side measures with macroeconomic adjustment, although in some areas a somewhat accelerated pace of reform might have been desirable. More specifically, it is discouraging that the overall fiscal deficit in 1986 will be high--at 6 percent of GDP; it had been hoped that the authorities could make further progress in that area during 1986 in view of the financing problems that have emerged.

Additional fiscal consolidation is being planned for 1987, and the authorities' commitment to reduce expenditures as a proportion of GDP is particularly welcome. However, further savings should be possible since government spending is expected to represent about 37 percent of GDP in 1987. More information on possible areas of expenditure restraint, both in current and capital spending, would be helpful. Substantial savings on subsidies are expected over the next several years, as the authorities reduce subsidies with a view to eliminating them by 1991. The ongoing deregulation of the economy should generate substantial producer response, which should help contain price pressures and cushion the impact of reduced subsidies on consumers.

I welcome the authorities' intention to implement a major tax reform with emphasis placed on reducing dependence on trade-related taxes. The unification of the taxes on income and profits appears to be on the right track. I would, however, appreciate any details from the staff on the planned evolution of marginal tax rates, exemptions, and other aspects of the reform, and any comments on how--as Mr. Msadek has suggested--tax reforms will encourage savings and production.

Supportive monetary policies will provide additional restraint on prices and could strengthen the inflow of workers' remittances. Several welcome steps toward the liberalization of interest rates are being taken, but controls on saving deposit rates will be maintained. Moreover, the authorities are continuing to provide some credit at preferential rates. I would be interested to hear the staff's views on the allocative effects of these policies.

Structural adjustment is an important component of the overall adjustment effort in view of the need to strengthen producer incentives, improve the trade accounts, and generate employment. The exchange rate adjustments that have already occurred are important in this regard and are expected to generate stronger growth in tourism and some increase in remittances over the next few years as well as growth in nontraditional exports. Nevertheless, if the payments position does not evolve as expected, and, in particular, if financing of the magnitude hoped for does not materialize in 1987, additional adjustments in the real effective exchange rate should be considered. It is reassuring to note that according to the Annexed Memorandum, the authorities are committed to such a course of action.

Exchange rate adjustment is being accompanied by some adjustments in the prices of controlled products. These steps are welcome, but the authorities' reasons for adopting such a cautious phasing of price liberalization are unclear. Such phasing might lead to an unnecessarily slow pace of resource reallocation. Also, the authorities have decided to set producer prices of cereals at a five-year moving average; could the staff comment on the reason for that decision? Finally, I welcome the introduction of a new investment code, which will eliminate investment controls on those entities requesting no special government treatment.

An action plan to reform the extensive public enterprise sector is to be completed by the end of 1986, and under the new five-year plan, the size of the sector will eventually be reduced from 550 enterprises to 160 enterprises. The planned reduction is substantial, but the number of enterprises to remain in the public sector still appears to be on the high side; I would appreciate any staff comment on the 160 entities to remain in the public domain. I would also be interested in any information the staff might have on the precise schedule of implementation of the plan for divestment, since the plan is expected to be finalized by end-December. Finally, I hope that the first review will pay particular attention to this area.

The import liberalization envisaged in the program could have the beneficial effect of reducing effective rates of protection. In view of the steps now being taken, a somewhat faster pace of liberalization might be desirable to avoid a partial effort that might ultimately lead to an inappropriate reallocation of resources.

On a related matter, I would be interested to hear staff comments on direct investment. Although investment might be expected to pick up following the authorities' exchange rate and liberalization actions, according to staff estimates direct investment by 1991 would exceed the level achieved in 1982 by slightly more than one half.

I support the general thrust of the authorities' program, which aims at liberalization of the economy and consolidation of the fiscal accounts. Nonetheless, I remain somewhat concerned that the pace of liberalization might be slow in view of the urgent need to stimulate economic diversification and growth. Also, large current account deficits are projected for 1986 and 1987, as well as large financing gaps. Staff comment on the filling of the 1986 gap, as well as any information on the 1987 gap, would be appreciated, since the Board will not be able to review the matter again until February 1987. Also, will the World Bank be able to accelerate its program in Tunisia? Substantial disbursements from the Fund will occur upon approval of the stand-by arrangement and compensatory financing requests, and firmer assurances that the Bank's program will continue as planned in 1987 would be welcome. It is particularly commendable that the authorities are not seeking debt relief in connection with their adjustment program and that they are attempting to maintain normal relations with creditors.

As to the request for a compensatory financing purchase, it is clear that Tunisia has a balance of payments need, and its cooperation with the Fund is evidenced by the program in support of a stand-by arrangement. Furthermore, part of the shortfall in export earnings--particularly with respect to oil exports--is largely beyond the authorities' control. However, I am not convinced that the shortfall in oil exports is temporary, in view of price developments in world oil markets. The word "temporary" implies a recovery of exports, rather than a continuing downward trend, as seems to be the case with oil exports. I also note that the amount of the requested purchase is substantially below the amount of the calculated shortfall. Nonetheless, the request gives rise to two concerns. First, the size of the purchase is large. The full amount permitted under the compensatory financing decision--exceeding 100 percent of Tunisia's quota--will be disbursed upon Board approval of the request, whereas purchases under the stand-by arrangement will be disbursed in tranches and are tied to program performance. While I recognize the commitment of the Tunisian authorities to the adjustment effort, it would be more reassuring if purchases under the compensatory financing facility were phased to correspond with performance over the program period. I look forward to discussing such issues during the forthcoming review of the facility.

Another concern is that the shortfalls for other exports, travel receipts, and workers' remittances appear to be related in part to the policies of the Tunisian Government, including past exchange rate and interest rate policies. While significant adjustments in these rates have occurred in recent months, in view of their lagged effect on exports, earnings might have recovered earlier if adjustments had been more timely. Perhaps the staff could clarify the extent to which these shortfalls might be related to economic policies and thus were within the control of the authorities.

I support the request for a compensatory financing purchase primarily because it accompanies an adjustment effort that is designed to reverse the deterioration in the external accounts. Moreover, the request is in respect of a shortfall that appears to be largely beyond the authorities' control and is for an amount substantially below the calculated shortfall.

The staff representative from the Research Department explained that, consonant with the Board's decision on compensatory financing, the temporariness of the shortfall was assessed in relation to total exports, and not in relation to a specific product or sector. It was necessary to assess temporariness on that basis because, over time, the composition of exports of a particular country might change; export products might disappear, for example, because of the exhaustion of a mine, or because of product substitution.

To say that a shortfall was temporary meant that it did not occur in consecutive years, the staff representative from the Research Department continued. To the extent that a shortfall could be measured from a declining trend as well as a rising trend, a recovery in export earnings was not a prerequisite for determining that the shortfall was temporary. In order for consecutive shortfall years to occur, a country must experience accelerating growth rates year after year, which no country was able to maintain indefinitely; instead, the growth rate of total exports usually varied from year to year, thus giving rise to the more typical situation where shortfall years tended to alternate with excess years.

