AGENCY FOR INTERNATIONAL DEVELOPMENT

Washington, D. C. 20523

PROJECT PAPER
AMENDMENT #6

TUNISIA: Private Sector Development
and Technology Transfer
(664-0328)

June 30, 1988

AGENCY FOR INTERNATIONAL DEVELOPMENT

PROJECT DATA SHEET

1. TRANSACTION CODE: C (A = Add, C = Change, D = Delete) — Amendment Number: 6 — DOCUMENT CODE: 3

2. COUNTRY/ENTITY: TUNISIA

3. PROJECT NUMBER: 664-0328

4. BUREAU/OFFICE: ANE — 3

5. PROJECT TITLE (maximum 40 characters): Private Sector Dev. and Tech. Transfer

6. PROJECT ASSISTANCE COMPLETION DATE (PACD): MM DD YY 09 29 91

7. ESTIMATED DATE OF OBLIGATION (Under "B." below, enter 1, 2, 3, or 4): A. Initial FY 82 — B. Quarter 4 — C. Final FY 89

8. COSTS ($000 OR EQUIVALENT $1 =)

A. FUNDING SOURCE	FIRST FY B. FX	C. L/C	D. Total	LIFE OF PROJECT E. FX	F. L/C	G. Total
AID Appropriated Total	1500		1500	7100		7100
(Grant)	(1500)	( )	(1500)	(7100)	( )	(7100
(Loan)	( )	( )	( )	( )	( )	(
Other U.S. 1.						
Other U.S. 2.						
Host Country						
Other Donor(s)		500	500		2000	2000
TOTALS	1500	500	2000	7100	2000	2000

9. SCHEDULE OF AID FUNDING ($000)

A. APPROPRIATION	B. PRIMARY PURPOSE CODE	C. PRIMARY TECH. CODE 1. Grant	2. Loan	D. OBLIGATIONS TO DATE 1. Grant	2. Loan	E. AMOUNT APPROVED THIS ACTION 1. Grant	2. Loan	F. LIFE OF PROJECT 1. Grant	2. Loan
(1) ESF	760	840		4700		500		6800	
(2) ARDN	120	080		300				300	
(3)									
(4)									
TOTALS				5000		500		7100	

10. SECONDARY TECHNICAL CODES (maximum 6 codes of 3 positions each): 920 | | 873 | 874 | 900 |

11. SECONDARY PURPOSE CODE: 700

12. SPECIAL CONCERNS CODES (maximum 7 codes of 4 positions each)

A. Code	PRE						
B. Amount							

13. PROJECT PURPOSE (maximum 480 characters)

This project has two purpose-level objectives (1) To encourage the Tunisian private sector to play a more dynamic role in achieving national economic targets/ (2) to increase the returns and/or the continued effectiveness of completed or nearly completed AID projects.

14. SCHEDULED EVALUATIONS: Interim MM YY 10 85 | MM YY | Final MM YY

15. SOURCE/ORIGIN OF GOODS AND SERVICES: [x] 000 [ ] 941 [x] Local [ ] Other (Specify)

16. AMENDMENTS/NATURE OF CHANGE PROPOSED (This is page 1 of a ____ page PP Amendment.)

This Amendment adds funds to increase the level of project activity. These funds will be used to continue activities in privatization, financial markets, trade expansion/liberalization and selected other private sector support.

17. APPROVED BY — Signature: Charles F. Weden, Jr. — Title: Director, USAID/Tunis — Date Signed: MM DD YY 06 30 88

18. DATE DOCUMENT RECEIVED IN AID/W, OR FOR AID/W DOCUMENTS, DATE OF DISTRIBUTION: MM DD YY

AID 1330-4 (8-79)

AMENDMENT NO. 6

TO PROJECT AUTHORIZATION

Name of Country: Tunisia

Name of Project: Private Sector Development and Technology Transfer

Number of Project: 664-0328

1. Pursuant to Section 531 of the Foreign Assistance Act of 1961, as amended, the Private Sector Development and Technology Transfer Project for Tunisia ("Cooperating Country") was authorized on September 29,m 1982 and amended on August 29, 1983, on April 27, 1984, on April 15, 1986, on September 11, 1986, and on September 24, 1987 ("Authorization"). The Authorization is hereby further amended as follows:

a. From paragraph 1 delete the phrase "involving planned obligations of Five Million United States Dollars ($5,000,000) in grant funds over a six year period from date of authorization" and insert in lieu thereof "involving planned obligations of Seven Million One Hundred Thousand United States Dollars ($7,100,000) in grant funds over a nine year period from date of authorization".

b. From paragraph 1, last sentence, delete "six years" and add "nine years".

2. Except as hereby amended, the Authorization cited above remains unchanged and in full force and effect.

Charles F. Weden, Jr.
Director

Date: 6/30/88

PROJECT PAPER AMENDMENT NO. 6
TO THE
PRIVATE SECTOR DEVELOPMENT AND TECHNOLOGY TRANSFER PROJECT
(664-0328)

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A. THE DEVELOPMENT CONTEXT

Opportunities for USAID involvement in private sector development have opened as a result of Tunisia's need to restructure and liberalize its economy. The Tunisian Government has already adopted a number of economic reforms as part of its Structural Adjustment Program. The VII Development Plan for 1987-91 aims to carry out additional reforms to further the adjustment process. The upshot of these reforms will be a much greater reliance on the private sector as the source of investment and growth.

For the time being, however, the Tunisian economy remains an essentially state-dominated economy. Significant changes in the economy will require decisions and actions at the state level. For this reason, the USAID strategy focusses on assisting the government to make some of the necessary policy changes designed to create a level playing field for the private sector.

