ICR Review
Operations Evaluation Department

Report Number : ICRR11220

1. Project Data:		Date Posted :	05/29/2002	
PROJ ID :	P053255		Appraisal	Actual
Project Name :	Tunisia: Economic Competitiveness Adjustment Loan II	Project Costs (US$M)	369.6	369.6
Country :	Tunisia	Loan/Credit (US$M)	159	159
Sector(s):	Board: FSP - Banking (47%), Capital markets (16%), General industry and trade sector (16%), General finance sector (11%), Central government administration (10%)	Cofinancing (US$M)	210.6	210.6
L/C Number :	L4461			
		Board Approval (FY)		97
Partners involved :	EU, AfDB	Closing Date	06/30/2001	06/30/2001

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2. Project Objectives and Components

a. Objectives

The second Economic Competitiveness Adjustment Loan (ECAL-II) continued supporting reforms in Tunisia's real and financial sector that were begun under ECAL-I. Besides maintaining an adequate macro-economic setting, the financial sector reforms under ECAL-II were aimed at: (a) increasing the financial soundness of the banking system through settling non-performing bank loans to public & semi-public enterprises, (b) improving the quality of loan collateral and foreclosure procedures, (c) privatizing banks, consolidating the banking sector, and reforming the governance of public banks, (d) modernizing the banking law and upgrading bank prudential regulations, (e) improving the payments system, (f) promoting indirect monetary control through a comprehensive reform of the Government securities market, and (g) enhancing the regulatory framework of non-bank financial intermediation by mutual funds, securities firms and insurance companies.

Privatization of public enterprises had begun under ECAL-I, and (h) their non-performing loans to banks were to be settled under ECAL-II. A 2 step program had the government buy back loans to 24 firms being liquidated, and guarantee the debt payments of 4 public firms that remain. Also, the government (i) pledged to increase the capital, and begin reducing its role and ownership in 5 public sector banks (accounting for half the banking system's assets).

b. Components

The project's components included (i) settlement of non-performing loans (TD 279 m or US$190 m by Board presentation & another TD 400m by 2nd tranche), (ii) liquidation & privatization of 24 indebted public enterprises (actions defined for each tranche), (iii) modernization of the bank payments system (TORs issued for consultant by Board), (iv) tax deductibility of loan loss provisions (Board) and submission of draft Banking Law & Civil code amendments (2nd tranche) to aid in creditor claims recovery, (v) strengthened accounting and prudential regulations (capital raised to 8% by Board), (vi) bank mergers and privatization (TORs by Board & competitive bidding by 2nd tranche), (vii) improving government securities market (licensing primary dealers by Board & new issues by 2nd tranche) and (viii) non-bank reforms (by 2nd tranche laws on regulating mutual funds & restructuring insurance Co.). The component to settle non-performing loans was revised and the government guaranteed the repayment of public enterprises being liquidated (over 25 years at zero interest rate).

c. Comments on Project Cost, Financing and Dates

The disbursement was in two equal tranches of Euro 69m equivalent (changes in the Euro-dollar exchange rate during the loan make the dollar equivalents different). The European Union provided a parallel grant of Euro 80m (US$70.6 m), and the AfDB a loan of US$140 m. The second tranche was released on Mar. 6, 2001, seven months later than originally projected. There were no cancellations.

3. Achievement of Relevant Objectives:

The loan's objectives were achieved, except for the increased private sector participation in banking. Specifically,

(a) Banks became more sound and their capital ratio rose from 6.3 percent in 1997 to 13.3 percent in 2000. Non-performing loans, while still high, fell from 18.4 percent in 1997 to 13.3 percent in 2000; but this was the result of the government taking over or guaranteeing bad debts rather than evidence of better lending .
(b) Civil code revisions to improve loan recovery took longer than expected; so it was approved by Committee of Ministers and was not submitted to Chamber of Deputies before the release of the second tranche (subsequently done).
(c) Bank privatization was not achieved. BTEI's other owner (another government) balked at its merger with UIB (another development bank). The government therefore decided to sell UIB, and this will be a condition of ECAL -III.
(d) Revised Banking law presented to Chamber of Deputies that increases prudential practices (e.g. tightens related transactions)
(e) No information.
(f) Non-bank intermediation increased with the volume of public stock market issues quadrupling between 1997 and 2000.
(g) The insurance company was restructured and privatized with 30% of its stock traded on the stock exchange .
(h) Settlement was achieved partly through government guarantees of the principal repayment over 25 years of impaired loans of public enterprises deemed viable, and the debts of the others were transferred to the government . The government began liquidating three enterprises, restructuring seven and privatizing ten .
(i) Increased private sector participation in banking was delayed for reasons under (c).
The overall macroeconomic situation was also satisfactory : growth was over 6 percent in 2000, inflation less than the targeted 3 percent, the budget deficit a modest 3.5 percent and foreign exchange reserves were 2.9 months of imports.

4. Significant Outcomes/Impacts:
Banks appear more sound now, but only time will tell if the quality of their lending improves and profits increase . Greater private sector participation may improve lending (three quarter of the NPLs were in public banks that are being privatized). Prudential regulation and supervision are being improved, but this is necessarily a gradual process that is yet untested.

5. Significant Shortcomings (including non-compliance with safeguard policies):
One important objective of increased private sector participation in banking was not achieved because the development bank's co-owner balked at its merger and sale. It would have been better for the government to have obtained the co-owner's agreement before the project was approved .

6. Ratings:	ICR	OED Review	Reason for Disagreement /Comments
Outcome:	Satisfactory	Satisfactory	
Institutional Dev .:	Modest	Modest	
Sustainability :	Likely	Likely	
Bank Performance :	Satisfactory	Satisfactory	
Borrower Perf .:	Satisfactory	Satisfactory	
Quality of ICR :		Satisfactory	

NOTE: ICR rating values flagged with ' * ' don't comply with OP/BP 13.55, but are listed for completeness.

7. Lessons of Broad Applicability:

8. Assessment Recommended? ○ Yes ● No

9. Comments on Quality of ICR:
The ICR candidly discusses the outcomes, both good and bad, and their causes; but it could have been specific about how the payments system and the government securities market were improved .