The Chairman remarked that he was reassured of the temporariness of the total export shortfall by the figures for exports shown in Table 3 of EBS/86/236. From 1982 to 1985, export earnings had amounted to nearly SDR 1,800 million, owing primarily to the favorable impact of energy prices. More recently, adverse developments in energy prices and in workers' remittances, as well as in receipts from tourism, had adversely affected the Tunisian current account so that in 1986 exports of goods and services had declined. Thereafter, exports were expected to begin an upward trend, with those of goods reaching more than SDR 2,100 million in 1991--compared with SDR 1,400 million in 1986. Although those projections might be optimistic, they indicated that exports would not continue to decline in the long run and that the shortfall was, therefore, temporary.

Mr. Goos stated that he had also judged the temporariness of the shortfall along the lines described by the Chairman. In that context, he disagreed with the staff's interpretation that the results of the formula for calculating the shortfall, and not actual export developments, decided the temporary nature of the shortfall. For that reason, it would be necessary to re-examine the decision on the compensatory financing facility. The spirit of that facility was to help bridge short-term declines and shortfalls, but not a steady decline, regardless of the results of applying the formula used for calculating shortfalls. The formula could also lead to absurd results, whereby a permanent shortfall would exist only if exports were rising at a continued increasing trend. That aspect of the compensatory financing facility was cause for concern and should be examined at the forthcoming review of that facility.

The Chairman remarked that, for operational reasons, it was necessary to use the formula that had been adopted by the decision of the Board. However, if Executive Directors felt that the formula led to illogical conclusions contrary to the spirit of the decision, then the formula should be re-examined. Meanwhile, the Board was guided by the compensatory financing decision. It should be pointed out, however, that the formula did not lead to illogical conclusions with respect to Tunisia, because a recovery of exports was expected.

Nonetheless, under the present formula, a compensable shortfall might occur, even with a linear decline in exports, as long as the shortfall did not occur in consecutive years, the Chairman observed. That possibility raised a more fundamental question. If the application of the formula allowed for a compensatory financing purchase, and the country was heading toward an unviable balance of payments position, the Fund's resources were then at risk. Should the Fund embark on financing such risky prospects? It was precisely those questions, among others, that he would like to see addressed in the forthcoming review of the compensatory financing facility.

Mr. Nimatallah commented that he agreed with the Chairman's remarks, but he was concerned that Mr. Goos and Ms. Bush were focusing on the magnitude of the shortfall for a particular sector. Whereas there might be a decline in export revenues from oil for some time and that development would raise a legitimate question about the temporariness of the shortfall with respect to oil exports, for Tunisia, the calculations showed that the magnitude of the decline was being compensated only to the extent that there was a true temporary shortfall in oil revenues based on a reasonable price assumption.

The Chairman remarked that one way to transcend the contradiction of the formula resulting in compensation to a country having a long-term downward trend was through the test of cooperation. Compensatory financing was not being provided to countries that were moving into an unviable balance of payments position, because management and staff had increasingly emphasized the test of cooperation, which was also incorporated in the compensatory financing decision, even though the application of that test had entailed criticism. Nevertheless, in addition to mathematical formulae, there was a more general principle--that resources put at risk in a program had to be repayable, and they would be repayable only if the member's balance of payments was moving toward viability in the medium term. To be reasonably satisfied that a member's policies were headed in that direction, the Fund had relied increasingly on the test of cooperation to alleviate the concerns that would arise from a permanent decline in export earnings. Although for the time being, the Board must rely on the present formula, it could also be satisfied that the more general principle of restoration of viability in the medium term incorporated in the cooperation test provided a safety net.

Mr. Zecchini stated that he agreed with the Chairman's remarks on the problem raised by Mr. Goos. Once a trendline for exports had been established based on the formula, even if the trendline was declining, there might be a shortfall compared with the trendline, and therefore a condition for the use of the compensatory financing facility would be met. But, as the Chairman had stated, there was also a test of balance of payments viability to be met, and in seeking a logical answer to that test, not only export trends but also import trends and the possibility of import compression beyond what was indicated in the trendline for imports needed to be examined. Those issues should be extensively dealt with in the Board's re-examination of the compensatory financing facility. In that regard, he wished to stress the importance of looking at both sides of the current account balance.

Mr. Goos, noting Mr. Nimatallah's remarks, said that when he raised the issue of temporariness, he had in mind overall exports rather than individual export components. In the past, situations had arisen wherein exports did not recover in the postshortfall period; that experience had prompted his intervention.

Mr. Lankester made the following statement:

> The Tunisian economy has needed action on several fronts for some time. The current account deficit has been unsustainably high for several years, while dwindling oil reserves have clearly indicated the need to boost non-oil exports. But the sharp fall in oil prices earlier this year has made matters more urgent. The Tunisian authorities have initiated a major program of reform. The scope of the new strategy is impressive and ambitious, and I particularly welcome the plans to deregulate the economy.
>
> For the stabilization to succeed in the short term, there are three major requirements. First, fiscal policy should be kept under appropriate restraint. In the short run, the emphasis would probably need to be placed on curbing expenditure. Three key areas will be consumer subsidies, which are likely to amount to 3 percent of GDP in 1986; net lending to public enterprises, which has massively overshot the budget position for this year; and continued restraint in public sector wages. The authorities' fiscal program is clearly in the right direction. However, I wonder whether the planned pace of fiscal retrenchment and of reform in other areas is fast enough. It would have been better for Tunisia had the pace of adjustment been more rapid and the authorities' actions more front loaded. For example, under the present timetable, it could take seven years to reduce subsidies as a percentage of GDP by one third. According to the staff, "the authorities have indicated their readiness to consider an accelerated implementation in the light of the experience during the initial phase of liberalization"; I welcome the authorities' readiness to consider this.
>
> A second requirement for stabilization in the short term is perseverance with the intended stance of monetary policies. Positive real interest rates will be needed, especially if emigrant workers' remittances are to be attracted on the scale assumed in the balance of payments projection. I note that even after the proposed liberalization of interest rates, some 25 percent of credit to the economy will continue to benefit from subsidized preferential rates of interest.

A third requirement is a sufficiently competitive exchange rate to underpin the projected, and rather ambitious, rise of about 9 percent a year in non-oil exports over the next five years. The real exchange rate has fallen sharply and, in our view, appropriately this year. Looking at the figures on the basis of relative consumer prices, competitiveness is now much greater than in 1980/81. However, this basis is distorted by the prevalence of consumer subsidies; on the basis of wholesale prices--which avoids this distortion and shows a more modest improvement in competitiveness--it is not clear whether the depreciation of the dinar has gone far enough, given the authorities' desire to boost non-oil exports so strongly. Related to this question is the authorities' intention to maintain an average import tariff of about 25 percent into the next decade to protect domestic industry.