USAID has selected three targets for its private sector strategy: privatization, capital markets development and trade liberalization. The Tunisian Prime Minister's economic advisor noted in a recent conversation that these targets are in direct sync with the Tunisian Government's economic needs and priorities.

1. PRIVATIZATION

a. Statement of the problem

Privatization is one element of the Tunisian government's plan to move away from a state-dominated economy. According to the Governor of the Central Bank, the ratio of public to private-sector ownership in Tunisian enterprise is 60:40.

As reported recently in the *Middle East Economic Digest* (1/2/87), the Governor of the Central Bank said, "we want to reverse this."

Parastatal enterprises dominate the economy in other ways. They provide 60 percent of exports, 20 percent of GDP and 33 percent of all wages. They employ nearly 50 percent of the workforce in the formal productive sector, and more than 10 percent of all productive employment (this excludes public administration). They account for 36 percent of gross value-added in the economy. While these figures are from 1983, they are representative of the current balance of private and public sector roles in the economy.

There are approximately 500 public enterprises in Tunisia. The World Bank estimates that 200 of these enterprises have more than 50 percent state ownership; the remaining 300 have minority or indirect state ownership. Nearly a quarter of all state-owned enterprises are considered "strategically important" and will not be eligible for privatization.

State-owned enterprises in Tunisia are noted for their lack of efficiency due to poor management. The new regime has moved quickly to make its mark on parastatal management; President Ben Ali's leadership brought major changes in the top management of a number of public enterprises in the financial, agriculture, transport and energy sectors. The new elite of public enterprise is composed largely of technocrats, who are said to heartily endorse economic reform and liberalization.

New management may help to reduce some of the inefficiencies in public enterprise. Nonetheless, the government can ill-afford to maintain the financial burden of several hundred enterprises which have incurred chronic deficits. Given limited revenues and high debt obligations, privatization is a financial necessity.

b. Government policy toward privatization

The Tunisian Parliament passed Law 87-47 on August 2, 1987 to create a framework for restructuring and privatizing state-owned enterprises. This law and an amendment currently before the Parliament represent landmark decisions by the government to pursue privatization in a systematic fashion. The amended law provides for the creation of an inter-ministerial committee (CNARFP, The National Commission for the Assessment and Restructuring of Public Enterprise), which will serve to select those enterprises to be restructured and/or privatized. Under the new law, foreign investors are encouraged to purchase shares in privatized companies.

c. Implementation of policy

Privatization is moving at a cautious pace to date -- and purposefully so. The governor of the central bank notes: "We are not in a hurry. Privatization is a slow process, but it must be started".

The process has started. About 30 firms have been singled out for privatization in the near-term, primarily textile firms and hotels. Building materials and trade will also be key sectors for privatization. Concrete steps toward privatization include:

SITEX: Societe Industrielle des Textiles. This firm is Africa's largest producer of denim jeans. The International Finance Corporation (IFC) and a Tunis-based Saudi/local bank, the BEST bank, are current working to bring SITEX to majority private ownership. The IFC had previously taken a 15 percent share in the company, however, a 30 percent share has already been sold to Canadian investors. Bankers say that the company's good reputation will encourage local investment as well.

SITER: Sociéte des Industires Textile Réunies. The IFC is also playing a major role in the privatization of SITER. Private Tunisian investors -- the Banque Internationale Arabe de Tunisie and the Banque de Tunisie -- will purchase 16 percent of the shares, bringing SITER's private ownership to 51 percent.

SOMOTEX: Société Monastirienne de Textiles. This is a semi-integrated spinning and weaving company set up in 1979. The proceeds from the sale of SITEX will be channelled into SOMOTEX. Somotex is expected to invite equity investment from the private sector in the near future. There appears to be considerable interest from private European investors.

Three state hotels have been sold and another fifteen are soon to be placed on the market.

The political decision to pursue privatization is in place. The actual implementation raises a number of thorny issues however. Foremost in the minds of many Tunisians are the employment impacts of privatization. State-owned enterprises have long been used as a vehicle for absorbing the country's growing labor force. The government hopes to minimize the adverse impact through gradual implementation of the privatization program, but this is clearly an area where the Tunisians need and want advice and expertise.

A second difficult issue concerns how to place a value on the firms being privatized. This raises technical questions of how to judge the real market value of an enterprise, as well as political issues. The Tunisian government cannot afford to be perceived as "selling the goods cheaply," particularly in light of the role foreign capital may play in Tunisia's privatization process. The Tunisian government needs assistance in developing a methodology for assessing the value of its enterprises.

Lastly, there is the issue of "how to" privatize: the techniques and mechanics of privatization. Many countries have adopted plans to divest public enterprises and have implemented these plans with varied levels of success. There are lessons to be learned and shared from the experience to date. The "how to" question also has important implications for the development of financial markets.

2. FINANCIAL MARKETS DEVELOPMENT

a. Statement of the Problem

Government revenues were the primary source of investment for the Tunisian economy until the economic crisis of 1986. During the past three years, however, the government investment budget has been steadily cut in line with overall reductions in public revenue and expenditures. The public sector can no longer carry the burden of investment, and will look to the private sector to increase its share of investment. The VII Development Plan calls for a real increase in private sector investment from 24% of total investment in 1986 to 38% of investment in 1991.

Such increases in private investment are contingent, however, on the availability of long-term finance to meet the private sectors' capital needs. Access to medium and long-term credit is extremely constrained in Tunisia. More than 75% of commercial credit is in the form of short-term loans secured by collateral, and the level of collateral required by banks is beyond the reach of most firms, especially small and medium-scale enterprises. In addition, public enterprises have tended to earn first priority in obtaining what little long-term finance is available. In the absence of increased access to long-term finance, private sector investment and growth will be seriously impeded.

