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TUNISIA

A STRATEGIC OPTION FOR THE 90's

USAID TUNISIA
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I. EXECUTIVE SUMMARY

Tunisia is emerging as the most dynamic country in the Mahgreb. President Ben Ali's peaceful accession to power on November 7, 1987 resolved the succession crisis and paved the way to increased political freedom and pluralism. Despite drought, locusts, and the other challenges faced by the new government, Tunisia has stuck to its far reaching economic adjustment program (SAP), initiated in 1986 when it was at the brink of insolvency.

Since then Tunisia's economic performance has been very impressive, resulting in significant improvement in public finances and exports. Much remains to be done to implement the reforms and to sustain growth in the post-petroleum economy. The adjustment program will not be finished by 1991. It will enter a second and more difficult Phase of economic transformation.

Structural adjustment is a fragile process during which the new Government will be vulnerable, at least until the economic benefits begin to outpace the social costs of reform. Employment is the foremost challenge facing the country in the coming decade. Jobs will be the measure of economic success for most Tunisians.

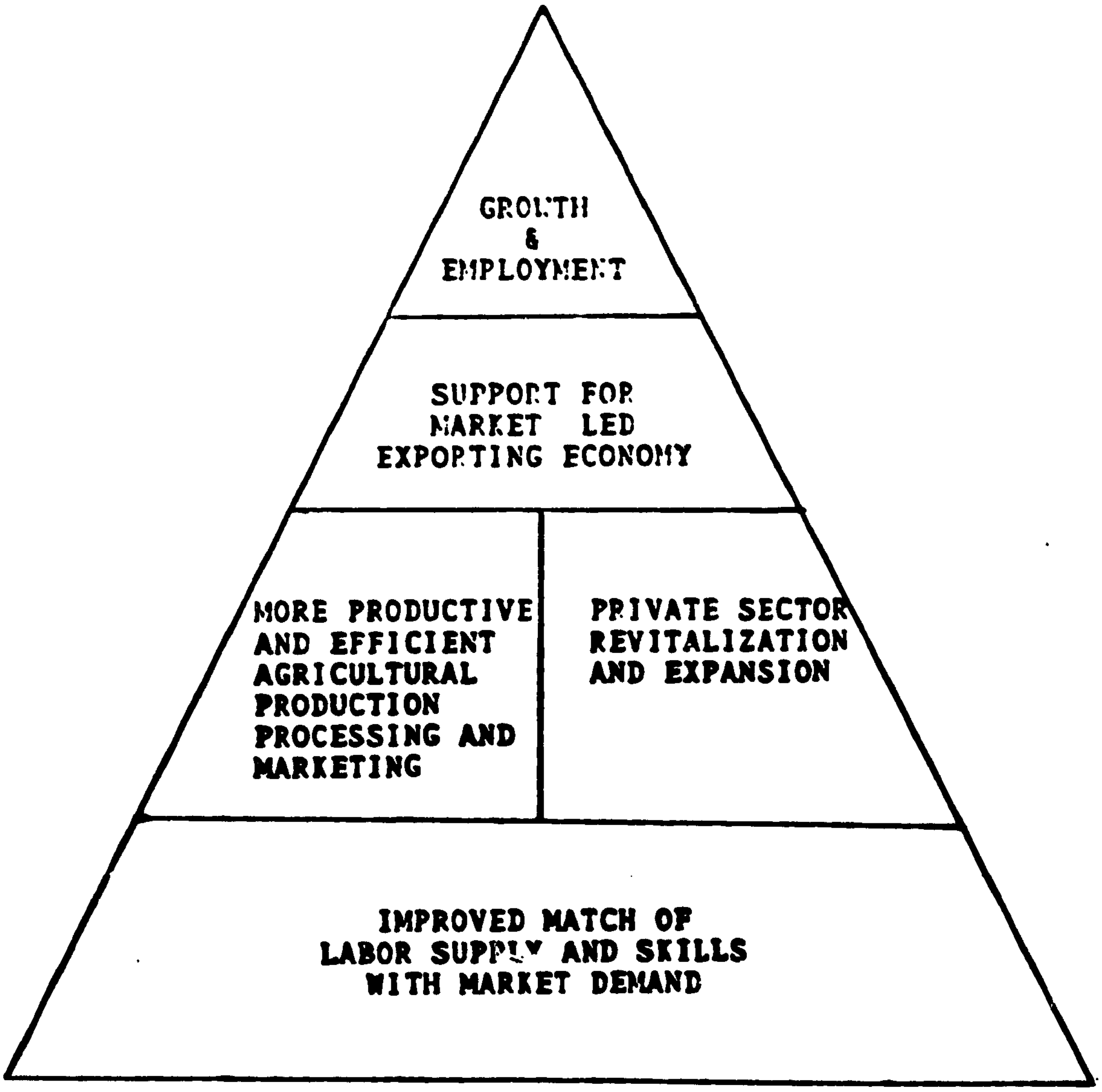
The government's strategy is to transform the economy into a dynamic market-driven, export-oriented economy able to provide jobs at home and compete effectively abroad, both within a Mahgreb economic union and vis-a-vis an integrated EEC after 1992. Shifting from a state-controlled, import-substituting economy to a private-led, outward-looking one will call for new approaches, new skills, new capacities, new technologies, new institutions, along with stepped up private investment. While Tunisia ranks as a middle income developing country in terms of per capita income, it can only aspire to becoming an advanced developing country while these gaps remain.

U.S. assistance can continue to play a vital role in this transformation process. Indeed the U.S. has a strong interest in seeing Tunisia succeed. A stable, democratic, dynamic Tunisia on the southern flank of NATO can serve as a model and constructive force in the region.

Since 1986 USAID has implemented a transition strategy directly supporting the SAP. About ninety-five percent of our resources have been quick disbursing (PL 480 Title I, a CIP and the Technology Transfer Project) that have helped meet short term foreign exchange needs and finance (through local currency) temporary jobs under a rural public works program. We have also responded to emergency drought and locust needs.

At the same time, we have realigned our portfolio and positioned ourselves through the APIP, Private Sector, Computer Technology, HG and Family Planning projects to address the medium and longer term needs as the economy stabilizes. Thus from FY 89 through FY 91 we will shift our emphasis from filling foreign exchange shortages to supporting implementation of sectoral policy reforms and private sector expansion. Local currency generated from continued CIPs and Title I will become increasingly important as a resource in support of these activities. A more directed Technology Transfer project will provide training in disciplines needed to further economic transformation.

The Mission proposes a new assistance strategy for 1992-1996 aimed at sustainable growth and employment. In the medium term, this means supporting the emergence of a more market-driven, export oriented economy. The outlines of the proposed strategy look like this:



The proposed strategy carries forward the high leverage elements in our current program such as policy analysis and privatization with significant shifts in emphases and innovations in program activities and modalities phased in over the strategy period.

New Emphases

In general, we will pursue a more explicit focus on employment, exports, and enterprise.

In agriculture we propose to concentrate increasing attention on higher value crops and agro-business, including distribution, processing and marketing, in line with Tunisia's stage of agricultural development.

In the private sector area, we propose to include key agricultural parastatals (e.g. Office de Cereales) in our privatization assistance efforts and to explore ways to promote private investment, particularly U.S.-Tunisian joint ventures. We are also prepared to look at export expansion activities.

With regard to labor skills and employment, the main innovation is an explicit effort to help the government devise and implement better employment and training policies and programs recognizing the government's short-term vulnerability to labor displaced by the structural adjustment process.

New Modalities

We see the Mission's role in implementing this strategy increasingly as that of a catalyst and facilitator, using our scarce resources in defined niches to remove bottlenecks or take advantage of opportunities to lever the transformation process along and to build lasting trade, investment, technological or institutional links between Tunisia and the United States.

Assuming funding and staffing at more or less current levels, we propose a lean portfolio of 4-5 umbrella projects providing flexible resources to respond selectively to the predefined sub-areas of the strategy. Policy dialogue, technology application, training, and institutional networking would remain the mainstay of our assistance tools.

We will explore the feasibility of a program grant to help import commodities needed by the private sector and to generate local currency for strategy activities. We will continue to rely on PL 480 Title I for most of our local currency generations. Local currency will be used for institutional grants, contracts with local consulting firms, lines of credit through local banks and other locally funded activities to support the strategy.

In carrying out this strategy we will continue building a more collaborative partnership relationship; thus moving beyond the traditional donor-recipient relationship which has existed in the past. We believe a new, more mature aid relationship is desirable and possible. We and the Tunisians will have to work out the modalities, develop new capacities, adjust our procedures, and aim our sights higher. This will take time. We hope the organizational and procedural innovations we are able to evolve can serve as a model for the Agency in relating to more advanced developing countries.

The Mission has thought hard on future directions and relationships. This paper outlines our conclusions and proposed emphases. The next step will be to develop a detailed implementation plan based on further analyses and discussions with our Tunisian counterparts.

II. WHITHER TUNISIA?

A. Overview of Economic Performance

Tunisia is a small country of nearly 8 million people with per capita income of about $1140. It has some agricultural potential, but no major natural resources beyond steadily declining oil reserves and low grade phosphates.

The structure of the economy has evolved considerably since independence in 1956, with the roles of agriculture and industry having been reversed. Out of GDP of $10 billion equivalent in 1988, agriculture contributed 14%, manufacturing 16%, mining and hydrocarbons 9%, construction and public works 8%, services 40%, and government 14%. Commerce alone contributed over half of the service sector GDP.

Despite good progress in lowering the fertility rate over the last twenty years, Tunisia still faces a burgeoning population (2.4% growth) increasingly concentrated along the coast and in its cities. Over 56% of the population is urban and nearly 60% is under the age of 25. Moderately rapid population growth and urbanization are expected to continue over at least the next 10-15 years.

Despite two decades of relatively rapid economic growth (5.8%) and significant export of labor (equivalent to perhaps 1/4 of the actual work force), Tunisia's endemic employment problem has worsened in recent years, with the decline in economic growth and the virtual halt in labor emigration. Of those classified as "employed" in the 1984 census, 27% were working less than 6 months of the year. Open unemployment in that same year was measured at 13.1%, but among males aged 18-24 it was 28.9%, compared to less than 8% for all others combined. Women represented 21% of the labor force and 18.5% of the unemployed. The data from the 1984 census suggests that perhaps 30% of the labor force was effectively unemployed. All of these rates are now believed to be higher.

Economic growth slowed significantly in the first half of the 1980s (3.6%) and will probably remain at reduced levels through the early 1990s (IMF/IBRD project 3.5% on average). This is expected to be the case even with good progress on structural adjustment.

The older sources of rapid economic growth of the 1960s and 1970s (export of hydrocarbons and import-substitution industrialization) have been fully exploited. Continuation of import-substitution industrialization, in the absence of large domestic markets, would doom Tunisia to the double burden of low growth and a worsening employment situation. At present the economy is providing fewer than 3 jobs for every 4 new entrants to the labor force, which is growing at more than 3% per year.

Growth and jobs must depend increasingly on non-traditional exports. In the absence of exports, agriculture (source of 27% of employment in the economy) offers little relief in terms of new jobs and will continue to contribute a declining share of GDP (14%). (One-half of the agricultural labor force already works less than 6 months of the year according to the 1984 census and is made up disproportionately of women). Similarly, the industrial sector (source of 35% of employment in the economy) would offer few new employment opportunities if it were to continue to stagnate as it has in the 1980s or to grow in capital-intensive ways as it has up to the present. Services, although important both in terms of their contribution to GDP and employment, tend to be a following rather than a leading sector.

Export-oriented market liberalization is clearly Tunisia's best option for addressing its growth and employment problems. It will (i) promote greater efficiency from existing ressources, (ii) create a greater bias toward labor use, (iii) remove the small domestic market demand constraint from the manufacturing sector, (iv) increasingly self-finance the external resource constraint, (v) provide a much higher growth path potential than the old import-substitution strategy, and (vi) result in much greater labor use.

Nevertheless, restructuring of the economy will take considerable time and is likely to lead to stresses and strains. Negative impacts will occur for formerly protected industries and the 25% of the labor force dependent on public sector employment, as well as on the more vulnerable groups with lower incomes. In addition, skills, attitudes, institutional arrangements, and existing regulations are far from market-oriented. It is human nature to resist change. Tunisia thus will need strong political resolve and interim donor assistance to stay the course and help cushion the worst effects of reform.

Tunisia is engaged in a classical structural adjustment program with three essential components: (i) the liberalization of the overall, macro/cross-sectoral policy framework, (ii) the restructuring, liberalization and finetuning of key sectoral policy areas, and (iii) the shifting of the balance of economic power and control progressively from the government and public sector toward the private sector. The emphasis in on freeing up incentive systems (prices and regulations) and moving toward an outward looking (export-oriented) policy stance in order to promote efficiency, productivity, and employment.

Employment is to be promoted both by the implicit higher levels of growth and by the implicit increase in the average labor intensity of output. The role of the private sector in the economy is to be increased by the freeing up of incentive systems, restraining government subsidies and transfers to public enterprises, decreasing the shares of government and public enterprises in new investment, and by privatization. The restructuring of the economy is to be accomplished within a macro framework of progressive improvement in external and internal balance which requires restraint of consumption and implicitly, subsidies, wages and salaries.

Progress on Tunisia's medium-term structural adjustment program (1987-91) has been encouraging to date. However, a Phase II adjustment program (1992-96) will be needed. Realistically, it will require another 8 years or more to complete and fully implement a comprehensive adjustment program. The pace and extent of public enterprise reform is a major question mark at this point and private investment is a major concern as are human resource and technology development.

The challenge is daunting, but other countries with less favorable circumstances have succeeded. Completion of the structural adjustment process is Tunisia's key to success.

E. A New Vision

1. November 7th

November 7, 1987 marked a watershed in Tunisia's modern history. Since the mid-1980s, Tunisia had faced a serious economic downturn, growing unemployment and a government in paralysis.