Suitably restrained policies in the fiscal, monetary, and external areas, together with a wholehearted commitment to the major program of liberalization that the authorities are undertaking, should provide the basis for sustainable growth in the medium term. These policies should also help to fill the financing gaps evident for both 1986 and 1987, because they will provide donors and banks with greater confidence concerning the long-term viability of the private sector in Tunisia and, thus, the sustainability of Tunisia's present and prospective debt burden. In addition, it is evident that the World Bank is prepared to play a significant role in supporting the authorities' liberalization efforts. The financing gaps are, however, a cause for concern, and any further information from the staff on prospects for closing the 1986 gap, and thereby ensuring that the program gets off to a sound start, will be welcome. The prospects for financing the 1987 gap will have to be examined at the first review. With these comments, I am able to give my authorities' support for the proposed stand-by arrangement.

With respect to the compensatory financing request, Tunisia clearly meets the test of cooperation with the Fund and of a balance of payments need. The shortfall, being due primarily to the fall in oil prices, is largely outside the authorities' control. However, the temporary nature of the shortfall is due to the projected recovery in non-oil exports. Although these projections are perhaps on the optimistic side, we can go along with the request. In doing so, I note that the amount of the shortfall substantially exceeds the amount of the purchase under the request.

I would like to make a few points that are relevant not only to this request but also to the forthcoming review of the compensatory financing facility and to which my authorities attach importance.

The staff notes on page 2 of EBS/86/238 that the current account in recent years has been affected by, among other things, "an appreciation of the real effective exchange rate." According to the staff report on the 1986 Article IV consultation, the real effective exchange rate, when measured on a wholesale price basis, was above its 1980 level for the whole of the four years to late 1985. However, the staff paper on the compensatory financing request does not mention--let alone attempt to quantify--the impact on the calculated shortfall of this prolonged period of exchange rate overvaluation; this is an unsatisfactory lacuna, particularly as the export forecast built into the stand-by arrangement seems to assume a strong volume response of exports over time to the depreciation of the exchange rate in 1986.

For Tunisia, as for the Philippines, the loss of export revenue due to falling energy prices is taken into account in the compensatory financing calculation, but not the corresponding gains from cheaper energy imports. A simple balance of payments calculation shows that about half of the export shortfall attributed to energy products would be offset by the reduction in the costs of imported energy.

The projected rate of growth of Tunisia's non-oil exports is perhaps ambitious, as are staff estimates of receipts from tourism and workers' remittances. Receipts and workers' remittances have fallen for four consecutive years. Although the exchange rate and interest rate policies being followed by the authorities might be more conducive to encouraging additional inflows in the future, it is difficult to see clearly what factors outside the authorities' own control give rise to any confidence that receipts will pick up as projected in 1987/88. A purchase under the compensatory financing facility seems inappropriate when exports are projected to increase as a result of improved government policies.

In sum, while there is scope for bolder action in some policy areas, the Tunisian authorities had undoubtedly embarked on a significant adjustment effort. The proposed extension of the tax base, the liberalization of interest rates, the reform of parastatals, and the liberalization of two thirds of domestic prices and of imports are all objectives that would stand the authorities in good stead. The more rapidly they were able to carry these measures forward, the better. I therefore support the proposed decision.

Mr. Romuâldez remarked that the program in support of the stand-by arrangement with the Fund was well designed; it was at once comprehensive and genuinely responsive to Tunisia's structural needs. The program contained appropriate elements of demand management, with proper focus on public finance, which had shown considerable weakness in the recent past. The authorities should utilize expenditure control mechanisms fully and effectively so that arrears arising from purchases of goods and services from public enterprises--admittedly small in recent years--did not get out of hand. In addition to focusing on public finance and demand management, the program included a wide array of structural and sectoral reform measures that addressed the major weaknesses in Tunisia's economy. The participation of the World Bank in the design of the program was especially noteworthy and welcome.

The elements of the structural reform package were appropriate, but the authorities could show greater determination and decisiveness by implementing some reforms at a more accelerated pace, Mr. Romuâldez continued. For example, the schedule for the reduction and ultimate elimination of budgetary transfers--namely, a reduction by 5 percent a year over a period of seven years--was too drawn out to be effective. Events might overtake such schedules, negating their effectiveness as signals to resource allocation decisions or postponing their effective implementation, particularly in view of the possible decline of oil revenue in the near and medium term. The timetable for the decontrol of prices and the introduction of greater flexibility with respect to prices still under control gave rise to similar concern. The reform of the public enterprises was welcome, but the lack of a timetable for that reform was disappointing. He looked forward to the presentation of a schedule of reforms at the time of the first review. The statement on page 19 of EBS/86/236 that the authorities intended not to increase minimum wages during the the 1986-87 program period by more than the inflation rate was also cause for concern. It seemed to be deliberately broad and not entirely consonant with the Government's decision to reduce the role of wage-price indexing in wage determinations.

He fully agreed with the staff appraisal and recommendation, particularly with respect to the need for export diversification and the pace of liberalization in the various sectors, including the trade system, Mr. Romuâldez remarked. The program was a tight one and deserved the Fund's support. He also supported the request for a purchase under the compensatory financing facility.

The authorities' decision to take so comprehensive an approach to adjustment was commendable, Mr. Romuâldez commented. He was particularly pleased to see the collaboration of the Fund and the Bank on the design of the program; the complementarity of their work was evident throughout. However, he urged the authorities to adopt a faster pace for the implementation of those reforms.

Mr. McCormack said that he concurred with the proposed decisions and the staff's assessment of the Tunisian economy.

A number of aspects of the ambitious program proposed by the Tunisian authorities were commendable, Mr. McCormack continued. In particular, the emphasis on structural adjustment and the extensive liberalization of markets was entirely appropriate. The authorities had prepared specific and detailed timetables for the liberalization of prices, investment, and imports, and similar timetables were to be prepared before the end of 1986 for reducing the number of public sector enterprises. He agreed with the staff that the pace of liberalization could be accelerated to provide clearer signals to the economy, and he welcomed the authorities' indication that they were open minded about the possibility of accelerating the implementation of reforms in the light of experience. Setting out policy commitments according to a detailed and specific timetable was a valuable procedure; it provided a measure of discipline for policymakers--which was a necessary, but perhaps not always sufficient, condition for credible adjustment--and in a sense constituted a contract between policymakers and the public. He wondered whether the timetables that had been prepared and the one yet to be prepared were to be publicized. Although doing so might raise some practical difficulties, making at least the essential features of the timetables public might serve to enhance the degree of discipline and credibility of the authorities' adjustment effort.