Efficient means of mobilizing and allocating finance are most important during periods of declining revenues. Tunisia has had a fairly nigh rate of savings over the past decade, averaging about 20% of GDP, but these savings have tended to flow to static investments rather than more productive investments with higher returns. Furthermore, this high level of savings reflects in large part the government surplus generated before the economic squeeze; as one would expect, the savings rate has dropped sharply in recent years.

A functioning capital market is also critical for successful privatization. First, the buyers of state-owned enterprises will require access to long-term finance to purchase and restructure firms. Secondly, financial markets provide the most effective mechanism for ensuring wide-spread ownership of privatized firms. The danger of promoting privatization without well-developed financial markets is that the beneficiaries are more likely to be limited to a few large families or institutional investors.

All of the above conditions call for the development of financial mechanisms that can effectively capture savings and channel them to productive investments. The financial markets in Tunisia are very shallow though. There is a "functioning" stock market, but there are few firms involved in active trading. The range of financial instruments available in Tunisia is also very limited.

b. Government policy toward capital markets development

As part of structural adjustment, the Tunisian government adopted a number of financial reforms in 1986 to address these problems. This package of reforms marked the government's recognition of the importance of financial systems in the Tunisian economy.

The reforms aimed to make interest rates more flexible and instill a more competitive environment among local financial institutions. Banks were to be given more discretion in setting interest rates for deposits and loans, rather than having them set by the central bank. In practice, however, the reforms did not fully achieve their objectives. Interest rates are still tied to a money market rate, which in turn is set by the government, and the portfolios of local banks remain subject to considerable control. The spread that banks can earn is set at 3%, which restricts their capacity to lend to more risky customers.

The Tunisian Parliament passed an additional set of reforms on August 2, 1987 to promote investment in the economy. The new legislation, Law 87-51, reforms Tunisia's Industrial Investment Code. The most important changes include incentives for export industries and a streamlined process for obtaining investment approvals. While these reforms do not directly impact on financial markets, they could have an important effect on the overall investment climate.

Under the new law, the Industrial Promotion Agency (API) will continue to regulate and promote investment in Tunisia. Its new role is to focus more on promotion though, and less on approvals and regulations. As part of this reorientation, API will carry out feasibility studies and organize training programs to assist firms. This will not be an easy transition for API though. The organization will have a major hurdle to cross in gaining the confidence of the private sector after years of attempting to control and regulate its activities.

Lastly, the Tunisian government introduced a number of fiscal reforms in October 1987, which were reportedly well received by the business community. One of the most important reforms provides an extension of amnesty for Tunisians who have not paid their taxes the past four years, but overdue funds must be used for investment. The package also provides for lower interest rates in an effort to boost investment.

c. Implementation of policy

The Tunisian government has taken some important steps toward improving the environment for financial markets development. These are initial steps, however, that must be supplemented by additional policy reforms. Again, political will is not the problem; the more difficult challenge is translating that will into concrete institutions, programs and actions.

The need for efficient financial markets will grow stronger as Tunisia moves forward with privatization. Meeting these dual objectives -- efficient financial markets and privatization -- will require reducing a number of barriers in the legal, fiscal and regulatory environment.

First, Tunisia's complex system of taxation serves to discourage the development of financial markets. In a recent survey funded by the USAID/Tunisia, Tunisian businessmen identified the government's fiscal policy as a major impediment. Taxes on firms' profits at the shareholder level can be as high as 82%; this clearly acts as a disincentive to potential shareholders. The taxes on financial intermediation are also very high, which reduces banks' motivation to collect deposits and lend funds.

In accordance with structural adjustment, the Tunisian government plans to introduce new fiscal legislation in 1988. This will include new financial guidelines and regulatory structures for the Tunisian stock exchange and other financial institutions. The prospect of revised tax legislation offers a unique opportunity for USAID to provide expertise to ensure that fiscal reform will promote financial markets development.

Another important constraint to the development of capital markets is the lack of reliable corporate financial statements. The tax system described above encourages firms to keep multiple sets of accounts, and hence, undermines the credence given to balance sheets. Fiscal reform may address part of the problem, but there is also a need to establish generally-accepted accounting and auditing principles.

Tunisian businessmen are generally risk-averse, particularly if the gains are likely to be realized in the long-term. This could impede the development of capital markets and privatization unless some form of protection is provided to investors. Many countries have developed systems to provide increased investor protection; knowledge of the experience of these countries would be valuable to the Tunisians.

Lastly, the lack of trained financial professionals in Tunisia will also impede capital markets development. Training is needed to develop a cadre of securities markets professionals, including accountants and appraisers.

3. TRADE EXPANSION AND LIBERALIZATION

a. Statement of the problem

Trade liberalization will imply major adjustments for the Tunisian economy; adjustments will have to be made not only at the macro-economic policy level, but also at the level of individual firms. Tunisian enterprises have operated in a highly protected and non-competitive environment for more than a decade. Trade barriers and price controls have protected business from having to confront international competition. The upshot? Low productivity and efficiency, excess capacity, and a reluctance to explore new markets.

The sharp increase in the 1986 trade deficit forced the government to reorient its strategy toward developing a more open and export-oriented economy. Tunisia's traditional export industries, oil and phosphates, will continue to face difficult prospects. The new export orientation will thus shift from public sector industries to the private sector. Manufacturing will replace oil as the key to Tunisia's economic growth. During the next five years, the manufacturing sector is expected to provide 27% of new jobs and 40% of exports.