The peaceful assumption of power by the 51 year old Prime Minister Zine El Abidine Ben Ali generated renewed hope. The speed and breadth of his political and economic liberalization measures have sparked excitement and a new dynamism. The record of his first 16 months in office has been commendable from almost all perspectives and is reflected in continuing popular support.

2. The VIIth Plan (1987-91)

Worsening balance of payments and budgetary deficits in the mid-1980s provoked the Bourguiba government to take stringent measures in 1985 and, to respond with a comprehensive macroeconomic adjustment program in mid-1986. This became the basis of the new VIIth Plan and provided the policy framework for an IMF Stand-by Arrangement and an IBRD Agricultural Sector Adjustment Loan in the Fall of 1986.

The VIIth Plan strategy is export-oriented, market liberalization within a macro framework of internal and external balance. It stresses expansion of productivity, exports and employment through the private sector. The plan accepts the need to contain consumption, expand private sector investment, improve the efficiency of resource use and allocation, and reorient the economy toward labor intensive technologies and export growth. Macroeconomic policy adjustment covers eight areas: wages and salaries, the budget, interest rates, monetary and credit policies, the exchange rate, and price, investment and import liberalization.

The VIIth Plan entails a comprehensive reform package that, if successfully implemented, will represent a fundamental restructuring of the Tunisian economy during the 1990s and address the perennial problems of productivity and employment. The Plan is highly ambitious, in its commitment to export-oriented market liberalization. The new government, to its credit, embraced this long-term strategy (despite its evident short-term political costs) and has made its implementation a top priority.

C. Structural Adjustment Progress

1. IBRD and IMF Support

The VIIth Plan has served as the framework for three structural adjustment related loans from the IBRD, two from the ADB, and an IMF Standby Arrangement and Extended Financing Facility totalling $925 million. It will serve as the framework for four more adjustment related IBRD loans through 1991.

In the process of negotiating and implementing these loans, the macroeconomic adjustment program has been refined and strengthened by complementary macroeconomic and sectoral adjustment programs and through close monitoring by the IBRD and IMF.

2. Progress Since 1986

Concensus holds that Tunisia's progress on structural adjustment has been good, based on review of macroeconomic indicators and scheduled reform actions and targets. Tunisia has met or exceeded its targets and taken promised actions according to schedule.

The IBRD and the IMF have given Tunisia good marks on the implementation of its structural adjustment program and have made disbursements in performance-conditioned programs within 13-19 months of their agreements.

The IBRD and the IMF negotiated further agreements in mid-1988, expressing satisfaction with progress and concurrence on the soundness of the revised medium-term adjustment program 1988-91.

- No official word has been received by the Mission on progress under the IMF Extended Financing Facility (7/88) or the IBRD Structural Adjustment Loan (5/88). Nevertheless, expectations are that conditions for the 2nd (and final) tranche of the IBRD Structural Adjustment Loan will be met by mid-Spring 1989 and that partial drawdown on the IMF Extended Financing Facility will take place as scheduled in the first quarter of 1989.

a. The Macroeconomic Tableau

Macroeconomic performance was exceptional in 1987 and good in 1988 within the context of the 1987-91 adjustment program negotiated with the IMF. Exogenous factors, particularly weather, tended to boost performance in 1987 and lessen it in 1988.

1987 Performance - Performance was aided by an unusually good agricultural year, a strong rebound in tourism, higher petroleum prices, and strong export performance in textiles and mechanical/ electrical exports.

Following negative growth in 1986, caused in part, by severe drought and terms of trade deterioration, the economy recovered in 1987. Strong performance in agriculture, tourism, and increasing exports boosted real GDP growth to 5.8%, (compared with -1.6% in 1986) and the IMF program target of 5.0%. The current account deficit dropped to 1.4% of GDP (IMF program targets were 5.8% in 1987 and 8.0% in 1986). The government budgetary deficit was significantly reduced from 5.7% of GDP in 1986 to 3.6% in 1987 compared to the IMF program target of 4.2%. Inflation increased from 5.8% in 1986 to 8.2% in 1987, and was slightly higher than the 8.0% program target. Official reserves increased from 1.3 months of imports in 1986 to 2.0 months in 1987, compared to a program target of 1.8 months. Altough the external public debt/GDP ratio increased from 56.1% to 57.8% in 1987, it remained below the program target of 60.8%. Finally, the debt service ratio fell from 27.9% to 26.2% in 1987, compared to a program target of 27.0%.

Although some shortfalls occurred in the program targets for growth in budgetary revenues, use of domestic credit by government, money supply growth, and share of gross capital formation in GDP, 1987 performance exceeded IMF program expectations. Still the larger than anticipated decline in domestic demand, brought on in part by lagging investment, negatively affected activity in those sectors geared toward the domestic economy.

1988 Performance 1/

Overall economic growth lessened significantly. The current account deficit increased moderately. The budgetary deficit increased slightly and inflation apparently abated. In relation to IMF program targets, performance ranged from fair to good. In contrast to 1987, where exogeneous factors such as weather and terms of trade tended to favor the adjustment process, 1988 experienced the reverse. Severe drought caused a 24% decline in real agricultural output and created serious inocme and employment pressures for a sector employing over a quarter of the nation's labor force. This created the dilemma of meeting budgetary targets while responding responsibly to the crisis. In view of the unanticipated burden posed by the drought on the budget and related indicators, overall 1988 performance probably will be judged mixed, but good on balance.

Real GDP growth fell dramatically to 0.9% in 1988, though still in line with the program target. Nevertheless, excluding the agriculture and fishery sector, real growth was 5.2%, up from 4.0% in 1987, demonstrating a favorable response to the structural adjustment process. The current account deficit increased moderately to 2.3% of GDP, but below the 3.8% program target. As a consequence of the mixed performance, the budgetary deficit increased to 4.4% of GDP, slightly above the program target of 4.1%.

Inflation fell from 8.2% to slightly below the program target of 6.5%. The ratio of external debt to GDP increased slightly to 60.1%, but was still below the program target of 60.6%. Debt service decreased to 24.3%, below the program target of 26.4%. Finally, official reserves may have increased significantly (possibly 200+ million SDRs).

On the positive side, it would appear that performance was better than programmed for growth in exports, government revenues, current budgetary expenditures and domestic credit, and the gross national savings rate. On the negative side, it would appear that performance was worse than programmed for growth in imports, budgetary capital expenditure and net lending, total budgetary expenditures and net lending, government domestic credit and expansion of the money supply, and the rate of gross capital formation.

1/ Official statistics are not yet in and the IMF and IBRD have not released their initial evaluations. However, preliminary assessment of performance can be made for most key indicators on the basis of GOT estimates in the Budget Economique 1989 which were based on 9 to 10 months of data.

• On the basis of this review, the macroeconomic and structural adjustment program through 1988 remains on target with good progress overall. External performance, in particular, has been very good, although led to date almost entirely by the extraordinary turnaround in tourism and, to a lesser extent, by the performance of textile and mechanical/engineering exports. Nevertheless, there appear to be worrisome signs relating to excesssive budgetary expenditures (particularly capital expenditures and consumer subsides), low private sector investment rates, and excessive expansion of liquidity.

b. Policy Reform Highlights 1986-88

1. Price Liberalization

-80% of agricultural producer prices decontrolled; remaining prices raised significantly 1986-87.

-Subsidized agricultural input prices raised in 1986/87 and 1987/88 crop seasons; fertilizer retail margins liberalized 8/87 and full cost charging for mechanization services achieved.

-60% of value of manufactured goods producer prices decontrolled by mid-1988; controls on most remaining items relaxed.

20% of distribution margins decontrolled 1/89.

-Certain public tariffs and petroleum prices raised in 1988.

-Share of consumer subsidies in budget dropped from 3.5% to 3% in 1987.

2. Restructuring of Public Enteprises

-State control limited to enterprises with 50% government participation, up from 34%.

-Legislation promulgated to permit gradual sale of government share of public enterprises to private sector and process has been initiated.

-Systematic review underway with view to improving financial viability of those enteprises remaining in public sector.

3. Import Liberalization

-Quantitative restrictions on imports of raw materials, semi-finished goods, and investment goods removed (with minor exceptions) by 1/88; value of freely imported goods 53% in 1988.

-Companies exporting more than 15% of output allowed to freely import needed inputs.

-Maximum tariff rate reduced from 236% to 41%; minimum tariff raised to 15%.

-Other tariff rates between 26% and 55% were reduced by 6 percentage points 1/87 and 9 percentage points 1/88, subject to a minimum tariff of 17%.

4. Exchange Rate, Exchange System and External Debt

-Floating rate exchange rate system adopted 10/85.

-9% devaluation of nominal effective exchange rate 8/86.

-21.5% depreciation of real effective exchange rate during 1986 with further depreciation of 4.5% in 1987.

-Real effective exchange rate maintained in 1988 with further nominal depreciation of 2%.

-Elimination of government subsidized exchange rate guarantee system 8/88 and replacement with temporary alternative government guarantee system.

-IMF program limits on non-concessional external debt 1987-88 observed.

-Established monitoring unit to centralize data on external debt structure in 1988 for purposes of managing external debt, including attendant exchange risk.

5. Tax Reform

-Value added tax system introduced 7/88 and extended to wholesale trade 1/89, replaced three turnover taxes.

-New personal income tax system with simplified structure and maximum rate reduced to 50% introduced 1/89.

-Corporate tax system reform under preparation.

6. Credit and Monetary Policies

-Prior approval of new credit and refinancing by Central Bank eliminated 1/88.

-Reserve loss provisions of banking system strengthened 1/88.

-Money market system strengthened by authorization of interbank transactions and participation of nonbank financial institutions and certain enterprises; certificates of deposits of these institutions now freely traded.

-Cost of credit effectively reduced by 1.1% by reduction on service tax on interest charges from 14% to 6% on 11/87.

-Interest rate controls on loans and deposits lessened; deposit rates essentially deregulated and ceiling on lending rates replaced by bank spread of 3% above money market rate.

-Money market rate raised to about 9.5%; treasury bond rates raised from 5.5% to 6.5%.

-Preferential interest rates limited to agriculture, exports and SMES, and artisanal and craft industries.

-Floor on preferential interest rates to be effectively raised to 7% 1/89.

-Offshore banks permitted to accept deposits and make loans in local currency, thus increasing domestic competition.

-Mechanisms available to Central Bank for intervening in money market diversified.

-1988 study conducted in preparation for introduction of treasury bills.

7. Investment Liberalization

-Implementation of new investment codes with no advance application necessary unless special incentives requested in 1987.

-Tax rates on investment earnings reduced by introduction of tax credit concept.

Government is consciously constraining public enteprise and government use of domestic credit in order to make greater proportion of credit facilities available to private sector.

In sum, overall progress on Tunisia's structural adjustment 1986-88 must be judged very good both on the basis of programmed macroeconomic indicators and reform steps taken to date. The economy has made a good, strong start in the first two and one-half years of its medium-term adjustment program. Substantial progress has been made toward shifting relative factor prices in favor of greater labor use, skewing incentive systems toward tradeable goods, and reducing the role of government and public enteprises in the economy in favor of the private sector. Meanwhile good progress has been made toward attaining internal and external balance, while maintaining conditions of relative price stability and reasonable growth (discounting for the 1987/88 drought). Much remains to be done both in the three remaining years of the current adjustment program and in the program that will follow in the VIIIth Plan 1992-96.

D. Challenges and Prospects

1. Challenges

a. Managing the Political Risks of Reform

The structural adjustment program is a highly complex and inter-related set of macro and sectoral reforms that shift the balance of economic power and control progressively to the private sector.

It requires careful phasing in order to avoid undue jolts to the economy. Considerable time will be needed for implementation and for the economy to subsequently adjust. In the interim, there will be belt tightening, people adversely affected and, in some cases, significant changes in social and economic status.

Managing structural adjustment will require an acute sense of political economy, as well as technical skill. The process is challenging but the rewards can outweight the risks if the government holds firm to the present course set.

b. Finishing the Medium-Term Adjustment Program

The most important strategic task facing Tunisia is the successful completion of the 1987-91 medium-term structural adjustment program.

Key Remaining Actions - Looking ahead over the period 1989-91, Tunisia has pledged to completely eliminate remaining agricultural input subsidies, align most agricultural producer prices with international levels, increase the percentage of decontrolled manufactured goods producer prices (in value terms from the present 55% to 75%), and increase liberalized distribution margins from the present 20% to 50%. The government has pledged (details and schedules are presently being negotiated with the IBRD) to restructure certain public enterprises, privatize others, and to improve operational efficiency of those which remain public.

Tunisia has committed itself to liberalize imports and remove quantitative restrictions from 80% of all goods (up from 53%) and achieve an average effective protection rate of 25%, within a range of 15% to 35% (down from present 41% maximum). Tunisia has pledged to maintain the real effective exchange rate of end-1987 and to limit adding new non-concessional debt. The government has made commitments to limit the budgetary deficit to 2.5% of GDP by 1991 (down from 4.4% in 1988) and to steadily reduce consumer subsidies, and transfers and subsidies to public enterprises. It has pledged to reform corporate taxation. Finally, the government has agreed to eliminate the interest rate differential between preferential credits and money market rates by 1991 and to introduce a market for treasury bonds as well as to raise their rates.

The Toughest Questions The privatization and restructuring of enteprises and reduction of consumer subsidies on bread and edible oil will be the toughest reforms to carry out. Delay on the subsidy issue while troublesome, will not overly threaten the structural adjustment process given the present size of budgets and the relative discipline achieved thus far. In fact, it may be necessary to cushion the effects of structural adjustment on the more vulnerable groups. Better targeted subsides may be the best interim solution.

Failure to substantially reform the public sector enterprises, however, would substantially undermine the ultimate potential of structural adjustment. Public enterprises loom so large and are so integral to the economy that failure to address their gross inefficiencies would leave an impossible burden for the rest of the economy to carry. Public enteprises by the early 1980s accounted for 25% of GDP value added, 24% of employment, 40% of investment, 75% of exports and 45% of imports. Surveys of individual public enteprises have almost invariably found profitability to be nil or negative, necessitating continuous direct budgetary subsidies and transfers plus use of substantial domestic credit.