He had a number of specific questions concerning various aspects of Tunisian policy and the proposed adjustment effort, which taken together, had a common theme, Mr. McCormack noted. They illustrated how difficult it was for policymakers to move from a regulated economy to a more liberal one. Indeed, in some instances, the arbitrariness that seemed to accompany direct control of an economy appeared to linger on in Tunisia. Although the conceptualization of policy issues was undergoing a profound change, the prevailing mode of thought about policy formulation was still somewhat dirigist rather than market oriented. For example, the authorities' wage and pricing policies would continue to subsidize, apparently indefinitely, the consumption of a particular category of goods--namely, socially sensitive goods. Income transfers effected in the context of the ongoing tax reform might be a more efficient means of income distribution than continued direct subsidization would be.

The description of the authorities' price liberalization effort was somewhat unclear, Mr. McCormack commented. The staff had indicated that the authorities had committed themselves to decontrol manufactured prices gradually--a process that would be completed by 1991; he wondered what proportion of industrial goods was expected ultimately to be decontrolled. Also, what were the authorities' criteria for "sufficient competition"? The manufactured product prices to be liberalized included those items for which competition was assured, either because of the existence of three domestic producers or because importation of the product was liberal; he wondered whether the authorities had taken sufficient account of the availability of product substitutes, a factor that would become more important as the trade regime was progressively liberalized.

The effort to reform the public enterprises aimed at reducing the number of entities under direct control from 550 to about 160, Mr. McCormack observed. He wondered what criteria had been used to determine which firms would be privatized and which firms would remain under government control; in particular, why was such a large proportion of the existing enterprises to remain subject to government control? Moreover, he wondered how important the remaining 160 entities were in the Tunisian economy.

The staff had noted that the proposed course of money and credit policy implied that the authorities had a firm grasp of the relationship between the provision of primary liquidity and the expansion of credit and money in the economy, Mr. McCormack remarked. He asked the staff to expand on the determinants and form of that relationship; that point was not entirely clear since, despite the planned liberalization, financial markets would remain subject to extensive direct control.

His chair supported the proposed decisions and commended the Tunisian authorities on taking the difficult decisions that were embodied in the proposed program, Mr. McCormack concluded.

Mr. Isleifsson said that he welcomed the Tunisian authorities' timely approach to the Fund and the World Bank for support of their adjustment and development efforts. The deterioration in Tunisia's terms of trade, combined with its weak balance of payments position, made the undertaking of the stabilization program a matter of urgency. For some time, consensus had existed within the Government to embark on a comprehensive adjustment program. He hoped that that consensus would be followed up with a strong commitment to implementing the measures envisaged in the program.

It was encouraging that the adjustment program proposed by the authorities conformed closely with the recommendation contained in the staff report for the 1986 Article IV consultation, Mr. Isleifsson commented. He commended the authorities for acting decisively in response to the deteriorating external position. Some measures had already been implemented, including the nominal depreciation of the dinar. He attached importance to the authorities' proposal to pursue a flexible exchange rate policy, which would be the subject of one of the reviews under the program; of course, the basic criteria of the appropriateness of the exchange rate would be the competitiveness of the Tunisian economy.

Another important, welcome measure to be implemented in January 1987 was the liberalization of interest rates, with certain exceptions, Mr. Isleifsson noted. He hoped that those exceptions would be phased out in the near future.

As to the fiscal situation, the 1987 budget would need to be formulated within tight constraints, with restraint being exercised largely on the expenditure side, Mr. Isleifsson observed. The measures envisaged in that area were welcome. However, the central government consolidated deficit was still expected to be relatively high in 1984-at almost 4 percent of GNP--and he wondered whether the pace of adjustment in that area was rapid enough.

He welcomed the comprehensive structural measures proposed under the program, particularly in the fields of investment and price liberalization, Mr. Isleifsson commented. He was particularly pleased to see that some of those measures had already been implemented or were scheduled for implementation in the coming few months.

The balance of payments outlook underscored the need to pursue the adjustment effort for a number of years, and he welcomed the authorities' intention in that respect, Mr. Isleifsson remarked. Furthermore, it was reassuring that Tunisia's debt servicing record was good and that in 1990 and in 1991--the two years when repurchases to the Fund were bunched--Tunisia's debt service obligations to the Fund would be equivalent to only 2.7 percent of current receipts. He therefore had no hesitation in supporting the request for a stand-by arrangement.

As to the request for a purchase under the compensatory financing facility, it met all the basic requirements under that facility, and he therefore supported the proposed decision, Mr. Isleifsson continued. He also supported the decision concluding the Article XIV consultation.

Mr. Zecchini made the following statement:

> The staff report for the 1986 Article IV consultation indicates that Tunisia's economic situation was rapidly deteriorating under the combined effects of a worsened external environment and inadequate domestic economic policies. Specifically, financial policies were supporting an excessively rapid rate of GNP growth and the internal and external imbalances were being tackled by reinforcing the widespread system of direct controls on prices, imports, and investment, which instead reduced the economy's resilience.
>
> I welcome that shortly after the issuance of the staff report for the Article IV consultation, agreement was reached with the Fund on a program that involves a broad reorientation of economic policies through a combination of structural reforms and tighter financial policies. Partly because of their nature, many important reforms, such as those relating to the restructuring of public sector enterprises, to price liberalization, and to import liberalization, are viewed by the authorities in a medium-term context and specifically in the framework of the 1987-91 development plan. Therefore, I wonder whether, because of its longer time span, an extended arrangement might not have been preferable in order to sustain this prolonged adjustment effort.
>
> With respect to specific aspects of the program, areas in which structural changes are needed relate to the liberalization of prices, investment and imports, and to the reform of the public enterprise sector. Measures in these areas are either being implemented or being planned. However, some further clarifications seem needed on two aspects: the expected pace of these reforms and their monitoring. As for the former, on page 31 of EBS/86/236 it is stated that "the staff believes that the pace of liberalization could be accelerated to provide clearer signals to the economy and that the authorities do not disagree with this." In this respect, I note, for example, that the liberalization of manufactured product prices will be completed only by 1991 and

that import liberalization will be extended to consumer goods only after 1988. I wonder whether it is possible that, if the process of price liberalization is carried out in an uneven way and with long delays, its impact might be insufficient, if not a source of other distortions, in the program period. Moreover, more precise timetables still need to be defined in some areas, such as the restructuring of public enterprises. I therefore encourage the authorities to tackle these problems resolutely.

In Table 5 of EBS/86/236, there is a dichotomy between the description of the program measures and the summary relating to the monitoring of the program. More specifically, under item 7 of the Table, references were made only to targets and performance criteria relating to fiscal policy, monetary policy, and external indebtedness, but no reference was made to the structural measures included in items 1, 2, and 3 of the Table. This again raises the point made by this chair, as well as by other chairs, during the discussion of the stand-by arrangements with Mexico and with the Philippines, as to the most appropriate ways of monitoring structural reforms in Fund-supported adjustment programs. I look forward to discussing these issues during the forthcoming discussion on program design and performance criteria.

As to fiscal policy, the objective of reducing the central government consolidated deficit by about 2 percent of GDP to 3.9 percent seems realistic, although it falls short of the authorities' initial target for 1986 of 3.2 percent. Also, on the expenditure side, attention is correctly being given to a reduction in subsidies and to a rationalization of the public investment program. However, a faster pace for reducing consumer subsidies might be required.