Export growth is contingent, however, on creating an environment in which the private sector can work. The past is illustrative. The VI Development Plan for 1982-86 gave priority to lowering the trade deficit; in practice, this meant severe cuts in imports. Private firms were unable to import the raw materials and equipment they needed, and thus, were unable to produce for export. In sum, excessive government control had an adverse impact on export growth and the trade deficit.

Trade liberalization is an important and necessary step toward creating an environment conducive to private sector export-led growth. Creating the right environment will be a top priority for the Tunisian government; learning to cope in this more competitive environment will be a top priority for the private sector. For firms that have grown dependent on the benefits of a protected economy, liberalization may come as a shock. For more productive firms, liberalization will offer significant advantages.

b. Government policy toward trade liberalization

Attempts to reduce the trade deficit in the VI Development Plan were based on greater government control: controls on imports, investment, prices and general business operations. This approach backfired, and in effect, exacerbated the trade deficit. In line with structural adjustment, the Tunisian government has taken steps to reduce these controls, but "letting go" will be a gradual process, in part, to cushion the impact on previously protected industries. These steps to create a more open trade regime are supported by the World Bank's $150 million Industrial and Trade Policy Loan.

Trade liberalization has involved policy reforms both the import and export sides of the trade ledger. On the import side, trade reform has meant a gradual dismantling of Tunisia's complex system of tariffs, licenses and restrictions. Import duties have been greatly reduced, particularly on the materials and equipment required for export production. As of January 1987, the minimum and maximum import duties were set at 15 percent and 50 percent, respectively. By the end of the VII Development Plan Period, Tunisia plans to have in place a relatively free trade regime, with duties ranging from 15 to 20 percent.

Tunisian businesses have traditionally been required to obtain a license for each import. This has often taken up to six months, a clearly unacceptable time lag for international business. The government plans to eliminate all import licensing by 1991.

On the export side, the government has attempted to stimulate and diversify non-oil export production. The effective devaluation of the Tunisian dinar by 20% in 1986 was a important first step. This has been followed by dramatic reductions in the controls that have hampered exporters to date. Exporters are now able to invest and operate in an environment that is relatively free from administrative controls, other than those designed to ensure that their production is actually for export.

Under the government's new Industrial Investment Code, exporters are eligible for full exemption from all taxes on profits; the distributions on profits are also tax exempt. They may import capital goods and intermediate inputs, free of duties and import licensing requirements. They also do not need to seek approval for new investments. To the extent that firms are foreign owned, they need not surrender their foreign exchange earnings. This is a very attractive set of incentives. Most importantly, all of these provisions apply automatically without the need for case by case approvals.

c. Implementation of policy

The Tunisian government is moving in the right direction to create an environment that will encourage private sector export production. The signals are right, but the question of whether firms will be able to adjust to the new signals remains open.

As a result of having operated in an environment which limited the scope for competition, Tunisian enterprises will face considerable adjustment as the government proceeds with liberalization. The government is concerned about the future of industries that have grown to depend on protection, but insists that they must adapt to the new economic enviroment. The government's solution is gradual liberalization.

The governor of the Tunisian central bank notes that "in order to protect these industries, we have given them a five-year period to adjust to the new situation. We intend to give them an effective protection of 25 per cent at the end of the period, mainly in terms of customs duties. If they cannot change, they should quit the business -- it would imply a waste of resources for them to continue" (reported in the Middle East Economic Digest, 5/30/87).

Change at the macro level is in motion, but change at the micro level may prove to be more difficult. First, Tunisian firms are generally unfamiliar with international markets. A recent private sector survey funded by the mission indicates that businesses are generally not oriented toward overseas marketing. They have long focused their production on the domestic market. They are equally comfortable with their traditional French trading partners, but have failed to seriously explore new markets for their goods. The major impediment appears to be lack of information. This is an area where the Tunisian private sector needs assistance.

Secondly, Tunisian firms tend to be risk-averse, particularly if the gains can not be realized in the short-term. Selling in overseas markets automatically implies greater risk. As part of developing private sector exports, it will thus be necessary to encourage the notion of greater risk-taking.

Thirdly, Tunisian entrepreneurs lack some of the technical and managerial skills required for international business. This is particularly true of marketing skills. The private sector survey indicated that enterpreneurs do not typically keep informed of recent technical developments in their field. Again, the major constraint appears to inability to access information. It is surprising that only 6% of all enterprises belong to industry or professional assocations. Strong associations would be able to provide valuable information and services to the Tunisian business sector, in addition to providing a forum for discussions and negotations vis-a-vis the government.

B. THE PROJECT

1. PROJECT ASSISTANCE THROUGH AMEMDMENT NO. 5

The mission has funded a broad array of activities to promote private sector development. These have tended to be small discrete activities, some having positive results. Taken in the aggregate, however, these activities have had only mixed impact on private sector development in Tunisia.

Prior interventions in training and specific skills development along with targetted activities such as the small and medium scale business consulting have had the most real impact. Prior investment promotion activities have generated little impact on either domestic or U.S. investment in Tunisia.

USAID's ongoing private sector project was initially obligated in September 1982. Over five years of implementation experience have been gained. This project was a forerunner of USAID's present and future private sector program and served as a basis for pilot activities or experimental forays into diverse areas of private sector support. Experience gained so far has demonstrated, at least in the Tunisian case, that USAID's comparative advantage lies more in policy development and less in direct interventions with specific businesses. In this regard, the focus presented in the strategy with three emphases on privatization, financial markets and trade, appears to hold unique potential returns to effort.

The following is a summary of the project support to date with particular emphasis on private sector activities:

The Entrepot Conference
Following a [illegible] Conference on installing the free trade zone concept in Tunisia, USAID financed a trip to the U.S. for Tunisian businessmen and bankers. The aim of the trip was to follow-up on leads developed at the conference for joint venture possibilities.