Whether the private sector will adequately respond (as assumed in adjustment scenarios) if government follows through on the reforms and incentives as promised is a major question. If government reduces the share of central government and public enterprises investment from 13% of GDP in 1987 to the targeted 9% in 1991, will the private sector expand its share from 9% to 13% as envisioned? Private investment levels currently are lagging behind earlier projections. This is not cause for alarm yet, given the political transition in late 1987, but it will be an increasing source of concern if private sector does not respond over the next two to three years.

c. Moving to Phase II of Structural Adjustment

Although not yet announced, it is clear that the GOT must continue the structural adjustment reform process into the VIIIth Plan (1992-96) if it wants to complete what it started in 1986. Implementation of public enterprise reforms will need to be continued well into the next Plan period. But there are other likely items on the agenda if Tunisia wishes to succeed in its export-oriented market liberalization strategy. Anticipating that VIIth Plan targets are set, these would include further liberalization of the remaining 20% of controlled agricultural producer prices, the remaining 25% of controlled manufacturing prices, and the remaining 50% of controlled distribution prices. Phase II should also consider making further progress on removing the 20% of imports that will still be under quantitative controls and reducing the anticipated average 25% effective tariff rate further. Liberalization in credit and financial market policies will remain in order. Undoubtedly, there will be other unfinished tasks from the VIIth plan as well as second round sectoral reform targets, to be added to the agenda.

2. Prospects

Tunisia's economic prospects are encouraging given its commitment to an export-led growth strategy.

Tunisia's position today is in many respects historically analagous to certain other small countries (Taiwan, Singapore, Hong Kong, Korea, Japan) which adopted an outward looking development strategy because of their lack of resources and small internal markets and succeeded against the conventional wisdom of the day.

The lack of employment opportunities with good wages is the central issue confronting the Tunisian Government today. Resolution of that problem would invariably improve the political situation and would directly attack many of the socio-economic issues it confronts. It would also tend to make Tunisia more impervious to external shocks.

Tunisia's success in achieving equitable growth will depend on the skill and luck with which structural adjustment is implemented, favorable international economic trends, rain, and its ability to capitalize on its assets and overcome its liabilities. Let's review what Tunisia's assets and liabilities are.

ASSETS

-Tunisia is advantageously located less than a day's sail from southern Europe and within 2.5 flying hours from most major European capitals. It is the keystone of the Maghreb and is reforging close economic relations with its fellow North African nations. Despite the Sahara, it is closely tied to francophone Africa and has been increasing its trade in this direction.

-Relative to population, Tunisia has an adequate supply of arable and productive agricultural land. Over 200,000 hectares are irrigated. Although this area represents only 4% of the arable land, it produces 40% of agricultural GDP.

-A functioning network of physical infrastructure is in place. Benefitting from its small size and good petroleum based income in the past, Tunisia installed roads, power, telecommunications and irrigation systems. The infrastructure needs upgrading and modernization to permit quicker economic expansion.

-A relatively well educated labor force exists with a 67% literacy rate and 90% of school age children attending school.

-Tunisia enjoys a relatively high per capita income of $1140 and relatively equitable income distribution with respectable quality of life indicators.

-While the society does not bubble with entrepreneurial spirit as does Hong Kong or Taiwan, Tunisians are mobile and ready to adjust themselves to market realities, which gives them a distinct advantage over many competing economies.

-The economic adjustment program is an indigenous initiative, formulated and managed by Tunisians aware of the nation's strengths and limits. The architects of the program are presently in control of Tunisia's economic and financial policies.

-The November 7, 1987 change gave Tunisia a relatively stable political system which promises more accountability to the public. This movement will continue with the elections scheduled for April 1989. The political malaise and uncertainty of the mid 80's was an important disincentive to increased private sector activity.

LIABILITIES

-Tunisia will become a net importer of oil in the early 90's and the price of phosphates is not expected to improve. There are roughly 400,000 Tunisians working offshore who provide remittances which are important to sustained economic growth. All of these were important factors in the 70's and 80's but they can no longer be considered engines of growth. Indeed, should workers return, phosphates become less competitive and oil prices remain low, Tunisia could well suffer another economic crisis similar to that experienced in 1986.

-Labor is still too expensive, food is too cheap and the cost of money does not reflect market risk and expected return. The concept that economic balance can be achieved by administering the cost of the factors of production still persists.

-The technological environment in Tunisia has been defined as at the "islands of modernization" stage in a recent report. 1/ Thus, it is at the level of Kenya and Sri Lanka and well below that of Malaysia, Singapore or Thailand. The technological infrastructure is presently not sufficiently developed to effectively support a competitive export economy.

-Tunisia's education and banking systems are also ill-suited to the demands of a market economy.

-The quality of production in Tunisia is generally low. Foodstuffs are ungraded and often of poor quality. Manufactured products are roughly finished and function unevenly, designs are not attractive to target markets, packaging is inappropriate and unattractive and services are uneven and unreliable. Islands of excellence exist which demonstrate potential extant in Tunisia, but these firms are few.

-Although the adjustment process has begun to work its way through, the economy continues to suffer from over regulation and control which stifles both investment and productivity. Erratic interpretation of import regulations and agreements heighten risks associated with investment. Conditions of employment remain highly controlled making the relative cost of labor high.

-A relatively high rate of population growth and nearly 30% open unemployment among youth threaten the GOT's ability to assure continued growth and to take difficult economic decisions. Bread riots in 1984 left lasting scars on political decision makers who remain cautious when making decisions which will impact young people. The emergence of popular democracy will increase the risks from this source during the plan period. Tunisians will be testing their new freedom and finding that the previously free lunch era now has a price tag just at the time when some of the more painful unravelling of the dirigist economy is being put in place.

The weighing of these factors has been a strong determinant in the choices of which directions to follow in our developmental interventions between 1992-96.

1/ Weiss, Scientific and Technological Constraints to Economic Development.

III. REVIEW OF CURRENT U.S. ASSISTANCE

A. OVERVIEW OF TRANSITION STRATEGY

USAID/Tunisia is currently in the second year of implementing a program in accordance with the assistance strategy which was revised and approved in AID/W in early 1987. From a traditional infrastructure and institutional development type program up to that time, the revised strategy shifted emphasis to one of supporting economic reform for renewed growth. The strategy aims the bulk of USAID's resources at support for the Government of Tunisia's comprehensive SAP adopted in late 1986. The revised assistance strategy was intended to be a short-term, transitional one, relevant to Tunisia's macroeconomic stabilization requirements through the initial period of the SAP (i.e. to 1991). It was also intended to allow the ANE Bureau and the Mission to gauge the GOT's commitment to reform and to see the actual direction and pace of the reform process as a basis for longer term assistance planning. To date the GOT has clearly demonstrated it has the political will and the economic managerial capacity to carry out a comprehensive reform prossss. Significant progress has been made in stabilizing the macroeconomy and laying the foundations for faster, more sustainable growth in the medium term.

The USAID program under the transitional strategy has made, and continues to make, significant contributions to the overall economic reform process and the accomplishments attained to date. Under the strategy new USAID assistance, both project and non-project, (ESF and food aid) have been programmed in accordance with two main objectives: a) providing foreign exchange for short term balance of payments relief, while supporting a "safety net" labor intensive public works program and b) assisting in preparing the way for renewed growth over the medium term, through agricultural sector optimization, private sector development, health/family planning and technology transfer. Activities which were ongoing at the time of initiation of the transitional strategy have either been phased out (Central Tunisia Rural Development project and the Agricultural Research project) or progressively modified or refined to better fit the revised strategy (e.g. Private Sector Development project and Technology Transfer project).

B. EASING THE SHORT-TERM EFFECTS OF STRUCTURAL ADJUSTMENT

To help carry out the Structural Adjustment Program, Tunisia arranged the before mentioned loans and standby from the IBRD and IMF in late 1986. The IMF noted at the time that these resources alone would not provide all the foreign exchange needed for implementation of reforms proposed under the SAP. Heavy reliance on the donor community to help fill the gap was foreseen as a necessity.

Tunisia also recognized that the human costs of pursuing the adjustment program were potentially quite high and if not addressed could derail the reform efforts. The Government was especially concerned with the negative effects of reform on the more disadvantaged and vulnerable groups, particularly the unemployed.

USAID's transitional strategy provided for resources to address both immediate needs, balance of payments relief and "safety net" assistance in order to better assure the economic and social stability to undertake planned reforms.

1. Balance of Payments Relief

Substantial support for balance of payments relief has been provided to date through non-project assistance, i.e., food aid under the Title I program and ESF grant funded Commodity Import Programs (CIPs). Title I concessional food sales and the CIPs helped to save scarce foreign exchange as well as reduce the revenue gap resulting from certain structural reforms, such as reduction of tariffs. To date, since FY-87 and initiation of the transitional strategy, a total of $65 million in Title I concessional credits and $16 million under three CIP's have been committed. While the HG Program is not specifically intended as balance of payments relief, because of its untied foreign exchange feature, it has, in fact, contributed $21 million since August, 1986. The approximate $5 million from the ESF budget programmed for the Technology Transfer project (664-0315) each year provides further balance of payments relief in that, like the CIPs, funds are disbursed within one year of obligation. CIPs and allotments for the Technology Transfer project together have constituted upwards of 75 percent of the ESF budget annually since FY-87. All told, USAID's foreign exchange contribution (Title I, CIPs and Technology Transfer project) amounted to $91 million over the FY-87/FY-88 period. The GOT's current account deficit over the same period was the equivalent of $364 million. Therefore, USAID's $91 million contribution, while relatively modest, was of significant benefit to the GOT which greatly appreciated our rapidly disbursing, essentially free foreign exchange assistance.

2. "Safety Net" Assistance

The response to short term balance of payments relief also resulted in generation of considerable local currency proceeds. Under the transitional strategy, monetization of Title I and CIP assistance has generated approximately $75 million in local currency. To date, approximately $47 million of this amount, from Title I proceeds, have been programmed to the GOT's labor intensive Work Relief Program (Chantiers Regionaux) under which the GOT provides productive work for unemployed persons.1/

1/ The remainder has been programmed for Section 108, locust control and policy change support under CIP. Once the FY 1989 commodities arrive approximately $9 million will remain to be programmed.

- The comprehensive SAP negotiated between GOT and IBRD did not make direct provision for Tunisia's serious unemployment problems, and many even have led to a worsening. Title I support for the Chantiers Regionaux program aims at providing jobs for 35,000 unemployed workers, thereby contributing significantly to a real "safety net" undertaking intended to better assure economic and social stability that will allow the GOT to pursue further needed, if not popular, reform measures. An evaluation of the Chantiers Regionaux program, conducted by an outside contractor in May 1988, revealed that the program was proceeding well and measurably easing the unemployment situation.

3. Drought Relief

In response to the 1987/88 drought, the worst in Tunisia's recent history, an Emergency Section 416 Program was provided in late 1988. The 60,000 MT of feedgrain furnished under the program will be sold and are expected to generate approximately $6 million in local currency. These proceeds, like Title I generations, are being programmed to provide rural employment opportunities, particularly for those most adversely affected by the drought in the politically important central Tunisia region, where the violent bread riots of December 1984 began.

4. Locust Control Assistance

Locust invasions begun in 1988 and forecast to continue for several more years, have posed an additional unforseen threat to Tunisian agriculture and economic reforms. USAID has helped Tunisia to prepare for better control of locust invasions through OFDA funded TA and commodities and under the FY-89 Commodity Import Program which is providing 3 spray planes. Moreover, the FY-89 CIP Agreement stipulates that the GOT will deposit into a special account the dinar equivalent of the U.S. spray planes (approximately $1.3 million dinar equivalent), said funds to be used for locust control efforts.

C. FACILITATING IMPLEMENTATION OF POLICY REFORM

1. Policy Dialogue

Policy dialogue is an important element of the Mission's transitional strategy. The policy dialogue agenda the CDSS Preamble and the March 1987 Action Plan included the following major items which have since been subjects of discussion and negotiation between GOT and USAID:

(i) Agriculture Sector Optimization:
(ii) Promotion of the concept and role of privatization to develop a healthy economy
(iii) Adoption of strong family planning policies, including promotion of the private sector for contraceptive delivery.
(IV) Rationalization of shelter finance and production and creation of a sustainable system for future production, led by the private sector.

To date a combination of jawboning by Mission staff and visiting experts, as well as reinforcement with USAID financed technical studies and sometimes the use of food assistance and local currency resources as added leverage, have advanced considerably the dialogue in support of concrete policy reforms..

The Mission's Commodity Import Program (K-602, K-603 and K-603A), currently amounting to $16.1 million in ESF obligations, was explicitly designed to support the overall transitional program strategy. Under the terms of the CIP agreements, local currencies generated from sale of CIP commodities are programmed to support economic reform, with particular emphasis on private sector promotion and improvement of the agriculture sector. To date the dinar equivalent of $10.5 million have been generated, with $5.1 equivalent already programmed. These resources have proven to be a valuable mechanism to facilitate the ongoing Mission policy dialogue associated with the economic reform strategy objective.

2. Agriculture Sector Optimization

Twenty-seven percent of Tunisia's labor force is involved in agriculture. While food self-sufficiency is not a realistic goal for Tunisia, there is considerable potential for greater efficiency in the agriculture sector. The GOT and the World Bank have made this goal (i.e., improvement of agricultural sector performance) a major element of the Structural Adjustment Program. Based largely on World Bank/GOT agreed-on reform needs for the sector, the USAID in its CDSS identified certain major areas where constraints to agricultural growth exist and where USAID efforts would be targetted, within its staff and financial resource availabilities. These included, inter alia:

-elimination of animal feed subsidies
-progressive increase in interest rates on ag. lending
-phase down and then out subsidies on other ag. inputs
-phase down and then out of price controls on ag. production to align them with external market prices

Under the FY 87 CIP Tunisia agreed to, and subsequently did, eliminate animal feed subsidies. But then a limited degree of subsidization was reinstated as a result of the crippling drought of 1987/88. This was a short term expedient in reaction to a threat to the national herd.