On the revenue side, measures such as the introduction of a value-added tax and the reform of the tax system should lead to an increase in the tax base and the income elasticity of public revenue. However, some of the specific measures relating to the 1987 budget still need to be spelled out; therefore, I look forward to having more information on these issues on the occasion of the first review.

As for credit and monetary policies, a major liberalization effort is needed both to give flexibility to interest rates and to eliminate the direct controls on individual loans given by commercial banks. Those liberalization measures are complementary. The monetary authorities should proceed toward a more market-oriented monetary management by leaving individual loan decisions to commercial banks and concentrating on controlling broader monetary and credit aggregates. By relaxing direct credit controls, market-determined interest rates might gradually emerge as a leading mechanism to allocate financial resources as well as to promote increased financial savings and capital inflows. Therefore, I welcome the important liberalization measures that will be introduced in January 1987. However, the usury ceilings, which will remain, should not prevent attaining the necessary flexibility in interest rate movements. In this respect, it should be noted that nominal interest rates could rise considerably as a result of the need to tighten monetary policy with a view to curbing inflationary pressures that could stem from price liberalization.

Finally, Tunisia's request under the compensatory financing facility is consistent with the established criteria, and I can support the proposed decision. In this respect, I note that the shortfall is due largely to a shortfall of oil revenues. In the oil sector, Tunisia has pursued a production policy aimed at maximizing output, and therefore qualifies for use of the facility under the guidelines on compensatory financing requests by oil-exporting countries approved by the Board at EBM/83/80 (6/2/83).

Mr. de Groote remarked that Tunisia's program in support of a stand-by arrangement was balanced; it combined demand management and structural policies and embodied fruitful cooperation between the Fund and the Bank. He especially welcomed the Tunisian authorities' commitment to a moderate rate of GNP growth that was compatible with a viable balance of payments position over the medium term, as well as their movement toward privatization. The timetable for price liberalization and the focus of the first review on import liberalization and tax reform went some way in meeting the Board's concern that the design of Fund-supported programs should incorporate structural objectives.

He was especially interested to see the relative distribution of the monitoring strategy between quarterly performance criteria and indicative targets, Mr. de Groote continued. There were good reasons for considering the consolidated budget deficit, total revenue, and total expenditure as indicative targets, because noncompliance in those areas would ultimately lead to further consultation with the Fund and to the adoption of new measures. It was even more interesting that domestic credit ceilings and credit to the Government were initially regarded as indicative targets and became performance criteria in the course of the program. "Indicative target" was thus used in two different senses: initially, for domestic credit and net credit to the Government, it was a future objective; and later, with respect to the consolidated budget deficit in total revenue, it became an objective that led automatically to consultation with the Fund.

The targets for investment were not included in the program, although they were extremely important for its implementation, Mr. de Groote observed. They were perhaps indirectly included as a by-product of the implementation of the objectives in terms of domestic credit and government credit and also perhaps linked with the notion of the introduction of an investment code. Also, the staff had mentioned that there was a specific timetable for liberalization of investment. In view of its importance, he would have preferred to see the inclusion of investment targets in the program.

He was particularly pleased to see that the program set out in operational detail how it would be implemented, Mr. de Groote remarked. For example, the real effective exchange rate was to be maintained at the August 1986 level and central bank rediscounting was to be rechanneled through the money market so that interest rates would reflect overall monetary targets and the expansion of credit and money could be controlled through the money base. The degree of specificity of the use of instruments in the program was very attractive. The program also carefully described the areas for cooperation between the Fund and the World Bank in helping Tunisia to attain a viable balance of payments position by 1991, whereby the current account deficit would represent only 3 percent of GNP and the debt service ratio only about 28 percent of GNP.

An acceleration of the liberalization efforts and of the pace of structural reform was needed to ensure the correct implementation of the program, Mr. de Groote considered. Indeed, if the implementation of the program was too gradual, there was a danger that opposition to some of the measures could build up over time and, more fundamentally, the positive effects of the first phase of the adjustment in the areas of consumption and prices could be rapidly jeopardized if they did not lead to supply-side effects. In particular, how could the targeted expansion of exports, which was necessary to the program, be achieved if the tariff and nontariff protection of domestic industry was not rapidly eliminated? According to Mr. Msadek, tariff and nontariff protection would be fully eliminated only by 1991, which posed a real danger to the realization of the desired supply effects in the meantime. Moreover, the phasing out of subsidies extended over a long period, and the reform of state enterprises was not subject to a specific timetable at present.

Wage policy remained vague, and he would be interested to hear Mr. Msadek's comments on it, Mr. de Groote remarked. The retention of a system of frozen and adjustable wages following deindexation of the wage system might not be favorable to the best allocation of resources and larger utilization of capacity. Instead, it might simply hide an insufficient budgetary adjustment and the maintenance of excessive subsidies. Over time, the program would not be credible unless a fundamental readjustment was attained between prices, the wage level, and the supply of goods. The program seemed to avoid a basic readjustment between macroeconomic magnitudes--that should be the primary topic for the coming review.

In sum, he was convinced that on the occasion of the quarterly reviews, there would be a need to introduce elements to accelerate performance under the program, Mr. de Groote concluded.

The Deputy Director of the African Department remarked that the staff shared many of the reservations expressed by Executive Directors, particularly about the need to accelerate the pace of liberalization, reduce the degree of sensitivity in the implementation of liberalization measures, and take more rigorous steps to improve budgetary savings as well as the need for a more specific timetable for the reform of state enterprises. However, in the course of the discussion of a possible reform program, the authorities had indicated their intention to move from a dirigist system of economic management toward "controlled liberalization." The agreed pace of liberalization thus represented a considerable departure from the authorities' previous position; nevertheless, the pace needed to be accelerated, and the staff hoped that the authorities would adopt measures to do so.

The authorities had shown their commitment to liberalization by taking all the measures anticipated for the last quarter of 1986 prior to the Board's discussion of the stand-by arrangement request, the Deputy Director continued. The program reflected the authorities' concern that the achievements might not live up to the commitments, and they had therefore been somewhat cautious in setting the pace of liberalization. The staff was relatively optimistic that, if experience with the first phase of liberalization turned out to be satisfactory, the authorities would implement measures more rapidly.

The staff had described the elements of the tax reform in the background paper on recent economic developments, the Deputy Director noted. With regard to the value-added tax, a faster pace of implementation than was proposed did not seem feasible. The proposals for the tax had been formulated; they were being discussed with the private sector and others affected by the tax, and there was insufficient time for their inclusion in the 1987 budget. Moreover, the authorities considered that while it might have been feasible to introduce a value-added tax in mid-1987, such a politically important measure should be introduced in the context of a full year's budget. Thus, January 1, 1988 had been decided as the appropriate time for the introduction of the reform. Meantime, discussions would be held with the Fund staff on the various measures that were needed to ensure that there would be no slippage with respect to the deadline for the implementation of the tax.