General Investment Conference
This conference brought together U.S. and Tunisian businessmen and investors to discuss joint venture activities with companies involved in the auto parts and related businesses, among others.

The General Motors Conference
This conference enabled Tunisian investors interested in producing auto parts for export to meet potential joint venture and trading partners in the U.S.

The [illegible] Conferences
[illegible] conferences on privatization in Tunisia. The [illegible] April 1987 focussed on "why" countries should [illegible] privatization; the second conference in April 1988 focussed on "how" to privatize. Both conferences were well-attended, and served to stimulate discussion and debate on privatization in Tunisia.

The Management and Technical Access Project (MTAP)
The Mission bought into this centrally-funded project to finance the trade and investment promotion activities of Georgetown Venture Trading Associates.

The International Executive Service Corps
The Mission attempted to provide technical assistance to Tunisian businesses through the IESC, but the program was fraught with problems. The IESC had seven country directors in one year. The cost of IESC assistance was not competitive with the cost of French technical assistance. Lack of French was also a problem for many volunteers as well as an apparent mismatch of IESC skills available [illegible] expressed by Tunisian entrepreneurs.

The Small Business Assistance Program
[illegible] signed and implemented by Catholic Relief [illegible] long-term consulting services to small enterprises. Small businesses have benefitted from the assistance, and the program will be expanded to other regions. Based on the implementation success of this program, the Tunisian government and a large private sector organization will continue activities with no further USAID or CRS financial support required.

Informal Sector

USAID co-developed and co-financed a conference on industrialization and the Informal Sector in Tunisia. USAID financed a number of U.S. and foreign experts in this 5-day conference which examined the role of the informal sector in job creation, capital formation and provision of cost effective goods and services.

Financial Markets Conference

The project financed a two day seminar on various financial market development topics to assist in financial markets stimulation.

Buy-In to the Center for Privatization

This program was signed by USAID and the GOT Prime Ministry on March 11, 1988 and provides for a range of services in privatization and financial markets development and support, including long term advisor support.

Save the Children Private Voluntary Organization

The project has financed grants to this organization to finance establishment of a Tunisian private voluntary organization and implementation of community based integrated rural development activities.

Housing Development Activities

The project has financed a number of training activities and studies/assessments of lowcost housing in Tunisia.

Other Private Sector Support

Project financing has been directed to:

- Equipping a library at a major Tunisian business school

- Several investment coordination seminars, conferences and workshops focused on domestic and foreign investment promotion

- A series of agricultural policy studies as precursors to USAID's APIP project and World Bank structural adjustment loans

- Other training programs and seminars for GOT and private sector individuals

- Assistance to USAID's project in Central-West Tunisia.

In sum, the mission has tried to encourage private sector development through a wide range of activities. The results have been mixed. On the one hand, conferences and activities intended to bring together Tunisian and American businessmen have yielded few concrete results. Deal making and brokerage activities such as our MTAP buy-in yielded few tangible results and proved to be cost ineffective. Despite high expectations on both sides, no joint ventures or trading relationships have developed from these activities. The mission has been more successful in its small enterprise program and in providing training and policy support to strengthen the private sector. Additionally, the Mission has been uniquely successful in developing and maintaining a progressive and substantive policy dialog on privatization and financial markets through its two privatization conferences and the first Tunisia-International Financial Markets Conference. These three activities were the initial activities in USAID's buy-in to the Center for Privatization Contract for a program of privatization and financial markets development and policy support.

Through these varied activities, the mission has learned a lot about what works and doesn't work in Tunisia. We now stand in a better position to "rethink" our approach to private sector development. The question is, given limited resources available to the mission, how can we ensure that our activities will have an impact on private sector development?

USAID has limited program funds and staff to devote to its numerous programs. At the same time, the new Tunisian government has accelerated its structural adjustment program in the areas of privatization, financial markets and trade. Windows of opportunity are present for substantive interventions with high potential policy payoff. Given all of the above parameters, USAID's private sector strategy must be predicated on a concentration of resources on a limited number of areas in which the Tunisian government has a serious and medium to long term interest.

2. PROJECT ASSISTANCE UNDER AMENDMENT NO. 6

Amendment No. 6 to the Project Paper provides a two year extension of the Project Assistance Completion Date (PACD) to September 29, 1991 and increases AID's life of project funding contribution by $2 million to a new total of $7.1 million.

The amendment will affect the following: (1) intensification of USAID's privatization and financial markets program through the Center for Privatization (CFP), (2) development of a set of trade and investment activities which respond to current USAID T&I policy under its ongoing economic structural adjustment program, and (3) provide time and resources to bring privatization efforts to fruition.

A.I.D. assistance provided under Project Paper Amendment No. 6 will support the following types of activities. All activities respond to the need to ameliorate the problems articulated in Part A (The Development Context) of this amendment.

(a) USAID Support for Privatization

The Mission's top priority for private sector development is to support the Tunisian Government's privatization program. We will provide technical advice/expertise and training to the CNAREP (The National Commission for the Assessment and Restructuring of Public Enterprise, the Tunisian stock market and privatized companies). The ultimate objective of this assistance is to increase the efficiency of productive enterprise in Tunisia. To summarize USAID's proposed support:

(1) Policy Dialogue: USAID will provide assistance to improve the policy framework for privatization. This will include assistance to promote changes in the legal, fiscal, regulatory and institutional environment, which in turn affect privatization. A first step toward bringing these issues to the table was through the USAID-financed Privatization Conferences, held in April of 1987 and April 1988.