Recently, USAID has used CIP proceeds to "facilitate" GOT policy changes governing its APMANE fund, the leading supervised agricultural credit fund, which has been steadily decapitalizing because of poor policies. USAID defined four major policy changes needed to restore APMANE to financial health and committed itself to provide CIP proceeds for each change made (four separate tranches, totalling approximately $5.2 equivalent). This in turn provided needed leverage to the Ministries of Agriculture and Plan in the face of the banking system which was benefitting from some of these poor policies. Two policy changes have already been made: Subsidized lending to the politically influential wheat farmers has been reduced in favor of more diversified, sustainable lending; and, uncollected loans over three years old are being purged from the books. The GOT presently is actively pursuing the other two USAID recommended reforms, i,e., reduction of administrative banking charges and establishment of a collection system which better motivates collecting. Technical assistance has been provided under APIP to assist in this effort.

A cornerstone of the Mission's program under the transitional strategy is the Agricultural Policy Implementation Project (APIP) (664-0343). The primary purpose of the project and the major progress indicator for the Ag Sector, as per our current Action Plan, is the provision of required analyses and monitoring of the agricultural sector in support of policy reforms under the SAP. The APIP, operational since 1988, greatly reinforces the Mission's dialogue for Agriculture Sector optimization.

Under the APIP project, USAID has collaborated closely with IBRD teams implementing their loans. APIP has supported GOT decision making under these loans by providing studies of Tunisia's major export crops and the impact of subsidies on the economy, among others. This has helped the GOT to make decisions regarding policy changes covenanted under the IBRD agricultural loans, for which insufficient evidence existed to permit the changes to be made. As well, it has helped focus the attention of the GOT and IBRD on the most important areas. In preparation for the second tranche of the IBRD agricultural loan USAID is providing the needed analysis to assist the GOT in how to liberalize the sector and in defining a residual role for the parastatals, presently heavily involved in marketing most of Tunisia's agricultural production.

Under the FY-87, FY-88 and FY-89 Title I Agreements USAID successfully negotiated certain self-help measures, including:

- improve private sector fertilizer distribution margins;
- analysis of opening up the export market of olive oil to the private sector;
- analysis preliminary to formulating for a drought strategy;
- design of improved crop forecasting methods;
- examination of alternative uses of land presently in cereals crops to protect fragile soils and cushion incomes against adverse impacts of drought.

These self-help measures provide positive reinforcement for our strategy objectives, both for ag sector optimization and private sector promotion.

3. Private Sector Promotion

In early 1987 the USAID Action Plan identified the private sector as a priority area for assistance under the transitional strategy. This focus was developed in recognition of the heavy burden imposed by the country's 500 parastatals and the all pervasive government controls and regulations on the economy and private initiative. Objectives and progress indicators for the private sector were tentatively defined and left to further refinement. The Mission used its private sector project with flexible resources to respond to needs and opportunities. The USAID's Private Sector Strategy completed in late 1988 further defined a three-pronged approach emphasizing trade liberalization and promotion, development of financial intermediation, and privatization.

Notable progress already has been attained in the area of privatization under the Private Sector Development project (664-0328). In early 1987, "privatization" was an unspoken word in Tunisia. One used "restructuring". In April 1987 USAID organized and funded a seminar on "Why privatization?" and invited experts from numerous countries to participate. Tunisia's daily newspapers carried the debate to the public. A second AID financed colloquium took place in early 1988. It focused on the topic "How to privatize" and had heavy participation from the private sector. Privatization is now an accepted concept and is a top priority. The GOT in December 1988 hired a USAID-funded advisor to sit in the office of the Prime Minister and assist with its privatization efforts; a major breakthrough. Another advisor who arrived in December 1988 works for the Director of the nascent stock exchange in transfering financial intermediation techniques. Three hotels are scheduled for imminent privatization and a major textile company has already been privatized. The issue in Tunisia is no longer whether to privatize, but what, how and how fast. While USAID cannot take all the credit, a very large part of the progress made to date is the result of our skillful and timely assistance, our willingness to fund the dialogue and our encouragement of the involvement of Tunisian policy makers at every turn.

The March 1987 Action Plan goal for the private sector was: "Increased production of goods and services and increased employment by a more dynamic Tunisian private sector." Within this context, our strategy and the GOT's Structural Adjustment Program call for export enhancement. An important tool in achieving this goal is insurance to cover risks to the exporter. Traditionally the Tunisian insurance company COTUNACE, has provided this coverage but the company has been severely under-capitalized and does not provide coverage to large parts of the world where export opportunities exist. In late 1988 USAID agreed to the use of CIP proceeds to increase the capitalization of COTUNACE if COTUNACE would agree to take steps to increase its exposure in non-traditional but promising markets. The GOT agreed to gather data and put in place a system to evaluate risk in Latin America, Sub-Saharan Africa and Asia in return for the capital increase. USAID further agreed to make funds available from the Private Sector Development project (664-0328) to provide short term TA to assist in this effort and to advise on how to keep and build a data base. We expect that COTUNACE will be prepared to evaluate possible exposure in these new markets within a year's time. The potential for new markets is significant and without our local currency and Private Sector project, as well as continued USAID policy dialogue, this would not have occurred.

As part of our policy dialogue on private sector development, USAID directly supported an important Tunisian trade and investment mission by financing assistance in international trade and marketing for the Tunisian Joint Commission for Trade and Investment (JCTI). The JCTI, comprised mainly of private sector businessmen, visited 4 U.S. cities in December 1988 to raise Tunisia's profile as a trading and investment partner with the U.S. USAID worked directly with the Tunisian Ministry of Industry and Commerce to sharpen the JCTI program in the U.S. and to focus the program on areas of comparative advantage for both countries. The JCTI was well received in the U.S. Numerous private sector contacts were made, some of which already are proceding beyond initial planning. For example, immediately following the JCTI visit, a U.S. bio-tech company involved in bovine genetics sent 4 of its officers to Tunisia to negotiate terms and financing for a cattle genetics investment project. Other projects such as aquaculture investments are under serious study.

Private Sector development has been given further impetus under USAID's Section 108 Program, for which $5 million in Title I generated local currencies have been programmed. Tunisia was the first country to sign a Section 108 Agreement. Our first loan was signed during the week of October 30, 1988 with one of the three privately owned banks in Tunisia. The USG is receiving market value of interest on this loan which will be on-lent by the recipient banks to private firms for industrial investments. It is projected that these investments will, in turn, create more jobs. Private Sector, local currency and employment aspects of our strategy have all been supported by this action.

4. Rationalized Shelter Production Systems

The Mission's Housing Guaranty Program contributes toward meeting our transitional strategy objectives. A broad sectoral agenda has been negotiated, designed to limit and clarify the role of the public sector in housing, while stimulating increased land and shelter provision by private developers. The first evidence of success has been the transformation of the former housing fund (CNEL) into a full service, largely private Housing Development Bank (BDH), which can now finance land development and provide construction financing to private developers. The agenda also targets increasing the supply of land available to private developers for shelter construction and to lower income families, by limiting a public agency (AFH) to a land "wholesaler" for the private sector. In addition, the agenda supports: streamlining the regulatory environment; improving coordination among public and private sector entities; revising norms and standards; encouraging municipal participation in shelter; and institutional restructuring.

D. SETTING THE STAGE FOR MEDIUM TERM GROWTH

While the foregoing policy dialogue agenda and accompanying supporting activities contribute to a reformed, revitalized economy, two major elements in the portfolio are aimed at growth over the longer run: technology transfer and population development and family planning.

1) Technology Transfer

Through technology transfer USAID is helping to prepare the way for renewed economic growth in Tunisia, both in the near term during the period of Structural Adjustment, as well as over the medium term. The Computer Technology project (664-0334) is assisting the GOT to develop its capacity to apply microcomputer technology to the national education system and to undertake research that will lead to the introduction of this technology in other productive sectors of the economy. The project is already applying microcomputer technology in practical ways which benefit of Tunisia's economy. One current application involves the use of computer technology for "greeness" mapping to assist in locust control and eradication. Project-financed computer technology is using satellite data to assist technicians in locating locust breeding grounds. The project is also training computer science professionals in the preparation and interpretation of this advanced mapping technology. In another effort, the project is working on the development of an optical character reader for Arabic script. IRSIT, the counterpart agency, plans to patent the software, which was developed in-house, and then to develop a joint relationship with AT&T for future production and distribution.

The major portion of the USAID's technology transfer assistance to Tunisia is through the scholarship program under the Technology Transfer project (664-0315). To date, this program has sent almost 700 students to the U.S. for academic degree training. The program, which was initiated by Tunisia with its own funds several years prior to USAID's initial participation in 1982 provides testimony to the high value the GOT assigns to U.S. higher education and technology. Over the past 18 months the USAID has refocussed the Technology Transfer project towards meeting the needs of economic adjustment by emphasizing training in disciplines such as business administration, economics, and computer engineering. Approximately 45 percent of the Mission's annual ESF budget is being applied to this human resource development endeavor which, as noted previously, also supports the balance of payments objective.

2) Population

The strategic goal for this sector, as set forth in the current, approved Action Plan is: 'Reduced population pressures leading to reduced economic pressures." Key progress indicators established were:

- Increase contraceptive prevalence (modern methods) among married women of reproductive age (MWRA) by 9 percentage points, from 33.7% in 1985 to 42.7%, and

- Increase distribution and incentive pricing for contraceptives in the private sector.

To date significant progress has been made. Based on a demographic health survey conducted by Westinghouse in October 1988 the contraceptive prevalence rate among MWRA has already increased 7.2 percentage points, to 40.9 percent. Moreover, through its innovative contraceptive social marketing (CSM) program the Family Planning and Population Development project (664-0331) is actively contributing to efforts to promote private sector involvement in FP and make the National Family Planning Office (ONFP) a self-sufficient entity. As a result of project related dialogue, in early 1988 the price of one cycle of pills distributed through the private sector increased six-fold. Pills and condoms are now being sold by private sector pharmacies throughout the country. The ONFP has been given permission to adopt additional measures to improve distribution of contraceptives and increase revenues. These include: a price increase for condoms, a uniform increased price for private sector pills, expanding the list of CSM products, and changing private physicians for IUDs which they presently receive free.

While the CSM program is making steady progress, there is room for improvement. Important next steps will be to assist the GOT to more effectively expand into the private sector and to most efficiently utilize newly derived revenues resulting from private sector measures fostered under the project over the longer term, ONFP will require additional improvements to management.

E. ALIGNING THE PORTFOLIO

The USAID's transitional strategy called for the orderly phase down of certain ongoing, classically-oriented development activities. The Mission has made great strides in consolidating its portfolio to increasingly devote more of its limited financial and managerial resources to economic reform oriented objectives. Since embarking on the transitional strategy, six separate Central Tunisia Rural Development (CTRD) umbrella project activities have been phased out successfully. The present remaining Range Development and Management Project (664-0312.8) will terminate, as planned, at the May 1989

PACD. A traditional Agricultural Research project was ended in an orderly fashion and the Rural Community Health project, a 10 year effort, was concluded. A Title II feeding program of 22 years duration was weaned from U.S. support. In the last 18 months significant amounts of funds from the CTRD umbrella project were deobligated for reobligation into key project activities supporting the transitional strategy. In sum, USAID's program has, and continues, to focus on our and the GOT's clearly stated economic reform objectives.

F. CONCLUSION

When viewed against ongoing activities and progress achieved to date, the USAID's transitional strategy as articulated in the CDSS Preamble and March 1987 Action Plan appears to be appropriate. Many of the major targets and benchmarks of the transitional strategy should be met as planned by the end of the strategy period, i.e. end of 1991. By that time, economic stabilization, which USAID has been supporting through such means as Commodity Import Programs and Title I for balance of payments relief and "safety net" assistance, should be well advanced.