The rate of income surtax for the highest income categories had been reduced in 1986 from 80 percent to 68 percent, and a ceiling of 60 percent of total income had been placed on the marginal income tax, the Deputy Director remarked. As regards other aspects of the tax reform, the unification of income and profit taxes could also be introduced in time for the 1988 budget. However, the authorities were reluctant to introduce the value-added tax and incomes and profit tax unification simultaneously, because the burden of both those reforms would fall basically on the same group. To avoid opposition to the introduction of tax reform, the authorities preferred to introduce the reforms over time. Of course, the question of the unification of incomes and profit taxes would be considered during the second review.

The staff and the authorities had examined budgetary expenditure restraint and had identified four specific areas where additional restraint was feasible, the Deputy Director explained. The authorities would be pursuing restraint in formulating their 1987 budget and the medium-term budgetary program; current subsidies and transfers would be cut by at least 5 percent every year--and the authorities were hoping that greater cuts would be possible; capital subsidies and transfers would be reduced by even a larger percentage; and direct investment would be reduced by 4-5 percent in real terms by canceling, delaying, or stretching out projects. The reduction in investment expenditures would be relative in order to reflect the greater emphasis being placed on employment creation; the authorities would be examining investment expenditures more carefully with a view to reducing costs. Expenditure restraint would also be exercised with respect to the wage bill. Whereas in the past, government recruitment had averaged an increase of about 8 percent a year, under the program the increase in recruitment would be kept to no more than 2 percent. A larger share of new employment was expected to be provided by the private sector.

The authorities had also attempted to break the link between wages and inflation with a view to reducing the rate of increase in wages over coming few years, the Deputy Director continued. The large wage increases between 1981 and 1983 were due not only to the increase in minimum wages but also to increases granted in the context of general wage-bargaining agreements. In recognition of the defects of the wage-bargaining agreements, the authorities had tried to move to a new system, which would link wage increases to productivity gains. Minimum wages would still be subject to government determination, but they accounted for only about 20 percent of the total wage bill.

The liberalization of producer prices was fairly complicated and reflected the policies and timetable already agreed with the World Bank in the context of the structural adjustment loan, the Deputy Director noted. Under that policy, the authorities would move away from determining producer prices on the basis of a cost of production formula to determining them on the basis of world market prices as the best indicator of the country's opportunity cost. That new formula would apply basically to cereals; producer prices would be fixed and would increase progressively over the next four crop years, reaching a five-year moving average equal to the price of corresponding unsubsidized imported products plus freight and a minimum import duty of 15 percent imposed in the context of the tariff reform; consequently, prices would exceed world market prices by the cost of freight plus 15 percent. The immediate effect of the new formula would be to improve the relationship between the producer prices of various goods. For example, in Tunisia the prices of hard wheat and soft wheat were at present the same, whereas in the world market a premium was paid for durum wheat; the new formula would allow for price differentiation in line with world market prices over the next three or four years.

The number of public entities remaining after privatization--some 160--was large, but nearly half of those enterprises were in fact public institutions, that in other countries formed part of government departments, the Deputy Director observed. For example, irrigation services provided by public enterprises in Tunisia might be provided by extension services of the department of agriculture in another country. In a stricter sense, the number of remaining public entities would perhaps reach 100. Public enterprise reform would be examined in the context of the first review; subsequently, the staff should be able to provide more information to the Board on the importance of the remaining entities' activities and the timetable for their reform.

Assessments of the competitiveness of the real effective exchange rate would differ when wholesale prices rather than consumer prices were used, the Deputy Director remarked. They would also differ depending upon the base year that was used. For monitoring future exchange rate movements, the staff and the authorities had agreed to use the wholesale price index because the consumer price index was obviously biased by the operation of the subsidy policy. However, as Chart 3 of EBS/86/236 showed, taking 1982-83 as the base period, the rate of depreciation of the exchange rate was about the same when deflated by either index. For that reason, the index used in examining competitiveness was not a cause for concern.

The inflation rate as measured by the consumer price index was expected to be between 9 percent and 9 1/2 percent in 1987 and about 8 percent in 1986, the Deputy Director noted. In fact, inflation performance for 1986 might be better than expected because in the nine-month period from end-December 1985 to end-September 1986, the rate of inflation had been 3-4 percent, notwithstanding the depreciation that had occurred during that period. That improved performance might be explained to some extent by the relatively restrained monetary policy that had already been put into operation.

On interest rate policy, Directors had expressed concern about the authorities' grasp of the relationship between the monetary base and the actual expansion of credit and money, the Deputy Director recalled. The authorities' policy was to some extent indicated in the monetary survey provided in Table 8 of EBS/86/236. The projections for the assets and liabilities of the Central Bank and the deposit money banks implied a particular relationship between the amount of refinancing facilities available from the Central Bank and the credit expansion that would occur. Claims on deposit money would be examined each month and compared with demand in the money market; to the extent that demand approached the maximum assumed in the credit program, interest rates would be adjusted to reflect the difference between the offer and demand for loanable funds in the money market. The authorities had not yet worked out the details of the new policy, but the staff should be able to provide additional information to the Board at the time of the first review.

With respect to the monitoring of structural reforms, the memorandum on economic and financial policy indicated that there would be three reviews of the program and referred specifically to some of the structural measures that would be the subject of those reviews, the Deputy Director noted. For example, the first review would focus on, among other things, price liberalization and public enterprise reform. The content of the reviews was covered in sections 3 through 7 of Table 5 of EBS/86/236. Most of the structural reforms had been clearly identified by information provided in the first five sections of Table 5 and would be monitored in relation to the date given in section 7 of that table.

In a detailed speech before the National Assembly, the Prime Minister had described the objectives of the program as well as the timetable for various liberalization measures, the Deputy Director remarked. The public had thus been fully informed about the program and was clearly looking forward to the implementation of the various measures.

It had been noted that one interesting aspect of the program was that Tunisia was not seeking debt relief, the Deputy Director recalled. The authorities were, however, seeking additional exceptional assistance, and they hoped that there would be sufficient response from the international community to close the financing gaps. The gap for 1986 seemed to have been filled. Since the program was negotiated, the authorities had received firm commitments of additional assistance, including a commodity loan of $100 million from Italy. Additional assistance from the Netherlands was also certain, and the authorities intended to send a mission to Japan in the near future to discuss possible financing. The authorities had also requested the World Bank, in cooperation with the Fund, to try to mobilize donor assistance, and they hoped that an informal meeting of aid donors in early 1987 would take place before the completion of the first review. Taking into account the contribution of commercial banks, the staff expected that the 1986 financing gap of SDR 375 million would be filled, and that some $250 million in donor assistance would be needed for 1987. The staff would report on the financing of the 1987 gap as part of the first review.