(2) Technical Assistance: The Mission will provide long and short-term expertise to the CNAREP to assist in the "how to" of privatization. This will include assistance in the following areas: privatization planning; financial analyses and audits; company valuation; the marketing of public enterprises; and the financing arrangements involved in privatization. Technical assistance will also be provided to privatized companies to ensure better performance.

(3) Studies/Assessments

The top priority for studies will be the employment impacts of privatization. The issue of investor protection after privatization will also be important to study.

(b) USAID support for capital markets development

While USAID's top priority is to support privatization, the development of financial markets is a necessary corollary. The promotion of financial markets and privatization are mutually reinforcing in that:

--financial markets provide the mechanism to transfer equity from the public to the private sector, particularly if privatization is to provide wide-spread benefits.

--privatization can stimulate the mobilization of local capital because it provides new opportunities for private sector investment.

Both USAID and the Tunisian government recognize the close link between privatization and financial markets in our respective strategies. For this reason, our second priority for private sector development is to provide assistance to expand and deepen capital markets. The mission's activities in financial markets development will include:

(1) Policy Dialogue: USAID sponsored Tunisia's first major conference on financial markets in May 1988. This will focus the attention of senior policy-makers on the importance of additional reforms to improve the environment for capital markets development. Tax reform and its impact on financial markets will be a major item for the mission's private sector policy agenda, as will revisions in Tunisia's commercial code.

(2) Technical Assistance: USAID will provide long and short-term expertise to the stock exchange to activate securities trading. This assistance will be closely linked to the expertise we are providing in privatization. For example, we will provide expertise to develop transaction plans for the sale of state-owned enterprises and develop the necessary financial instruments and procedures to broaden the benefits of privatization. Improved systems for financial disclosure will also be important.

(3) Training: USAID will provide short-term training in finance, accounting and stock market mechanics. It will also provide funds for observation trips to U.S. and developing country financial centers.

(4) Studies/Assessments: Studies will support USAID's policy dialogue agenda. The top priority will be to examine the impact of tax reform on financial markets development. Other studies might include an analysis of Tunisia's commercial code or a study on investor protection mechanisms.

(c) USAID support for trade liberalization

The Tunisian government has already made significant progress in opening the economy. The World Bank will continue to assist in creating the right policy framework for export-led growth through its Industrial Trade and Policy Adjustment Loan and the upcoming Structural Adjustment Loan. Unless the constraints at the micro-level are addressed, however, there will be a large gap between policy and results.

USAID can assist in bridging this gap through technical assistance and training. It is important to note that the mission is just beginning to explore opportunities for assisting the trade sector.

In the refinement of the activities under this component the Mission will address the dual objectives of expansion and liberalization of Tunisia's trade and of increased trade and investment with the U.S. These complementry objectives are in keeping with both Agency policy and, more specifically, with Asia Near East Bureau policy. The most significant impact on increasing Tunisia/U.S. trade will undoubtedly stem from three factors: gradual movement of Tunisia's economy into private sector ownership; new focus on an economy driven largely by an export sector forced to compete in world markets; and, lastly, increased imports aimed at making the domestic market producers more efficient.

Tunisia plans to borrow heavily from U.S. financial, commercial and management concepts in both of these areas. To the extent that specific project interventions can assist in this process, resources will be directed at them. To measure the success of the trade liberalization support provided under the project, the following benchmarks will be used:

--Percentage increase in Tunisia's agricultural and merchandise exports to and imports from the U.S.;

--Number of new U.S. commercial investments and joint ventures in Tunisia on an annual basis;

--Percentage increase in COTUNACE export guarantees for the U.S. market.

Based on evidence to be developed through further analysis, interventions in the trade area will be drawn from the most productive of the following illustrative set of activities.

(1) Savings Mobilization, Financial Markets and Trade Policy Program:

Activity in this area would include two principal components:

(a) Applied research on policy changes needed for:
- increased real savings mobilisation
- stimulation of financial markets development
- privatization
- trade

(b) A multi-country conference to discuss and debate the applied policy research completed and make substantive recommendations to the governments of Mauritania, Morocco, Algeria, and Tunisia. Policy research and the conference will focus on the four francophone countries of North Africa (Mauritania, Morocco, Algeria, Tunisia).

A number of applied research policy studies will be produced in a long term effort ending in mid 1989. These documents will analyze high level policy issues germane to the four Maghrebian countries participating.

The objectives of the activity are:

--To identify policy issues and recommendations for constructive action in:

- savings mobilization
- financial markets development
- trade expansion/liberalization

--To create the analytical foundation and policy forum for affirmative and results-oriented policy dialog in the above three areas.

--To establish a consensus for policy change among the four participating governments which will lead to increased, sustained real growth of their economies, and

--To improve understanding of the policy frameworks and operations of the political economies of the four participating countries to enable further movement towards a Maghrebian Common Market.

(2) Technical Assistance to COTUNACE: COTUNACE provides export credit insurance to the Tunisian private sector. Export credit insurance is important becauses it reduces the cost of taking risk to the entrepreneur. An exporter can take the additional risk of selling to new buyers and new markets, knowing that he is insured in case of lack of payment.

The current policies of COTUNACE impede exporters from entering important markets. COTUNACE will insure shipments to the Maghreb, Europe, North America, and some Middle East and Asian countres. It does not provide insurance for countries in Latin America or Sub-Saharan Africa. These markets should be exploited by the Tunsian exporter. USAID will explore the possibility of providing assistance to strengthen COTUNACE's ability to assess risk in developing countries; wider insurance coverage would help to expand and diversify Tunisia's export markets.