IV. STRATEGY OUTLINES FOR THE 90'S

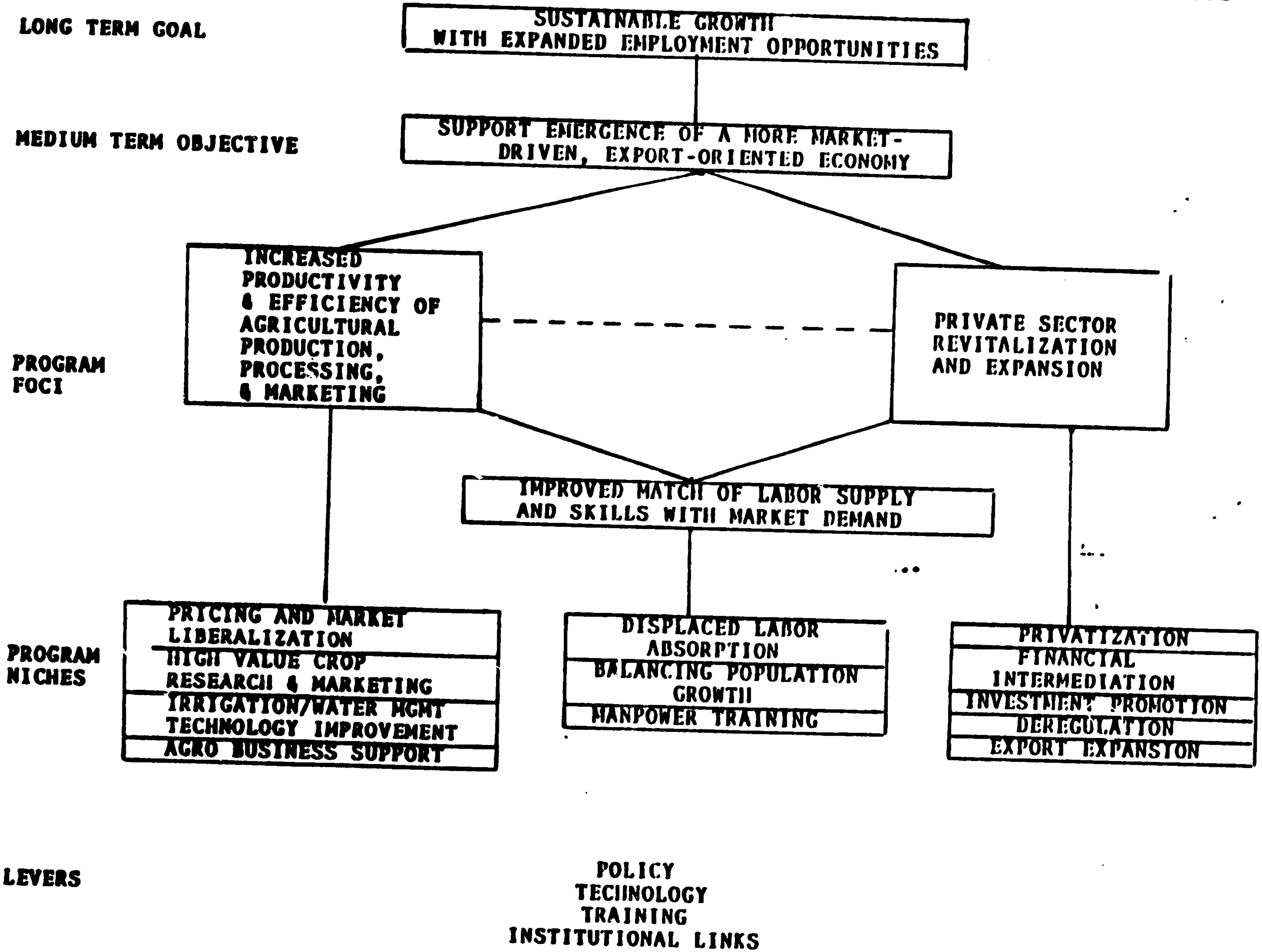
In formulating an assistance strategy for the 1990's we have been guided by Tunisia's aspirations and actions to become a more democratic polity and a more competitive economy; by the successes and lessons of our assistance in support of the Tunisian structural adjustment program; by the challenges and opportunities facing Tunisia in the decade ahead; by its assets and liabilities; and by our own best judgements of how our limited resources can be focussed strategically to facilitate Tunisia's success in this social transformation process.

To help us decide on future directions, we held a series of meetings to examine possibilities and to identify areas of promise. We listened to a number of in-depth presentations and engaged in lively discussions of Tunisia's economic geography, human resources, employment problems, science and technology capacities and needs, population dynamics, private sector activity and economic history and policy since independence. We also considered Tunisia's exporting potential, investment promotion, urbanization and equity. A thorough review of U.S. political interests in Tunisia and Tunisia's political outlook was held with the Country Team. We assessed A.I.D.'s comparative advantage vis-a-vis other donors' plans and sought areas of complementarity, especially with the World Bank programs.

This exercise, when combined with data and analysis contained in the private sector strategy, the revisited agriculture sector strategy, the ATDM and JCTI reports, the S&T review prepared by Charles Weiss and other studies provided an objective filter through which the Mission examined six different strategic options. (See bibliography.) Three choices, a S&T strategy, a poverty oriented strategy and a targetted export strategy were discarded for various reasons. The three remaining options, employment specific, private sector specific and structural adjustment support specific were debated at length and combined into a unified option emphasizing sustainable growth and employment. The outlines of this strategy are discussed in the next section.

In this way, our preliminary CDSS analyses and deliberations have permitted us to identify clearly and with some confidence what should be our central objectives and to delineate the core program foci we should pursue in the first half of the 90's. We have also zeroed in on possible program niches: some of which we are already implementing and will want to build upon; others of which we will need to explore in greater depth in terms of relevance and feasibility. Clearly, with limited resources, we have to be highly selective about what we choose to do and modest about how much impact we expect to have. Figure No. 1 shows a schematic of our strategic thinking at this stage of development.

FIGURE NO. 1
U.S. ASSISTANCE
STRATEGY OUTLINES



A. OBJECTIVES

The long term development goal of the Tunisians, which we can readily espouse, is that of sustainable growth with expanded employment opportunities. Tunisia faces the challenges of sustaining a respectable growth rate (e.g. 3.5%) in a post-petroleum exporting economy while, at the same time, creating enough employment opportunities for an increasingly large, young, and urban labor force.

Sustainable growth depends on Tunisia's ability to efficiently produce a wider range of products that can compete effectively in the domestic market with imported goods, and can compete internationally to compensate for lost foreign exchange from oil exports after 1992. The aim of such production would be to reduce vulnerability to international price swings in primary commodities and to exploit Tunisia's comparative advantages of lower cost labor and proximity to Europe. The structural adjustment program is aimed at establishing a favorable macro-economic climate to encourage this evolution.

Employment creation will both depend on and determine the success of the structural adjustment process. But this process will take time. Meanwhile, population growth and urbanization will bring at least 70,000 new entrants into the labor force annually against a backlog of at least 275,000 job seekers. As structural adjustment unfolds, the effects of declines in real income, of higher prices, and of public sector layoffs will become more apparent. The demands for remunerative jobs will become increasingly insistent. In an increasingly open political system, these demands, if unmet, can be exploited politically and lead to the retarding or derailing of structural adjustment reforms. This puts a premium on accelerating job creation and on facilitating labor absorption in the short term.

Given the twin challenges of growth and employment and our comparative advantage, we have concluded that we can be of greatest help to Tunisia by selectively supporting the emergence of a more market-driven, export-oriented economy in the medium term, while mindful of the short term employment imperative.

Despite the impressive progress made in structural adjustment in the first two years of the program, Tunisia remains a highly state-dominated and regulated economy, with heavily subsidized social and economic benefits, and entrenched anti-market attitudes and interests in the public as well as in the private sector. A strong USAID voice in favor of a private market economy, matched with judicious use of our influence and resources, can strengthen and legitimize the pro-market forces. The faster and further Tunisia can travel in a private market direction the more dynamic growth and employment creation is apt to be. A second important consideration in pointing our sights in this direction is to encourage and facilitate investments, whether public or private, in activities that promise relatively earlier and higher returns in terms of market-driven growth and employment. A third consideration, is that this objective will not be easy to pursue nor will our impact be predictable or precisely measurable. We will need to be practical, balanced, and flexible rather than rigid in our approach.

B. PROGRAM ELEMENTS

To contribute to achievement of the long-term goal and to the Mission's medium-term objectives, three program elements have been delineated. First, we will target increased productivity and efficiency of agricultural production, processing and marketing. We envisage continued support of liberalization in the agricultural sector, of greater exploitation of high value agriculture potential, of promotion of greater efficiencies in irrigation management, and of development of agro-industry. Secondly, we will continue implementation and refinement of our current private sector strategy through activities in support of privatization and deregulation of the public sector, improved financial intermediation, and through examination of ways to further promote private investment (Tunisian and American) and to enhance exports. Lastly, in support of the first two elements we will assist Tunisia to improve the match between its supply of labor and the needs of the economy, both in the short term and over the long term.

These areas of concentration are interdependent and mutually reinforcing. Policy dialogue, technology adaptation, training, and institutional networking will be the principal instrumentalities for implementation. We propose to integrate gender concerns into our overall program which is the most efficient way to address the special needs of women and children.

1. Increased Productivity and Efficiency of Agricultural Production, Processing, and Marketing

Tunisian agriculture has a continued role to play in sustaining growth and employment in a more open economy. Like many countries in transition to a balanced, diversified and industrialized economy, Tunisia has experienced a relative decline in the importance of agriculture over the past three decades. The sector now accounts for about 14% of GDP, 27% of employment and 13% of export earnings. This is a desirable evolution that reflects the growing importance of other sectors; chiefly petroleum, manufacturing, and tourism. But it also reflects a decline in the performance of the sector over the last decade and a failure to fully exploit the demand at home and abroad for higher quality produce such as fruits and vegetables, meat, poultry, dairy products, fish and processed foods. Public sector dominance of agriculture has retarded private agricultural input, processing, marketing, and transportation industries and services. Moreover, in view of population, production, and consumption trends and given comparative advantages in the agricultural sector, Tunisian agriculture, even at its maximum potential, will be unable to satisfy more than 50% of its food and feedgrain requirements. We foresee continued decline in employment in the cereals and livestock sector. Some of the released labor could be absorbed in high value agriculture and in agro-industry which tend to have high labor intensities and higher wages. We have concluded that we can make a major contribution by helping Tunisia accomplish the shift from traditional cereals and livestock production to a diversified, high value agricultural and agro-industrial economy.

a) Pricing and Market Liberalization

Our analysis suggests USAID can make the greatest contribution toward this end by continuing to assist the GOT to adjust input and output prices and to support the liberalization of markets. The GOT has committed itself to a move to market pricing of all agricultural products but foodgrains and edible oils by 1991. These politically sensitive items will undoubtedly be targetted for liberalization by the mid 90's and the Mission can help the Government in this process through policy analysis and advice on how to liberalize the cereals sub-sector, including parastatal reform. We are collaborating with the GOT and the World Bank on the initial stages of this process. We are working successfully on seed and fertilizer subsidy removal and private distribution. Another profitable area of collaboration in the future could be agricultural credit. By 1992 interest rates will be at market levels, in line with commitments made to the World Bank. At this point, banks may be more inclined to direct more of their assets toward agriculture and U.S. experience in this area would be useful in assuring the smooth and rapid growth of credit facilities.

b) High Value Crop Research and Marketing

Experts provided under APIP and World Bank projects have encouraged Tunisia to lessen its emphasis on cereals and target its attention to marketing its high value, differentiated crops in the EEC and, to a lesser extent, in the U.S. The recent Agricultural Trade and Development Mission (ATDM) concurred with this finding. Poor packaging and grading, lack of knowledge of market potential and deteriorated genetic material all hamper Tunisia's ability to compete. Experts have noted that the timing of Tunisian vegetable crops is such that if they could transport properly graded and packaged produce to the EEC they could sell all they could ship for a 6-8 week period with little competition. Physical proximity is an important element of this advantage. As well, certain speciality fruits almost unique to Tunisia have a market far greater than Tunisia's ability to supply. U.S. technology in the areas of packaging, grading, hygiene and marketing could be most useful in assisting Tunisia with these types of exports. Judicious interventions in these areas aimed at improving technologies, efficiencies, and marketing will help Tunisia become competitive, adding to employment and foreign exchange earnings as well as lessening the pressure to continue with unwise investments in crops in which Tunisia has a strong comparative disadvantage.

Our analyses of the changes in the sector have led us to the conclusion that Tunisia will not receive the full benefits of its enormous effort in structural adjustment unless complementary steps are taken to increase the efficiency of technology transfers to the private sector. Entrepreneurs at all levels are searching for new and adapted technologies which are appropriate to the new economic conditions they face. At the farm level, several of our APIP studies have shown that export potential for traditional Tunisian crops--e.g. fruits, olive oil and wine grapes-- could be significantly improved with introduction of new agricultural technologies to reduce per unit production costs and to increase production. Improved technology could, for example, lead to increased production of virus-free root stock for fruit trees; better pruning techniques and weed control methods for olive plantations; and improved wine grape varieties for production of higher quality wines.

c) Irrigation Water Management and Technology Improvements

In reviewing our medium-term options, we remain convinced that improving efficiencies in water use, increasing yields of irrigated crops--particularly those of high value for export, and increasing land use intensity in the irrigation sub-sector are important to the prospects for overall success in the agricultural sector adjustment program. The sub-sector is clearly functioning at below optimum efficiency -- i.e. degree of irrigation intensity is only about 70 percent on public perimeters. The benefits of moving that intensity to, for example, 110 percent would be enormous. There is evidence from APIP reports that many of the irrigation techniques used for high value crops waste large quantities of water through poor scheduling of deliveries and lack of producer familiarity with more appropriate technologies. We believe, therefore, that significant increases in productivity can be achieved over the medium-term with well-targeted assistance mounted quickly and aimed at reforming current operational policies and encouraging greater private participation in the ownership and management of the existing perimeters. Our efforts will complement current World Bank efforts in the irrigation sector.

Moreover, since the GOT has already made substantial investments in irrigation infrastructure, our assistance at this point has the distinct potential of gains in operational efficiencies and production without enormous up-front investment costs. The skewing of investment decisions which has resulted from inappropriately priced water needs to be reduced if Tunisia is to realize a fuller measure of the potential from its agricultural sector. For these reasons, the Mission intends to work in the area of irrigation management and appropriate technology transfer during the CDSS period. Our concentrations will be on policy change and on selection and adaptation of technologies both to increase the profitability of agriculture and to reduce costs. The possibility of joint ventures between Tunisian and American firms producing irrigation equipment will be explored.

d) Agro-Business Support

A final area of emphasis in the agriculture sector will be the support of agro-business. The GOT is moving steadily toward freeing up the marketing of agricultural inputs and outputs. As decisions are made to privatize state enterprises which control agricutural inputs, assistance will be needed to assure that these actions proceed smoothly. Likewise private enterprises moving into this sector to take up and expand production and services related to food transportation, processing, packaging, and marketing will need to understand the new rules of the game, and to have access to improved technology and investment capital. American expertise in agricultural research and agro-industrial processing and marketing technologies can make a significant contribution to Tunisia in this effort. Through technical assistance, training and pilot programs we can help foster closer links between American and Tunisian researchers and businesses in selected high pay off areas.

Joint ventures between U.S. and Tunisian companies is another promising area. For example, there is scope for production investment in aquaculture in Tunisia and several U.S. firms have expressed interest in joint ventures. We have just sponsored aquaculture training for 4 private sector representatives and 2 public sector representatives in this field. The recent Joint Commission on Trade and Investment (JCTI) concluded that Tunisia would be a good platform for U.S. investors interested in investing in food processing for the EEC. Low cost labor in an enclave setting enhances the profitability of such investments. Our intervention in this area is attractive given the need for investment in Tunisia, the labor intensive characteristics of many agro-industries, and the potential for creating additional markets for U.S. agricultural products, machinery, and feed grains. Given the proven success of the enclave sector and the projected competitiveness of Tunisian agriculture once prices are in balance, the Mission believes investments of expertise in agro-business will result in large paybacks in the mid 90's.