It had been noted that staff projections of foreign direct investment were perhaps rather modest when compared with investment in the early 1980s, the Deputy Director remarked. In the early 1980s there had been substantial investment in the petroleum sector, but investments were declining as a result of lower prices for oil and limited fields for exploration. However, nonpetroleum sector investments were projected to increase substantially, reflecting the liberalization of the authorities' investment policy.

On the decontrol of prices of manufactured goods, Table 5 of EBS/86/236 indicated the percentage of goods to be liberalized at each point in time, the Deputy Director commented. For example, price liberalization for approximately 25 percent of manufactured goods had been announced for September 1986. In determining the extent of price liberalization, the authorities had utilized the notion of sufficient competition--namely, goods--the importation of which was free or those goods for which there was a minimum of three independent producers existing in the country. That notion did not take into account the availability of substitute goods.

The program target for investment and the timetable for liberalization would be worked out once the new investment code was available, perhaps before the end of 1986, the Deputy Director remarked. A World Bank staff mission would be visiting Tunisia before the end of the year to discuss the investment code, among other things, after which further details would be incorporated in the liberalization program for investment.

The staff had not suggested an extended arrangement for Tunisia for two reasons, the Deputy Director of the African Department explained. On the Fund side, the staff had not had sufficient experience with Tunisia's performance under a program. On the Tunisian side, the authorities did not have sufficient experience with the use of Fund resources. In fact, initially, the authorities had intended to request only a compensatory financing purchase; only later did they decide that compensatory financing should be requested in the context of a comprehensive economic framework under a program supported by a stand-by arrangement. Once some experience with a Fund program had been gained, the authorities might request an extended arrangement toward the end of 1987 if the pace of adjustment, as well as performance under the program, pointed in that direction.

The staff representative from the Research Department remarked that although the paper on the compensatory financing request had not formally assessed the impact of exchange rate policy on the shortfall, the staff was satisfied that variation in the exchange rate had not contributed to the shortfall. The exchange rate had appreciated in the preshortfall years and depreciated in the shortfall year, so that, ignoring the lagged effects on exports, the exchange rate had the effect of lowering exports in the preshortfall years and raising them in the shortfall year. Both those changes would have reduced, rather than increased the shortfall. In fact, the strong growth of non-oil exports by more than 15 percent in the shortfall year was almost entirely related to volume; further growth was projected in the following two postshortfall years, but at a less substantial rate of about 12 percent. Assessing the lagged effects of exchange rate changes on exports was a difficult exercise, but in the present instance, export volume had performed well in the shortfall year.

The main factors adversely affecting tourism were more related to tension in the region--which resulted in cancellation of bookings--and those affecting workers' remittances were more related to the slowdown in economic activity of neighboring countries than to movements in the exchange rate, the staff representative from the Research Department continued. Thus, although the staff paper did not contain a formal analysis of the impact of the exchange rate changes on the performance of receipts from exports and services--which would ultimately require an assessment for each of the five years comprising the trend period--the staff believed that evidence strongly indicated that exchange rate policy did not contribute to the shortfall, and, therefore, the staff was satisfied that the shortfall was beyond the authorities' control.

Mr. Msadek remarked that over the past three decades, the management of Tunisia's economy had gradually evolved from a centralized system to a more liberalized system, and in view of the difficulties recently encountered owing to external factors, the authorities had decided to review all aspects of the economy with a view to reform. The record of growth that had been achieved and the infrastructural facilities that had been put in place had to be viewed in that context. Developments in 1986, particularly with regard to the sharp decline in oil prices and the gradual depletion of oil reserves, had led to a decision to review the economy's structural imbalances. A program was thus drawn up and put into place before the Tunisian authorities requested Fund assistance, and it must be recognized that the pace of implementation depends not only on the success being achieved as a result of the changes already implemented but also, to some extent, on the social and political situation of the country.

The Tunisian authorities were ready to accelerate the pace of the program, and had indicated their willingness to do so on many occasions, as soon as it appeared feasible, Mr. Msadek continued. In fact, since July 1986, several measures had been introduced in the area of price liberalization, most recently, an increase in prices for olive oil and dates, and the Central Bank had organized a meeting with commercial banks to inform them of its decision to liberalize interest rates and to give them more responsibility in the determination of the rate of credit for depositors.

At the international level, several approaches had been made with respect to cooperation with the Common Market, and a conference had recently been held in Marseilles with representatives of the Mediterranean countries and the Economic Communities to further examine aspects of cooperation in the areas of trade as well as financial and technical cooperation, Mr. Msadek noted. Those efforts underlined Tunisia's readiness to promote its exports, while at the same time taking strong domestic measures to rehabilitate the economy and improve its future productivity.

The reform of the public enterprises, which was being reviewed with the Fund was also being studied by the World Bank, Mr. Msadek remarked. The authorities' determination was clearly evident in the decision to decontrol several of those enterprises, many of which were now being readied to be placed on the market through participation in the Tunisian stock market. Of course, some entities providing essential services and those considered socially vital would remain in the public sector, but once the study of the public enterprises was completed, the authorities would move ahead as quickly as possible with further privatization measures. In addition, Tunisia had signed the MIGA convention, and the authorities expected that the investment code to be put in place as of January 1987 would enhance prospects for greater participation of foreign investment.

Mr. Nimatallah asked whether the authorities or the staff had estimated the amount of revenue that might be raised through divestment of the public enterprises. If not, perhaps a rough estimate could be provided at the time of the first review.

The Deputy Director of the African Department said that the staff did not have an estimate at present. However, the authorities intended to place the revenues arising from the sale of the public enterprises into a special fund to be used to reform the remaining enterprises. Thus, the funds resulting from privatization would not accrue directly as budgetary revenue.

The Chairman then made the following summing up:

> Directors noted that Tunisia's generally satisfactory performance in terms of economic growth and inflation over the past several years had been accompanied by continued interrelated weaknesses, including a decline in the national savings ratio, large external current account and budget deficits, excessive increases in money and credit, a deterioration in the external debt position, and a sharp drawdown in foreign reserves. Moreover, there had been a continued reliance on price controls, and the economic system had become increasingly rigid. In the past year the constraints had become even more severe owing to the drop in oil prices, slack tourist activity, and unfavorable weather conditions. Thus, notwithstanding the corrective measures taken since late 1985, real GDP in 1986 is expected to show little growth, and the external account and budget deficits are expected to widen. Moreover, by mid-1986 foreign reserves were almost depleted.
>
> Directors therefore welcomed the authorities' decision to address their financial problems in a comprehensive and orderly manner. In view of the need to improve the external position, the authorities are contemplating more modest growth targets than in the past, combined with a substantial reduction in the external current account deficit through 1991, and stabilization of the debt service ratio.
>
> Within this medium-term context, the authorities have developed an 18-month adjustment program, in close collaboration with the staff of both the Fund and the World Bank, in support of which they have requested a stand-by arrangement. Directors commended the authorities for the wide-ranging actions contemplated within the adjustment program, which combine domestic demand management and export promotion measures with structural reforms, including especially the liberalization and privatization of the economy. They welcomed the early implementation of some of the policy actions, including a substantial depreciation of the exchange rate, supplementary measures to reduce the budget deficit, increases in producer prices and in prices of subsidized products,

and significant steps in price and import liberalization. Substantial additional steps in the liberalization program are to be completed over the program period, but several Directors commented that the implementation of many of the liberalization measures relating to prices and investment should, in their view, be accelerated. They also considered that there was scope for bolder action in several key areas of the program, and that continued emphasis should be placed on wage restraint.