(3) Technical Assistance to FEDEX: FEDEX is Tunisia's equivalent of the National Association of Manufacturers. Due to the weak status of industry associations, FEDEX provides one of the few forums for dialogue between the private and public sectors. As the government looks increasingly to the private sector for investment and growth, this forum for dialogue will become more important. The mission intends to look at how it might assist in making FEDEX a stronger institution for representing the private sector's interests and needs.

(4) Technical Assistance to ISG: The Institut Superieur de Gestion (ISG) provides business training. In order to address the lack of technical/managerial skills noted above and based on analysis to be carried out in FY 89 to identify optimum means of inervention, USAID will consider providing support to ISG's courses for mid-level managers.

(5) Technical Assistance to CEPEX: The Center for the Promotion of Exports is a source of information for Tunisian exporters. It could potentially be a much stronger source of information with limited technical assistance. We will explore opportunities for assisting CEPEX address some of the information constraints described. For example, the development of an information database on new markets and potential trading partners would be very useful to exporters.

3. PROJECT FINANCING

The total cost of this project from its inception in FY 1982 through 1991 is estimated at U.S. 9.1 million. Of this total, and subject to availability of funds, U.S. 7.1 million will be funded by A.I.D. with the balance (equivalent to an estimated U.S. $2.0 million) to be contributed by the Grantee. The Project Budget appears at Annex I.

A. FY 1988 Funding

A.I.D. will provide $0.5 million in assistance during the 1988 U.S. Fiscal Year. The Government of Tunisia will provide additional in-kind support to cover costs of activities, as needed, estimated at $150,000 equivalent.

A.I.D. assistance provided under PROAG Amendment No. 6 will finance the following types of activities:

a. Privatization Support: Under this component, A.I.D. will finance additional costs of follow on efforts to the Tunisian privatization program with the Prime Ministry and the Tunis Stock Exchange. This program is implemented by the Center for Privatization, a consortium of U.S. companies with specialized expertise in privatization and financial markets.

b. Financial Markets Support: A.I.D. will finance additional costs of the continuing efforts of the Tunisian Government to stimulate and develop its stock exchange and its financial market system. This program also is implemented by the Center for Privatization.

c. <u>Trade Expansion and Liberalization:</u> A.I.D. will finance several activities designed to assist Tunisia to expand its international trade and investment and to deregulate its policy framework surrounding trade:

(1) Applied research on trade policy and savings mobilization for investment in the productive private sector in the Maghreg region. Up to fourteen research papers and monographs will be produced. A five day multi-country policy conference on trade, savings mobilization and investment is planned to provide a forum for discussion of substantive policy reform;

(2) Technical assistance and training for the Federation of Private Exporters (FEDEX);

(3) Technical assistance and training to the National Company for Export Credit Insurance (COTUNACE); and

(4) Provision of technical assistance to the Institute of Higher Management Studies (ISG) and the Institute for Investment Development (IFID) to expand mid level training and short courses on trade and export operations.

A.I.D. financed inputs will include technical assistance, training, and observational tours.

The Grantee will provide government staff and office space, some international travel, in-kind support for the Tunisian privatization and financial markets programs, and financial and in-kind support for the trade program.

B. <u>Future Year Project Funding (Over U.S. Fiscal Years 1989-1991)</u>

Subject to availability of funds in future U.S. fiscal years, A.I.D. plans to obligate an estimated $1.6 million of additional funds to the project to support various activities for private sector development in Tunisia which are consistent with USAID and GOT development strategy.

The Government of Tunisia contribution over the period will be an estimated $0.550 million, mostly in in-kind support.

A.I.D. financed inputs will include technical assistance, training, and observational tours.

The Grantee will provide government staff and office space, some international travel, in-kind support for some activities in the Tunisian privatization and financial markets programs, and financial and in-kind support for possible continuation of trade activities, among others.

4. PROJECT IMPLEMENTATION

1. GOT Project Management

The project will be administratively located in the Ministry of Plan (MOP). The Tunisian project coordinator will be a member of the General Directorate of International Cooperation of the Ministry of Plan.

Other GOT offices are expected to be involved in the project such as the Prime Ministry and the Ministry of Finance.

Long term advisors financed by the project through the Center for Privatizatiion will work in the Prime Ministry with the Economic Counselor to the Prime Minister and at the Stock Exchange with the President of the Stock Exchange (which is under the administrative supervision of the Ministry of Finance). USAID has worked closely with all of these elements of the GOT, most especially over the past 18 months and has found them institutionally and administratiely capable of profitably using the levels of US assistance outlined in this document.

2. USAID Project Management

A Project Officer of the USAID/Tunis Project Management Office will manage the project and coordinate with the MOP, the Prime Ministry and the Ministry of Finance. The Project Officer will assist in resolution of program, policy, and operational issues and in the preparation of program strategy and planning.

5. PROJECT EVALUATION

One evaluation and one major project assessment have been completed for the project. The first evaluation took place in October 1985 and focused on evaluation of past activities and development of a strategy for future assistance.

The project assessment took place in June 1986 and focused on the place of the project within USAID country development strategy and the then emerging GOT Structural Adjustment Program.

Evaluations and assessments are undertaken collaboratively by representatives of the contractor, the GOT and A.I.D. Funds for project assessments, studies, and evaluations are included within the project budget.

A project evaluation will be scheduled early in 1990 specifically to assess the impact of the project's new three-pronged approach to USAID's private sector support. The evaluation will address the major Center for Privatization component including the long-term technical assistance to the Prime Ministry and to the Stock Exchange.