As we orient our agricultural assistance in these directions, there are many problems in other areas that will be left to the GOT and other donors to address. One area, which is a particular agency priority for which we neither expect to have resources nor provide a priority focus, is Natural Resources Management. It should be noted that efficient land use and conservation of natural resources in Tunisia is constrained by fragmentation of land holdings, lack of clear titles and security of tenure, and inefficient management of collective and public lands. Land consolidation measures have been launched in irrigated areas and public agricultural lands (les Terres Domaniales) are being turned over to private enterprise. The problem of overgrazing and extension of agriculture into marginal lands places heavy pressure on rangelands. Except for occasional policy analyses, training and short-term consultancies, the Mission does not intend to assist the GOT in this domain.

2. Private Sector Revitalization and Expansion

The second major focus of our activities will be the revitalization and expansion of the private sector. It is useful to note that until the early 1960's there was a strong and vital private sector in Tunisia. Regretably for Tunisians, virtually all of the enterpreneurs were French or Italian. The socialist experiments of the 60's and 70's did little more than displace the expatriate businessmen and produce an extremely unbalanced economy. Recognizing the unsustainably high costs associated with this dirigist approach, the GOT decided to move toward greater private sector involvement in the economy as part of the economic adjustment program. The November 7, 1987 change of Government further accelerated the move toward private sector activity.

The Mission's private sector strategy, approved in August 1988, presented a three part strategy with concentration on privatization, financial intermediation and trade liberalization. The Mission further refined the strategy in light of the recent Joint Commission on Trade and Investment and additional experience gained over the seven months since the strategy was finalized. We have added deregulation and investment promotion to the list of priority areas for U.S.-GOT collaboration in the private sector.

a) Privatization

Perhaps the most important contribution which A.I.D. can make during the CDSS period will be to continue to support the privatization efforts of the GOT. It is estimated that it will take at least until the year 2000 for the program to reach its conclusion. Advice on how to approach privatization and techniques of assuring its success are presently being provided by the U.S. In the future newly privatized firms will need managerial training as well as technical advice on operations. Also, the opportunity exists to engage U.S. joint venture partners in privatization to the mutual advantage of Tunisia and the U.S. Privatization assistance will not only be targetted at agricultural, industrial or manufacturing activities. There is potential for government savings and private profits, as well as greater efficiency, in the privatization of municipal services. If resources permit, privatization of health service delivery and private contraceptive distribution will also be encouraged.

b) Financial Intermediation

Financial intermediation is key to privatization and revitalization of the private sector. At present, interest rates are relatively low and financial instruments are limited. While a stock exchange exists, it has neither breadth nor depth. Other instruments normally used to raise capital are virtually non-existent. Over the CDSS period there will be a continuing need for expert advice on how to structure and create financial systems which will permit Tunisian firms to raise capital for investment and keep their profits working. While the financial instruments presently being created will be primarily directed at the local market, increased liberalization of the foreign exchange regime will create a greater need for financial instruments with international standing. This will do much to attract and keep outside private capital. A sophisticated and complete legal environment is also needed to support these markets and in this the U.S. has a clear comparative advantage. Training of Tunisians in finance and financial management and analysis will be a component of this element of our private sector strategy.

In the urban area, the country will need financial instruments and institutions which will permit municipalities, including those in the central areas of Tunisia, to provide services, such as housing and infrastructure, for their growing population. The Mission will work with RHUDO to focus GOT attention on the need for these underpinnings, which can make urban areas more efficient and thereby facilitate private sector investment.

c) Deregulation

Over-regulation is a major drag on the ability of firms to operate profitably. Firms with offshore status, which is tantamount to operation as an enclave, are highly profitable. These firms are not subject to Tunisian pricing or labor regulations; they set their own hours, pay what the market demands and can reduce their labor force when cyclical circumstances require. Deregulation in Tunisia will be a difficult but important aspect of the transition to a more market-driven economy and we intend to explore the targeting of deregulation as an important component of our private sector expansion strategy. Analysis which will feed a policy dialogue on this matter will be important in convincing GOT decision makers of the need to change long-existing practices.

d) Investment Promotion

The promotion of greater investment in Tunisia by U.S. firms is an important aspect of our strategy. Tunisia is likely to continue to enjoy a privileged relationship with the EEC after 1992. If so, Tunisia will be an excellent site for U.S. firms interested in selling to the EEC. Lower labor costs in Tunisia coupled with relatively skilled labor and close physical proximity make Tunisia attractive. The GOT is interested in creating additional ties with EEC firms to reduce the possibility of exclusion from the Common Market in the future. U.S. firms are technologically well-suited to investments in agro-processing here and such investment would be most useful in addressing the employment difficulties which Tunisia will face in the 1990's. The Mission will design appropriate assistance for the JCTI as well as the various service agencies: the Investment Promotion Agency (API), the Agricultural Investment Promotion Agency (APIA), The Tunisian Federation of Industries and Handicrafts (UTICA). This assistance will focus on helping them to articulate Tunisia's case as well as to act as brokers for investment rather than regulators and paper pushers. With the freer exchange regime which is to be established by the next plan period the possibilities for investment and profit will be notably improved.

We are encouraged by the initial success of the JCTI and the proposed follow-up plans which include:

- -follow-up on leads in the U.S. to identify potential traders and investors
- -development of contacts with U.S. subsidiaries in Europe
- -sectoral trade and investment missions in the U.S. (e.g. aquaculture and electronics)
- -A "Tunisia-Europe 1992" Conference
- -Studies of comparative advantage and technical constraints
- -Support for a Business Council and a private trading company
- -A set of trade and investment initiatives with the Ministry of Industry

We expect to build on these initiatives and provide flexible support for U.S. investment.

e) Export Expansion

In line with our objectives of increasing employment opportunities and of reorienting the agriculture sector, the Mission will work with the Tunisians to increase exports. The increased export of agricultural products is essential if that sector is to redirect itself from a cereals orientation to one dealing with high value exports. Advice on grading, packing and marketing as well as pricing will be important during the CDSS period. Across sectors we may want to offer selective help on trade policy. We will also explore ways to develop exporter services. The Center for Export Promotion (CEPEX), the Federation of Private Exporters (FEDEX) and the Export Training Center of the Institute of Higher Management Studies are all possible partners. Continued collaboration with COTUNAS on export insurance is also attractive. Other opportunities will no doubt arise which we should be prepared to consider.

3. Improved Match of Labor Supply and Skills with Market Demand

The final major program element of our strategy will be improving the match of the labor supply and skills with market demand. This broad area of intervention simultaneously confronts the challenge of creating a human resource base suited to a transformed economy as well as the serious adversity of identifying productive employment for a labor force at least temporarily displaced. Neither the short-term unemployment problem nor the development of new skills were dealt with conscientiously prior to the GOT decision to proceed with the Structural Adjustment Program. Thus, the Mission's financial and management contributions to the rural public works program (Chantier Regionaux) have been duly applauded as an appropriate measure. Given the length of time required for the economy's revitalization, however, additional remedies are required.

During the CDSS period the Mission expects to continue more targetted short-term programs. Simultaneously, the Mission will provide substantial analytical and policy support to the GOT to assure that the structural impediments to employment generation are identified and optimum responses defined. Preliminary evidence from other countries undergoing structural adjustment programs indicates that the short-term negative impacts may hurt women more than men. Thus, our support will include gender disaggregated analyses and interventions where appropriate.

In addressing the effectiveness of the formal education sector, the Mission recognizes that we have neither resources nor a comparative advantage to deal with an essentially outmoded French-based educational system. The World Bank is undertaking a major sector loan which well suits these needs. The loan will target reforms of the primary and secondary systems and, of equal import, will aim to develop stronger links between professional training and the productive sectors of the economy. The Mission plans to complement the World Bank support by focusing mainly on training in management and other market-oriented skill areas.

a) Labor Absorption

Unemployment will be one of the serious constraints to Tunisia's successful adjustment and transition to a more open economy. Reduced absorption by the public sector of young people coming on the job market may result in less than 3 out of 4 new entrants obtaining work. While the economic adjustment will ultimately result in expanded employment opportunities in the private sector, the large number of jobs required make it unlikely that the majority of job-seekers will be requited, even by the mid 1990's. The existance of a large body of unemployed youth is likely to be the source of considerable concern to the government in the early 1990's. Many of the present problems with the parastatals stem from their use as employment sumps notwithstanding the costs to efficiency. The Government's sale and restructuring of parastatals will mean the remaining parastatal enterprises (some 220 by 1996) will have at least 30,000 fewer employees at the end of the CDSS period. The GOT will need to find ways to retrain, pension off, help establish them in business or find temporary work for these individuals until the market is able to provide jobs.

While there is no possibility that U.S. assistance will be able to provide jobs for these and the existing unemployed, our experience with the ongoing rural public works program (Chantiers Regionaux) shows that U.S. investment can lever additional investment from the GOT and other donors. We plan to assist with the more serious analytical work required and with development of more efficient and targetted programs. We intend to continue U.S. involvement in the area of public works with modifications: our target will be smaller, and we will require a greater contribution from the GOT. Finally, we will target the programs more directly at the youthful unemployed and those in the secondary cities of Tunisia. Additional analysis is required to determine appropriate targetting of female beneficiaries. A productive urban focus will characterize the short term efforts to absorb displaced labor and the un- and semi-skilled unemployed. We believe that the "pressure relief" aspects of this program will provide sufficient stability to help the GOT stay the course on some of the more difficult decisions of economic adjustment which will need to be made in the first half of the 90's.

b) Balancing Population Growth

The Mission sees an opportunity to continue its work on reducing the long term size of the labor force and consequently will continue its work on family planning. The goal is a rate of population growth of 2.2% by the year 2000 down from the present 2.4%. We estimate that selective inputs of U.S. private sector experience to support the GOT's efforts in social marketing, improved linkages with U.S. population research institutions as well as U.S. technology and training will return large dividends in the early 90's. We may not need large amounts of assets nor do we envision a need for interventions past the CDSS period.

c) Human Resources Development

The two objectives noted thus far will work on the size of the unemployed labor pool in the short run and size of the entire pool in the long run. Our analyses has shown that the quality of labor skills needs improvement. A major impediment to increased efficiency of both public and private enterprises is a lack of management talent, both technical and general. Consequently the Mission will undertake to train Tunisians in skills appropriate to the needs of the reshaped and modernized economy. Skills such as financial management, computer engineering, business administration, marketing, bio genetics, etc. will be important to maintain the pace of transformation. Such skills will also permit Tunisia to improve its product quality. A correlary benefit will be to introduce U.S. technologies to a future population which will be making major economic decisions in the 21st century. We will also look for ways to improve employment referral services for returned trainees and to expand training opportunities for women and private sector candidates.

C. IMPLEMENTATION

1. Risks and Uncertainties

In pointing our assistance in these directions it is important to note that we need additional analysis, and that we have not fully vetted these ideas and their implications with the Tunisian Government. At the same time we need to recognize that Tunisia itself is in an early stage of both its structural adjustment and of a new government that is opening up the political process as well. We can see several variables that will affect Tunisia's pace of reform and the ease with which we may be able to move with success in these strategy directions.

- Parastatal reform and privatization, especially in agriculture, will not be easy.

- Removal of subsidies on farm inputs and outputs will be a slow and risky process.

- A freer trade regime will conflict with entrenched interests.

- Private sector expansion may be slower or less competitive than expected with discontinuities in service and production.

- Demands from unemployed youth and displaced workers could become an explosive issue.

- Tunisia's access to the EEC could wind up to be less than expected with serious repercussions for the export-led growth strategy.

We will be assessing these risks as we refine our thinking and seek to implement our strategy.

We also need to recognize that pursuing this kind of a strategy will also challenge us to find more innovative, flexible ways of doing business if we are to be responsive to private sector trade and investment opportunities.

2. Phasing in New Strategy Elements

Figure 2 on the following page depicts the evolution in the program, retrospectively and prospectively.

3. Implementation Levers

We now need to delineate these areas of assistance and develop a portfolio of activities most appropriate for pursuing our assistance objectives and foci. We can identify certain levers at our disposal that are well suited to our purposes, resources, and Tunisian needs. These include: policy dialogue, technology transfer, training and institutional networking.

a) Policy Dialogue

The GOT has demonstrated its commitment to policy reform and its capacity to formulate a sound macro-economic policy framework. It looks to USAID as a colleague in helping the responsible ministries implement these reforms at the sectoral and subsectoral level. We can make a valuable contribution by providing analysis and advice on policy options, impacts, and implementation plans, through short and long term advisors, policy research, and frequent dialogue at high levels. We see our role as facilitator rather than enforcer of policy reform. We do not see the need for heavy conditionality in our program, though we are prepared to use

TUNISIA
PROGRAM EVOLUTION
1981 - 1996

RETROSPECTIVE		PROSPECTIVE	
1981 - 1985	1986 - 1989	1990 - 1992	1993 - 1996
ntral Tunisia velopment Activities	Phase out, except Potable Water Project	Potable Water Institutions (National replication)	--
ditional Agricultural earch, Training support of Livestock Cereals)	Phase over with new focus on Ag policy reform	Continued Policy Reform Emphasis with Reorientation to High Value Crop Productivity and Efficiency (Horticulture, Aquaculture)	Same with increasing emphasis on Agro-Business, processing, marketing of high value crops
loratory Private tor Activities	Focussed privatization, financial markets, trade	Focussed privatization, Financial markets Trade Investment Promotion Export Services Support Deregulation	Focussed Privatization Financial markets Trade Investment Promotion Export Services Support Deregulation
ditional Health vice Delivery Rural Health Population	Phase out Health except ORT Introduce Social Marketing	-- Consolidate Social Marketing	-- Expand Private FP Services
--	Rural Public Works	Public Works Employment/Training Policy	Employment Policy, Training and targeted PW programs
sing , ,	Housing Policy	Privatization of Housing Development and Banking	Services and re in rivate Secto.