Particular support was also expressed for the need to accelerate the reform of the public enterprise sector in close coordination with the World Bank and to strengthen the budgetary process and the monitoring of public expenditure and external debt. Directors urged the authorities to adopt a timely schedule for the privatization of public enterprises, and several Directors expressed concern that the number and the importance of enterprises that would remain in the public sector was still, in their view, too great.

On public sector revenue, Directors endorsed the decision to speed up the tax reform and the proposed reduction in tariff protection. However, concern was expressed at the forecast decline of government revenue in terms of GDP from 1986 to 1987. In addition to speedy action to raise tax revenue, Directors called for more vigorous action to restrain current expenditures, particularly transfers and consumer subsidies, public sector wages, and lending to public sector enterprises. The size of the budget deficit for 1986--at 6 percent of GDP--was regarded as too high, and some Directors urged the authorities to reduce the 1987 deficit below the planned 3.9 percent of GDP.

Regarding monetary and credit policies, Directors welcomed that under the program the present complex and tight system of regulations and preferential interest rates would be replaced by a system of more market-determined interest rates and global instruments of monetary control. They also considered appropriate the authorities' commitment to limit monetary expansion to less than that in nominal GNP.

Directors cited approvingly the intended policies regarding the agricultural sector and supported the authorities' intentions to raise producer prices to international levels and to reduce input subsidies.

Directors welcomed the authorities' new stand with respect to exchange rate policy, in particular, their commitment to at least maintain the real effective exchange rate at its post-devaluation level and their agreement to review the exchange rate policy more frequently in light of developments.

Directors expressed concern about closing the financing gap, particularly for 1987. They urged the authorities to take the necessary steps as early as possible to secure the financing of the gap, which should, if possible, allow for a more ambitious reserve target. Generous donor support was obviously critical to close the financing gap. Directors also encouraged the authorities to pursue rigorously their intention to improve the debt profile by seeking concessional or long-term capital flows, thus reducing the recourse to commercial, medium-term borrowing. They noted favorably the authorities' record in remaining current in their external debt obligations.

There was a broad consensus among speakers that the full implementation of the structural reforms and the liberalization of the economy were essential to achieve Tunisia's growth target for the next few years. Similarly, a sharp expansion of nonenergy exports was also essential to achieve the growth target, and several Directors therefore emphasized the critical importance of adequate access for Tunisian goods to export markets.

Although Directors commended the authorities' program as a major step in terms of liberalization, a number of them believed that the enhanced role expected from the private sector argued for a more rapid pace of liberalization. Thus, they encouraged the authorities to consider an accelerated implementation of measures in the initial phase of the program. Continued close collaboration between Tunisia and the Fund and the World Bank would be essential to assist the member on the road toward balance of payments viability, Directors concluded.

It is expected that the next Article IV consultation with Tunisia will be held on the standard 12-month cycle.

The Executive Directors then took the following decisions:

Decision Concluding Article XIV Consultation

1. The Fund takes this decision in concluding the 1986 Article XIV consultation with Tunisia, in the light of the 1986 Article IV consultation with Tunisia conducted under Decision No. 5392-(77/63), adopted April 29, 1977 (Surveillance over Exchange Rate Policies).

2. As described in SM/86/237, the restrictions on the making of payments and transfers for current international transactions are maintained by Tunisia in accordance with Article XIV, and none of these restrictions is subject to approval under Article VIII.

The Fund is encouraged by the authorities' intention to ease these restrictions and urges an early and vigorous implementation of this intention.

Decision No. 8436-(86/177), adopted
November 4, 1986

Stand-By Arrangement

1. The Government of Tunisia has requested a stand-by arrangement for the period of 18 months from November 4, 1986 in an amount equivalent to SDR 103.65 million.

2. The Fund approves the stand-by arrangement set forth in EBS/86/236, Supplement 1.

3. The Fund waives the limitation in Article V, Section 3(b)(iii).

Decision No. 8437-(86/177), adopted
November 4, 1986

Purchase Transaction - Compensatory Financing Facility

1. The Fund has received a request by the Government of Tunisia for a purchase of SDR 114.71 million under the Decision on Compensatory Financing of Export Fluctuations (Executive Board Decision No. 6224-(79/135), adopted August 2, 1979).

2. The Fund notes the representations of Tunisia and approves the purchase in accordance with the request.

3. The Fund waives the limitation in Article V, Section 3(b)(iii).

Decision No. 8438-(86/177), adopted
November 4, 1986

3. MEXICO - REPORT BY STAFF

The Associate Director of the Western Hemisphere Department, reporting on recent developments relating to the financing package for Mexico, remarked that almost 60 percent of the amount being sought from commercial banks--approximately $4.6 billion out of a total of $7.7 billion--had been agreed. Twelve out of 13 banks in the committee had reported favorably. Approximately two thirds of the banks participating in the financing bridge had responded positively, but of the total number of banks involved--more than 500--only 88 had responded positively.

The Chairman commented that assembling the critical mass of financing was a very slow process. He had contacted a number of Directors the previous day to ask them to convey to their authorities the need to accelerate the process as much as possible, because it had been understood that the extension beyond October 31 was to be for only a limited period. He therefore urged Directors to again draw the attention of their authorities to the situation.

DECISIONS TAKEN SINCE PREVIOUS BOARD MEETING

The following decisions were adopted by the Executive Board without meeting in the period between EBM/86/176 (11/3/86) and EBM/86/177 (11/4/86).

4. CAPE VERDE - 1986 ARTICLE IV CONSULTATION - POSTPONEMENT

Notwithstanding the period of three months specified in Procedure II of the document entitled "Surveillance over Exchange Rate Policies" attached to Decision No. 5392-(77/63), adopted April 29, 1977, the Executive Board agrees to extend the period for completing the 1986 Article IV consultation with Cape Verde to not later than November 26, 1986. (EBD/86/287, 10/31/86)

Decision No. 8439-(86/177), adopted
November 3, 1986

5. EXECUTIVE BOARD TRAVEL

Travel by Executive Directors as set forth in EBAP/86/220, Supplement 1 (10/31/86), EBAP/86/263 (10/31/86), and EBAP/86/171, Supplement 1 (10/31/86) is approved.

APPROVED: June 29, 1987

JOSEPH W. LANG, JR.
Acting Secretary