ANNEX I

PROJECT BUDGET FOR PRIVATE SECTOR DEVELOPMENT AND TECHNOLOGY TRANSFER
($000)

	USAID Oblig. Through AMD 5	AID Oblig. Added by AMD 6	USAID Total	GOT Total	CURRENT Total	LIFE OF PROJECT TOTALS USAID	LIFE OF PROJECT TOTALS GOT	LIFE OF PROJECT TOTALS TOTAL
A. Private Sector Component								
1. Umbrella Fund Activities	200		200	50	250			
2. Agricultural Pricing Studies	300		300	60	360			
3. MTAP	150		150	-	150			
4. Small Business Consulting/CRS	406		406	100	506			
5. IESC	200		200	50	250			
6. Privatization Conferences	90		90	30	120			
7. Financial Market Conferences	35		35	10	45			
8. Privatization/Financial Markets Program	1288	250	1538	400	1938			
9. Trade Expansion/ Liberalization	-	250	250	200	450			
10. Private Sector Support Activities	281		281	50	331			
Sub-Totals	2950	500	3450	950	4400	5050	1500	6550
B. Technology Transfer Component								
1. Umbrella Fund Activities	100		100	20	120			
2. Community Development Foundation/SCF	372		372	100	472			
3. RHUDO Studies	525		525	200	725			
4. CTDA Activities	125		125	30	155			
5. Other Technology Transfer Support	928		928	150	1078			
Sub-Totals	2050	0	2050	500	2550	2050	500	2550
TOTALS	5000	500	5500	1450	6950	7100	2000	9100

ACTION: AID-2 INFO: AMB DCM ECON

VZCZCTU0614 23-JUN-88 TOR: 05:45
RR RUFHTU CN: 22412
DE RUEHC #0743 1741500 CHRG: AID
ZNR UUUUU ZZH DIST: AID
R 221500Z JUN 88 ADD:
FM SECSTATE WASHDC
TO AMEMBASSY TUNIS 2444
BT
UNCLAS STATE 220743

AIDAC PASS TO JSPERLING

E.O. 12356: N/A

SUBJECT: DRAFT AMENDMENTS TO AUTHORIZATION AND GRANT AGREEMENT FOR PRIVATE SECTOR DEVELOPMENT AND TECHNOLOGY TRANSFER PROJECT 664-0328

REFS: (A) TUNIS 05137, (B) STATE 192597, (C) TUNIS 05515

1. GC/ANE GIVES ITS CLEARANCE TO AMENDMENTS NO 6 TO AUTHORIZATION AND GRANT AGREEMENT FOR PRIVATE SECTOR DEVELOPMENT AND TECHNOLOGY TRANSFER PROJECT BASED ON DRAFTS PROVIDED IN REF A, PROVISION OF APPROPRIATE SIGNATORIES AND DATE AS PER REF B, AND CLASSIFICATIONS AND REPRESENTATIONS PROVIDED IN REF C, SUBJECT TO AA/ANE APPROVAL OF LOP FUNDING INCREASE AND PACD EXTENSION BEING COMMUNICATED TO YOU SEPTEL. SHULTZ
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#0743

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UNCLASSIFIED STATE 199987

ACTION: AID-2 INFO: AMB DCM ECON

ANNEX 3

664 328

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22-JUN-88 TOR: 05:05
CN: 02112
CHRG: AID
DIST: AID
ADD:

AIDAC

E.O. 12356: N/A
TAGS: N/A
SUBJECT: TUNISIA PRIVATE SECTOR AND TECHNOLOGY TRANSFER (664-0328) AMENDMENT APPROVAL

REF: TUNIS 05374

1. AA/ANE APPROVES MISSION PROPOSAL TO AMEND SUBJECT PROJECT AS PER REFTEL. MISSION MAY PROCEED TO AMEND PROJECT PAPER. AMENDMENT WILL: (1) PERMIT EXPANSION OF ACTIVITIES AS DESCRIBED REFTEL, (2) LENGTHEN PACD BY TWO YEARS TO SEPTEMBER 29, 1991, AND (3) INCREASE LOP BY DOLS 2.1 MILLION TO A TOTAL OF DOLS 7.1 MILLION.

2. AMENDED PP SHOULD CONTAIN THE FOLLOWING:

A. FULL DESCRIPTION OF SUCCESSES IN POLICY REFORM AREAS, INCLUDING INVESTMENT LAW LIBERALIZATION AND FINANCIAL MARKETS DEVELOPMENT.

B. COMPONENTS SHOULD FULLY DESCRIBE FIT WITH CURRENT PROJECT OBJECTIVES AND WITH MISSION'S NEW PRIVATE SECTOR DEVELOPMENT STRATEGY NOW BEING DRAFTED. TRADE AND INVESTMENT COMPONENT SHOULD SPECIFY BENCHMARKS AGAINST WHICH PROGRESS WILL BE MEASURED, SPECIFY LINKAGE TO U. S. TRADE, WHAT ADDITIONALITY IS EXPECTED AS A RESULT, AND HOW COMPONENTS MESH WITH NEW AGENCY-WIDE TRADE AND INVESTMENT STRATEGY.

ACTION	INFO
DIR	
EXO	
PER	
PROG	
TRG	
PM	
CONT	
HPN	
RHUDO	
P. C.	
EMB/ADMIN	
EMB/GSO	
POL	
ECON	
C & R USAID	
CHRON	
RF	

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3. PROJECT LAST EVALUATED IN 1985. NEW EVALUATION SHOULD BE SCHEDULED. ANY NEW PRIVATE SECTOR PROJECT MAY BENEFIT FROM FINDINGS AND RECOMMENDATIONS OF THAT EVALUATION.

4. AID/W HAS RECEIVED REVISED CN AND DOCUMENT IS NOW IN CIRCULATION. SHULTZ
BT
#9987

NNNN