PL 480 self-help measures and local currency proceeds to reinforce positively the implementation of difficult reforms. We do see the need to focus our resources on helping the GOT carry out reforms in a few critical areas with potentially high impact on medium term growth and employment.

While our policy agenda must be an evolving one, certain areas already emerge as likely priorities for us in the coming years:

Agricultural price and subsidy policies
Privatization
Credit and interest rate policies
Employment
Investment and business regulation
Private social service delivery and cost recovery
Technology policy

We will need to determine which specific policies in these areas we wish to concentrate on. We will need to ensure the timely dissemination of policy research results so the key policy makers will be able to make informed decisions and manage the reform process sensibly. This will require close relations, based on mutual trust and respect, with the Prime Ministry, Ministry of Plan, Ministry of Agriculture, Ministry of Industry and Commerce, the Central Bank, and others. We also will look for ways to help institutionalize local policy research flows into GOT policy making.

b) Technology Transfer

Tunisia will require improved technologies across a wide spectrum if it is to produce internationally competitive products and services. At Tunisia's present stage of technology development it is not yet able to effectively mobilize technology to serve its development objectives. Major constraints to Tunisia's technology development still exist: an elitist/conformist education system; a rigid, public dominated research establishment; weak private sector demand. We do not see a role for USAID in the major transformation required in the S+T system. The Carthage Institute of Technology proposal, for example, was an initiative designed to respond to this challenge; but the GOT is not yet ready to tackle the problem through this major investment. While we will remain flexible with regard to possible institutional development, we see our main roles as a catalyst for improved technology and a facilitator for Tunisia's adaptation of available technologies. Technology areas in which the U.S. has a comparative advantage and which respond to critical gaps in Tunisia's move to a market-driven, export-led economy include:

- Management
- Informatics and telecommunications
- Bio-Technology
- Irrigation/water management
- Agro-business and food processing
- Contraceptive research
- Mass media applications

We will be developing a technology applications project to support research in such areas through support of joint ventures between U.S. and Tunisian companies, research grants to local institutes like IRSIT or ISG, scientific exchanges and technical assistance.

c) Training

Tunisia needs to have available an increasingly better qualified labor force, including skilled workers and tradesmen, to support its economic transformation. The U.S. has a long established relationship with Tunisia in this area. We see training, both long and short term, in-country and U.S., public and private sector, as an important vehicle for our assistance strategy. In the coming months we will assess how to most productively target training resources, while responding to Tunisian interest in continued long term U.S. degree training as an alternative to a French education.

d) Institutional Networking

As Tunisia moves toward a more open and private economy and a more pluralistic society, closer links between private, government, and academic institutions will need to be developed. Likewise, as the U.S. and Tunisia move toward a more mature aid relationship, closer links between Tunisian and American businessmen, scientists, and a wide range of institutions are desirable. While recognizing the difficulty involved, we will be looking for ways to help foster such linkages as we implement this strategy.

4. Financial Resource Needs

The Mission estimates that between FY 1992 and 1996, the period covered by this strategy, $75 million in ESF and $75 million in PL-480-I resources will be needed. The availability of local currency is important to the success of the program. PL-480-I resources will be used to generate local currency to support selected aspects of the program, as outlined below.

The ESF resources will be directed essentially toward provision of LT and ST technical assistance and training needed to develop and communicate the policy changes and new activities which will occur as a result of the new emphases. One of the areas which the Mission will explore further is the use of a CIP to support new activities. For example, the CIP could be used to support agro-business development or improved irrigation efficiency by targetting importation of U.S. food processing machinery or irrigation equipment. Introduction and adaptation of new technologies can be reinforced by local currency resources. We will also examine the desirability of using a CIP for contraceptive procurement.

In addition to any CIP generations, it is our intention to use PL-480-I generations to support several aspects of the program including privatization, pricing and marketing liberalization, agro business support, and displaced labor absorption. We can envision a greatly expanded Section 108 program to support increased exports as well as to support higher levels of domestic investment.

Market development for U.S. producers can continue to be an exciting by-product of the PL 480-I and CIP programs, in pursuit of our trade objectives. In the past two years PL 480-I and CIP have reintroduced soymeal pellets to Tunisia as well as sorghum for animal feed. There are numerous other possibilities for U.S. exports which could be assisted by a PL-480-I program. We anticipate that the bulk of Tunisia's food and feed needs will be met through less concessional channels such as the GSM 102 and 103 programs and that PL-480-I resources will be based on export promotion needs and local currency support for the development objectives being pursued by the USG.

Finally, given the increased urbanization of Tunisia, we anticipate that HG assistance could be programmed over the plan period. This could support development in urban areas as well as privatization and expansion of municipal services. To the extent that funds are available the Mission will support these efforts under the private sector revitalization focus of our program.

V. TOWARD A MORE MATURE RELATIONSHIP WITH TUNISIA

A. The Relationship

In order to characterize the type of assistance relationship that should prevail between the U.S. and Tunisia through the mid-1990's, the Mission has examined three elements: the nature of the aid program, the ability of Tunisian public and private sector entities to manage the assistance, and the vehicles available to AID to successfully deliver the assistance.

The transition strategy under which the Mission has implemented its program since early 1987 has already signalled a new, more mature response to the development needs of Tunisia. From a traditional infrastructure and institutional development portfolio, the program of support has shifted focus to the more specialized needs of a transforming economy. The strategy options outlined for the CDSS period 1992-96 articulate even more decidedly a program attuned to serious economic analysis, innovations in technology and management and strategic niche playing selected subsectors.

In managing that transition strategy during the last two years, the Mission has determined that the type of assistance required, while not experimental in nature, has to be more specialized and sophisticated. For example, the Mission conducted an extended dialogue with the Prime Ministry on implementing the GOT decision to begin to privatize the economy. One conclusion of the dialogue was that the Prime Ministry did require a long-term expert to help set policy and to draft a detailed action plan. The task required development of a scope of work and identification of a special individual with hands-on experience in actually privatizing an economy. The Mission succeeded in meeting the understandably high expectations on the part of the Tunisian counterparts. However, that particular level of dialogue and the placement of an unusually qualified consultant will, in the next few years, become the pattern rather than the exception in our program. The demands for expert assistance as well as for custom tailored short-term training from non-traditional sources will increase.

In light of our strategy formulation, our judgement on where Tunisia is placed on the development continuum, and the above speculations on the character of the assistance program, we began to evaluate Tunisia's capacity to assume greater responsibility for managing the assistance program. The institution-building objectives of many of the traditional projects have continued within the donor-recipient mode. In moving toward the new strategy of assistance it was assumed that the Tunisian-U.S. relationship should also undergo transformation. The Mission assumes that a more collaborative style of operations, a partnership if you will, is warranted by the new strategy.

While the program will take advantage of opportunities to increase collaboration as they arise, it appears that in the short-term the donor/recipient approach will persist. The predominant reason that leads us to this conclusion is a dearth of Tunisian intermediary institutions through which more collaborative assistance programs can be designed and implemented. Private voluntary organizations or foundations, as such, do not exist in Tunisia, having been trampled by the GOT enthusiasm for a social welfare approach since independence. Private financial institutions, business councils and professional associations are still few in number and require substantial nurturing before they would be able to independently manage aspects of an assistance program. The university system, with some minor exceptions, retains a strong French academic flavor. It is a system ill-suited to the analytical problem-solving approach required in dealing with the transition of the economy.

In summary, the assistance strategy will take advantage of intermediary institutions to the extent possible in easing into collaborative implementation, and will encourage the emergence of local resource institutions that we can work with. Some capable institutions include several with which AID has worked in the transition strategy: Institute Supérieur de Gestion (ISG), Institut Régional des Sciences Informatiques et Telecommunications en Tunisie (IRSIT), two private commercial banks under the Section 108 Program, and the Institut de Financement du Développement du Maghreb (IFID). In addition, the Mission plans to continue its collaboration with Peace Corps in an effort to place appropriately skilled volunteers, especially in technology fields such as irrigation which AID has targetted. As the Mission becomes involved in more innovative technology and private sector endeavors we will need to be prepared to work in different modes depending on the capacity of cooperating ministries or organizations. We will be alert to opportunities to work with and to support the emergence of private groups, associations, and federations.

B. The Modalities

In the course of examining new or more innovative funding mechanisms for delivering development assistance to Tunisia, we have made three assumptions:

- **During the CDSS period the Tunisia program will continue with an annual ESF program estimated at $15 million in grant funds, with a food aid program estimated at $15 to $20 million per year and with continuing access to AID centrally funded activities;**

- AID as an agency will continue to have a physical presence in Tunisia with a lean staff during the CDSS period; and

- The concept of an endowed foundation, similar to the Portugal arrangement, is premature for Tunisia.

There are six funding mechanisms or modalities which the Mission has determined are most appropriate to its business in Tunisia in the CDSS period: project grant, program grant, commodity import program, PL 480 Title I, Section 416, and the HG program. The mix of these funding mechanisms will continue to provide to the Mission and to the GOT the flexibility needed to respond to the dynamics of the assistance program. We continue to view centrally funded projects as a major source of expertise and quick access through buy-ins from our portfolio.

With regard to projectized assistance, the Mission will reduce its current portfolio to eight active projects by mid-1989 with further reductions possible as older projects are completed by 1991. For the CDSS period, the Mission expects to design an efficient portfolio of four to five long term projects in the areas of policy, technology, private sector, and training. These projects would support the primary program emphases of the strategy, i.e. increased productivity and efficiency in the agriculture sector; private sector revitalization and expansion, improved match of labor supply and skills with market demands. Within each of these global projects, the Mission would seek to implement innovative components tailored to particular needs. The components would cover a range of possibilities: research grants to Tunisian institutions, funding of linkage agreements between Tunisian and U.S. institutions, support for joint ventures, etc.

The only one of six funding mechanisms identified above which is not currently being utilized is the program grant. Particularly in the agriculture sector, the Mission plans to examine the possibility of a program grant in lieu of a project, combining elements of policy analysis and implementation, introduction of technologies, support to fledgling agro-business concerns and commodity imports. The feasibility and utility of this approach in Tunisia have not yet been examined in detail.

Under the rubric of food aid, the Mission anticipates continued Title I and possibly Section 416. While it is expected that the local currencies use plan will be revised to parallel certain new strategy elements, the local currencies have already been applied to support a range of target programs including displaced labor absorption (through the Chantiers Program) and private sector expansion (through the Section 108 program). Further matching of local currencies generated by the food aid program will be explored in the CDSS analysis.

Staff resources at approximately the current levels will be needed to carry forward this strategy though between now and 1990 at least one additional USDH private sector officer will be essential to meet the early demands of strategy phase in and implementation. We will also need more operating expenses to support legal, contractor, and other direct hire TDY services. Some adjustment in staff mix will be in order. Given the lean staff it is imperative that we devise efficient programs that concentrate energies on implementation rather than frequent design documentation. The Mission's current strong reliance on evaluations conducted by outside experts will be maintained. Objective project and program evaluations, particularly mid-term reviews, will continue to serve as a valuable means of supplementing staff capabilities, of identifying innovative approaches, and of assuring responsiveness to the dynamics of an economy in transition.

VI. CDSS REQUIREMENTS AND TIMING

This strategy paper has gone farther in analysing and synthesizing Tunisian development directions and needs than we originally expected. As shown by the bibliography far more recent good analytical work and data existed than was first anticipated. As a result we have been able to define the broad outlines of a strategy for the 90's with considerable confidence. What we need now are certain additional data and in-depth analyses to determine the feasibility and the actual details of implementing such a strategy.

We plan to undertake or draw on the following analyses in developing our ideas and implementation plans:

	Analysis	Sponsor	Funding	Completion Date
1.	Employment Assessment	USAID	PDS	Dec. 89
2.	Tunisia's Economic Relations within Maghreb Economic Union and with EEC Post 1992	USAID	Prvt Sector Project	Dec. 89
3.	Public Enterprise Restructuring Plans and Implications	IBRD	NA	Sept. 89
4.	Updated Agricultural Strategy Statement	USAID	PDS	May 89
5.	Agro-Processing and Export Potentials and Assistance Priorities	USAID	PDS/APIP	Oct. 89
6.	Ag Pricing, Subsidy, and Marketing Studies	USAID/ MinAg	APIP	Dec. 89
7.	S+T Assessment Follow up	USAID	PDS	Nov. 89
8.	Trade and Investment Follow-up	USAID Min I+C	Pvt Sector project	Nov. 89
9.	Savings Mobilization Conference Results	USAID/ IFID	Pvt Sector project	May 89
10.	Private Sector Training Needs Assessment	USAID	Pvt Sector project	June 89
11.	WID Action Plan	USAID	Central Funds	Oct. 89

In view of the timetable for this analytical work and Mission work schedule we recommend that the next submission and review be scheduled for February of 1990 or later. We will also need additional PDs funds in FY 1989 to carry out these studies.

ANNEXES

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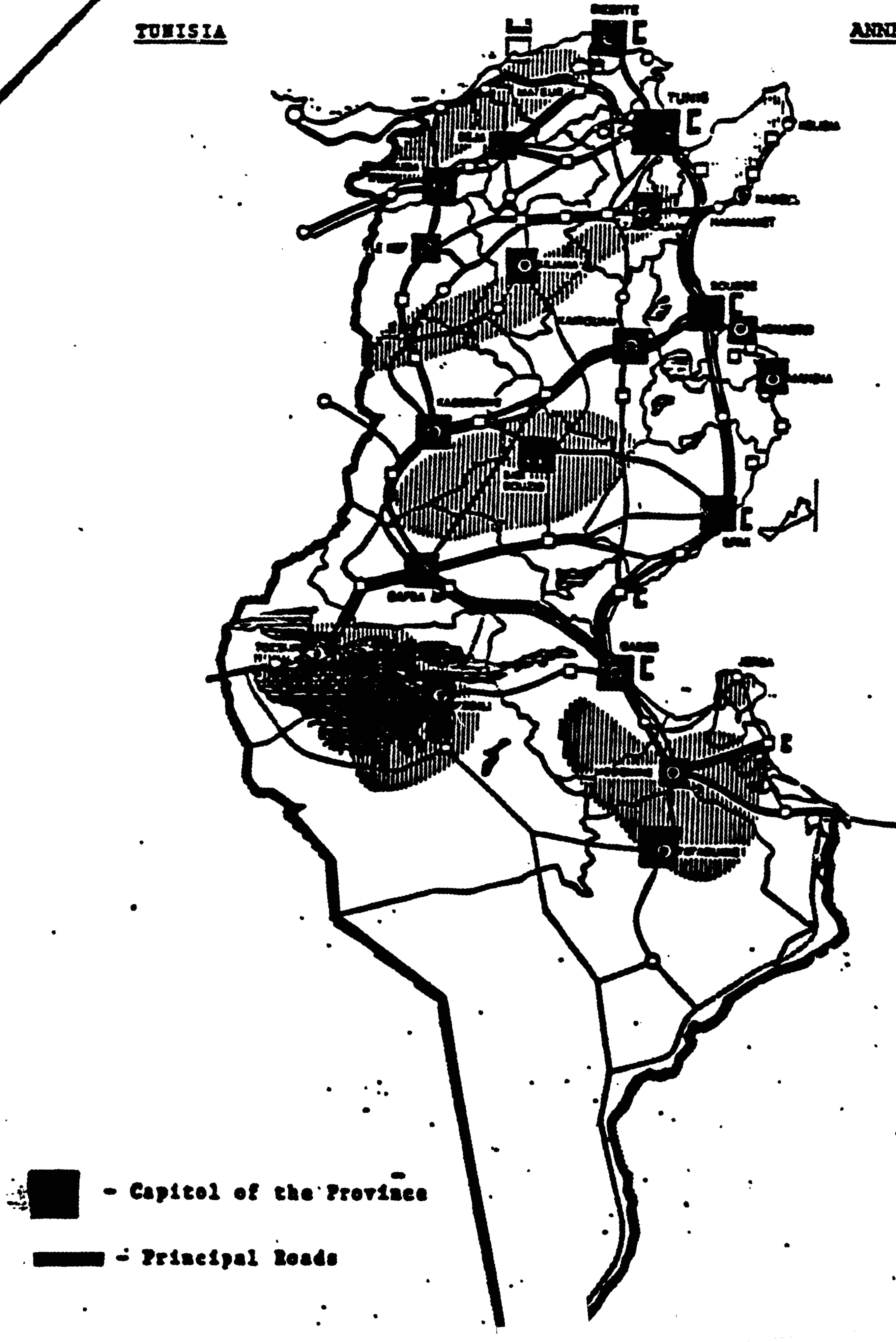
TUNISIA

ANNEX I



OTHER DONOR ASSISTANCE AND RELEVANCE TO STRUCTURAL ADJUSTMENT

AID FLOWS

The donor response to the Tunisian Structural Adjustment Program has been excellent. Net official assistance flows rose from $211 million in Pre-Adjustment 1985 to an average of $437 million between 1986 and 1989. In 1988 18% of Gross budgetary receipts were from concessional foreign sources demonstating the relative importance of donor assistance in the Adjustment Process.

MAJOR DONORS

The major donors in the adjustment process to date have been the IBRD, IMF, France, Italy, the EEC and the African Development Bank in that order. Other significant donors have been the USG, the Arab funds, Spain and Japan. Minor amounts of aid have been provided by Canada, Belgium, UK the FRG and the UNDP and specialized agencies.

IBRD

The IBRD is the major donor, with five Structural Adjustment related loans totalling approximately $500 million in its portfolio in addition to its regular lending program. It provides the leadership to the donor community in the policy area as well. The first loan, the Ag Structural Adjustment Loan I (ASAL I) was executed in October 1986 and provided $150 million in quick disbursing assets for agricultural commodities. Numerous policy changes were covenanted for the Ag Sector as well as for the economy as a whole. A large number of non covenanted policy suggestions were noted in the loan. Following closely was an Industrial and Trade Policy Adjustment Loan (ITPAL) for $100 million which covenanted numerous policy changes intended to liberalize industry and trade. Like ASAL I, this was a fast disbursing loan for commodities. An ASAL II Loan is presently in final negotiation and should be signed in March 1989. This will be partly fast disbursing assets and partly projectized. A fourth loan, the public enterprise restructuring loan will aim at revitalizing the mining and railroad companies, large users and losers of GOT official resources. This loan will also address the privatization of certain GOT Public Sector companies. A final program loan the SAL of $150 million was approved in the spring of 1988 and became effective in the summer. The further adjustment and rationalization of tax, and credit policies as well as subsidies, trade, foreign exchange and producer prices were conditions of effectiveness of the loan. Accompanying the IBRD's

SAP programs were loans to assist Ag Credit, and impact the social side of the SAP as well as education training and employment projects. A small and medium industry project was also recently approved.

U.S. programs are closely linked with IBRD efforts. The APIP project provides studies on various policy changes and was critical in permitting the GOT to meet conditions of effectiveness under ASAL I. The private sector project has fed data to the design of the PERL project and the expert in place in the prime minister's office will assist in promulgating the policies which will guide implementation of this loan. The UNDP is also involved in this Sector.

AFDB

In 1987 and 1989 the African Development Bank approved $205 million of support to the SAP. The most recent loans directly complement the overall SAL loan of $150 million and, with slight differences, carried the same conditions for effectiveness as the IBRD loan.

IMF

In July of 1988 the IMF approved an extended arrangement for Tunisia in an amount of $270 million. Conditions were aimed at rationalizing banking credit profile and the Government external debt maturity profile.

EEC

The EEC is a major donor, having committed $430 million since the start of the Adjustment Program. $195 million of this is in the form of loans from the European Investment Bank to be made available to Tunisian entities. The remainder includes capitalizing various Tunisian development Banking institutions and a few projects. The EEC has emphasized agricultural development, with large credits going to the agricultural development bank, irrigation projects and improvemental of crop yields. Tourism and improvement of the railroad system have also been targetted. All of the EEC activities complement the SAP.

FRANCE

The French Government has a regular program of approximatly $200 million per year, most of which is tied to French technical assistance and commercial endeavors. A large percentage of this is directed toward payment for seized French assets and French teachers (cooperants) Food AID is also provided.

While useful for Structural Adjustment the French Government has not made any extraordinary effort as have other donors to assist the GOT in the adjustment process with greater and more concessional resources. Perhaps the difficult economic issues which remain in contention between France and Tunisia accounts for this anomaly.

ITALY

The Italian Government has committed $600 million since the SAP started, a sharp increase in their usual levels. $100 million in credits for Italian products at highly concessional rates (1.75% 5 year grace 30 year pay back) was extended in October 1986 at the launching of the SAP. A second $500 million package comprised of $175 in new credits, a $75 million grant, $175 million for Italian development projects in Tunisia and $75 million for TA was approved during 1988. As the Italian credits are for goods, the drawdown has been relatively slow. Italian development projects are centered on the Southern part of the country and, although there has been some interest in using US Peace Corps Volunteers in these projects, close coordination in the field remains elusive.

OTHERS

Other donors, realizing the need for quick disbursing assets in the early years of the SAP (Tunisian foreign exchange reserves in June of 1986 approached $0), have come forward with concessional quick disbursing programs. Spain loaned $50 million as did Japan. The Arab monetary fund and Kuwait fund as well as other middle East donors made available slightly over $100 million in soft loans in February 1987. These were non projectized assets directed at permitting the Tunisian economy to function while the adjustments were made. Japan, at the urging of the USG provided a $50 million fully untied loan in early 1988 to support adjustment. The first drawing of this loan was for US spray airplanes for the locust campaign.

Canada and the FRG have been helpful with food AID and credits respectively. The FRG increased its yearly levels slightly and accelerated disbursements. The UNDP has continued its normal programs of technical assistance as have the specialized U.N. agencies.

DONOR COORDINATION

Communication between donors on the SAP and policies related thereto has been excellent and the GOT has supported these interactions.

The UNDP resident representative chairs informal meetings on a regular basis during which subjects of general interest are discussed. Most recently, these meetings discussed techniques of tracking and programming local currency generations and the donor response to the locust emergency. In the latter case, genuine cost savings resulted from a realistic projection of pesticide supply and demand which devolved from the donor meetings.

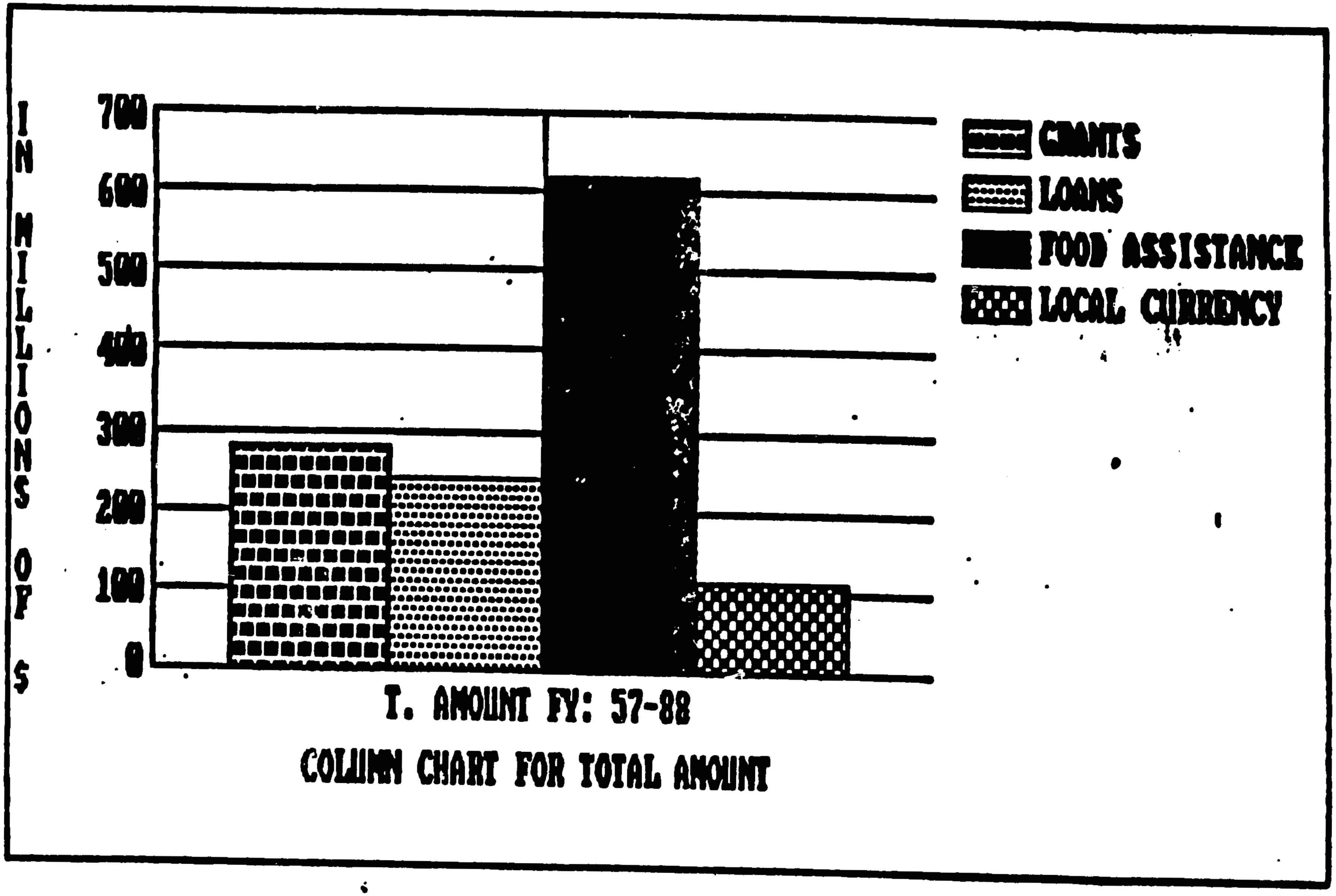
In February 1987, a major donor coordination meeting was held in Paris chaired by the World Bank. A full and frank discussion was held and the meeting succeeded in raising $270 million in additional assets. A major result of the meeting was the acceleration of drawdowns of existing lines of credit by the Tunisians and a confirmation of support from the donor community so long as the GOT continued to perform well against targetted objectives. Neither the IBRD nor Tunisia have seen fit to call another meeting and, given the close coordination amongst donor, none appears necessary at this time. There is no full time IMF or IBRD representation in Tunis, although IBRD Missions are in country 4-5 times per year.

The USG programs continue to be closely coordinated with those of the bank and there are numerous areas of synergy with other donors. Both the Belgium and World Food Program are collaborating with the PL-480-I funded workers program. The Italians are considering using some local currency in that program as are the Canadians. To date, communist country donors have not been involved with the SAP.

OUTLOOK FOR DONOR RESOURCES AND PRIORITIES

Future concessional assistance is not expected to rise at the pace of the last few years. IBRD lending will revert to its previous level and the extraordinary Italian transfers will probably not reoccur. It is expected that major inputs by other European nations will be through the EEC, which maintains a sizeable Mission in Tunis. French AID is expected to continue at existing levels. The GOT will probably use commercial credit markets more actively at the end of the current SAP. Tunisia's credit rating is excellent, with Tunisian paper trading at par or better. European programs will most likely continue to be closely tied to parochial commercial objectives in the outyears. Pressure to continue drawdowns as a respectable pace will be a constant requirement for the donor community.

U.S. ASSISTANCE TO TUNISIA
From FY 1957 through FY 1988
(in millions of dollars)



ANNEX IV

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